



Sell Presentation

November 15th, 2016

Morgan Zhuo, Jonathan Wong, Raunak Gera, Curtis Yu, Maanit Patel, Carolyn Wu



Disclaimer

The analyses and conclusions of the Western Investment Club (“WIC”) contained in this presentation are based on publicly available information. WIC recognizes that there may be confidential information in the possession of the companies discussed in the presentation that could lead these companies to disagree with WIC’s conclusions. This presentation and the information contained herein is not a recommendation or solicitation to buy or sell any securities.

The analyses provided may include certain statements, estimates and projections prepared with respect to, among other things, the historical and anticipated operating performance of the companies, access to capital markets and the values of assets and liabilities. Such statements, estimates, and projections reflect various assumptions by WIC concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies and have been included solely for illustrative purposes. No representations, express or implied, are made as to the accuracy or completeness of such statements, estimates or projections or with respect to any other materials herein. Actual results may vary materially from the estimates and projected results contained herein.

The sole responsibility for the content of this publication lies with the authors. Its contents do not reflect the opinion of the University Students’ Council of the University of Western Ontario (“USC”). The USC assumes no responsibility or liability for any error, inaccuracy, omission or comment contained in this publication or for any use that may be made of such information by the reader.

Valuation Fundamentals

Table of Contents

- **Business Overview**
- **Investment Thesis**
- **Internal Analysis**
- **External Analysis**
- **Investment Recommendation**

Business Overview



WESTERN INVESTMENT CLUB

Business Overview

Company Profile

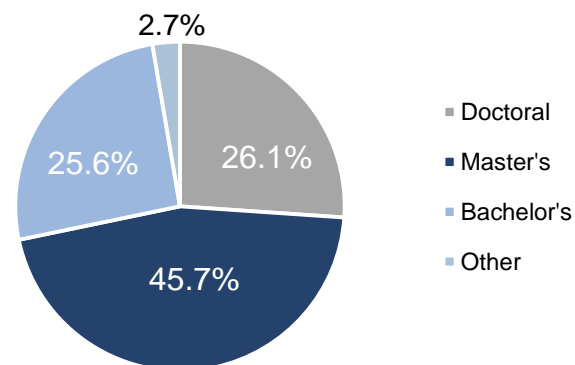
Education Services

- Capella Education Company (“Capella”, “CPLA” or the “Company”) is an education services holding company based in the United States
- The Company’s primary source of income is Capella University, a 100% online, private for-profit university that currently serves over 38,000 students
 - Capella University offers degrees at various levels, including bachelor’s, master’s and doctoral
 - Capella University has also recently developed a flexible, competency-based learning program that is well-suited to working professionals
- In addition to Capella University, Capella owns and operates San Francisco based Hackbright University

Public Markets Overview

Ticker	NASDAQ:CPLA
Market Capitalization	\$949 MM
Enterprise Value	\$834 MM
Current Share Price	\$83.05
52-Week Range	\$39.06 - \$84.85
2016E EV/EBITDA	9.2 x

Enrollment Mix By Degree



Business Overview

Summary of Operations

Capella University



- Serving more than 37,000 learners, Capella University is an online educational platform that offers degrees at the bachelor's, master's and doctoral levels
- Capella University focuses on a number of subject matters, including: Health Care, Counseling, Higher Education, Human Services, Information Technology, Nursing, Psychology, Public Administration, Public Safety & Criminal Justice, and Social Work

Learners: 38,503

Hackbright Academy



- Capella acquired Hackbright in 2016 for \$18 million in cash
- Hackbright's mission to increase female representation in the tech workforce through education, mentorship and community
- In addition to graduating software engineers, Hackbright Academy alumnae have started new careers such as Support Engineers, Software Engineers in Test / Quality Engineers, Security Engineers and Systems Engineers

Learners: 7,000

DevMountain



- Capella acquired DevMountain 2 weeks after Hackbright for \$20 million
- DevMountain offers 12 week full-time software coding programs in Web and iOS development for a total cost of \$10,500, including free housing
- DevMountain is the largest coding/technology school in the Intermountain West, and one of the highest rated coding schools in the country

Learners: Variable



Investment Thesis



WESTERN INVESTMENT CLUB

Original Investment Thesis

The original investment thesis from last year has been largely realized

Investment Highlights

1

Scalable Online Strategy

- As a 100% online university, Capella has the potential to scale the business at a faster pace than many of its competitors, which operate physical campus locations with limited capacity
 - As the online market grows, Capella will become an increasingly attractive destination for learners
 - Capella has first-mover advantage by being one of the first fully online post-secondary institutions

2

High-Quality Business

- The Company has a solid track record of delivering high-quality education services
 - On average, Capella University students increase their salary by ~60% five years after graduation
 - Employers report a ~90% satisfaction rate with employees with graduated from Capella University

- Capella has a history of generating strong cash flows

3

Strong Regulatory Position

- Although many major companies in the for-profit education sector have recently struggled, Capella has maintained enrollment growth while effectively complying with all DoE regulations and requirements
 - When recently stress tested, all 94 Capella programs passed the new GE requirements
 - In comparison, many of Capella's competitors, including DeVry and Apollo Education Group, estimated that about ~10% of their programs would fail to meet the new requirements

4

Discernible Catalysts

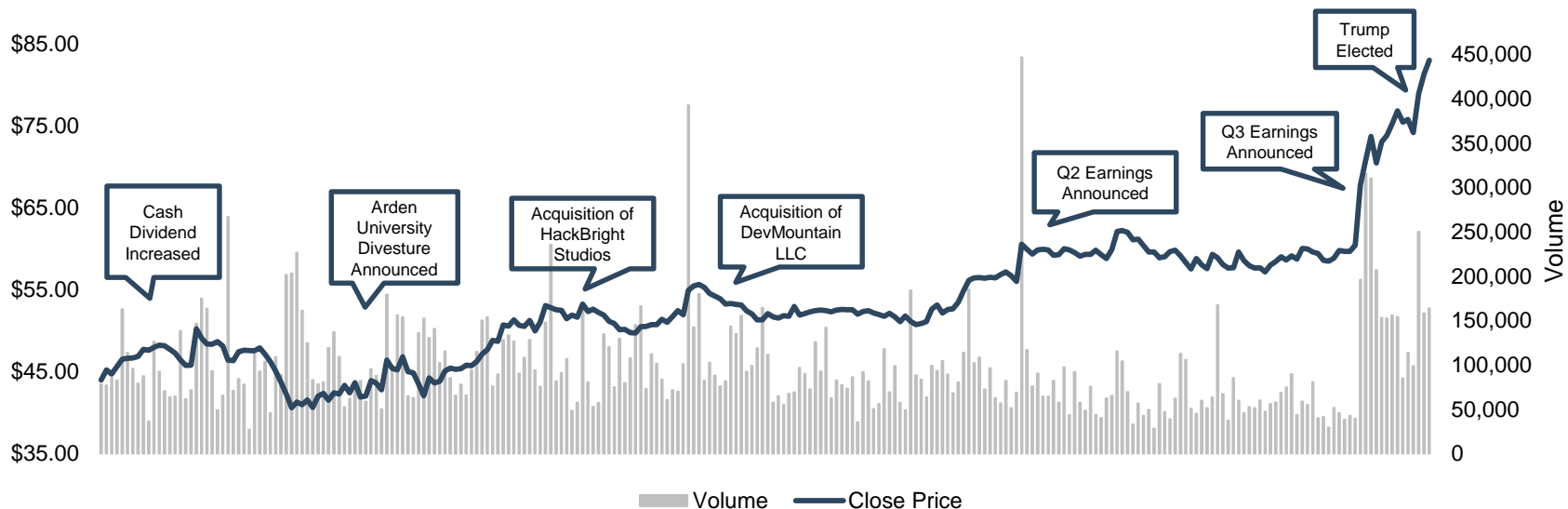
- Capella's U.K.-based subsidiary, Arden University, recently gained post-secondary accreditation, which provides them with the opportunity to take advantage of opportunities overseas
- Capella has successfully developed the first approved online, competency-based learning program, which is expected to drive enrollment growth
 - The education market is continuing to shift to flexible online programs, where students can acquire credentials at their own pace
 - Management estimates that the up to 40% of students in the market will move to competency-based learning programs



Investment Thesis

Since our initial investment, Capella's stock has appreciated 63.9%.

Historical Price-Volume Chart



- Since late 2015, Capella's share price has increased drastically as a result of favourable earnings announcements and external factors
- Over the past 12 months, Capella has announced increases to its cash dividend, and issued positive earnings announcements which have brought its valuation to be trading at a slight premium to its peers
- As time goes on, it is uncertain whether Capella will be able to realize synergies from its new acquisitions, raise its declining enrollment growth, or continue the company's margin expansion

Investment Thesis

Capella faces an increasingly difficult competitive and political landscape in the near future

Investment Highlights

1

Political Risks

- Over 80% of Capella's revenue comes from "Title IV funding", which is a government grant
 - Congress typically renews the Title IV legislation every 5-8 years, and because the previous renewal was in 2008, the legislation is overdue for review
 - Republicans have promised to decrease federal funding for education, including grants given to Universities; it is uncertain whether this major revenue stream will remain secure in the long term, especially given the recent election results
- Capella's share price appreciated significantly (approximately 10%) since Donald Trump's election, as a result of investor speculation about deregulation in the industry (the share prices of competitors appreciated as well)
 - This is actually a net negative for Capella, as the company was uniquely positioned to handle Obama's tough GE regulations, which was decreasing competition in the industry

2

Positive Earnings Overstated

- Capella's stock price surged as a result of recent earnings growth which beat analyst expectations by ~30%
- While this is generally a positive sign for the company, if we remove the effect of inorganic growth from the newly acquired segments, earnings growth is relatively stagnant (rev growth of 3.5% vs 5.5%).

3

Increasing Competition

- Although many major companies in the for-profit education sector have recently struggled, most have now stabilized and are investing heavily in new degree programs, which could lead to increased pricing pressure
- A few Australian and British universities are considering expansion into the US, including GUS

4

Difficulties Realizing Synergies

- DevMountain LLC and Hackbright academy both offer programs which are largely different in both format and content than most of Capella's offerings
- There are uncertainties as to whether Capella will be able to effectively integrate the two schools under its broader charter, or whether it will be forced to divest, as with Arden University



Internal Analysis



WESTERN INVESTMENT CLUB

Internal Analysis

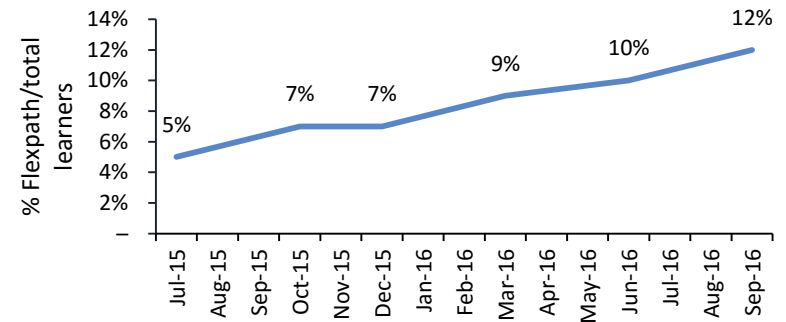
Short-term and long-term catalysts are priced in by investors.

Divestiture of Arden University limits international growth opportunities

- Acquired in 2011 by Capella for \$16.6M; the second distance-learning (online) university to open in the United Kingdom¹
- Sold Arden University on August 18, 2016 for ~\$19.5M to Global University Systems; share price rose 3.7% on announcement date
- Strategic milestones were achieved following the government approval of Arden's University title in August 2015
- Management decided to focus resources on FlexPath and the US non-degree market

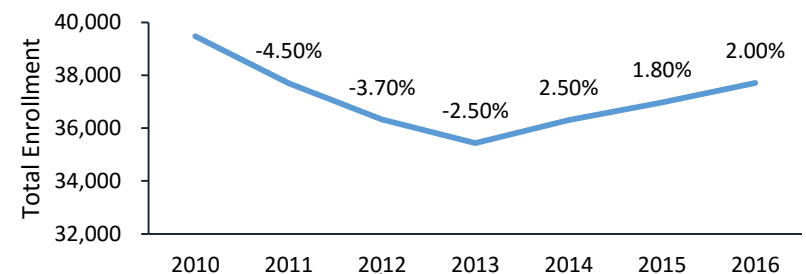
FlexPath has offset declines in total enrollment

- Flexpath user growth has been clearly identified in recent financial reporting
- FlexPath program is limited to the masters and bachelor's programs; does not offset the declines in the doctoral segment
- Allows higher flexibility, speed, and lower tuition costs
- Likely that competitors will also enter into the direct assessment space; expects will be a category for capex investment going forward



Despite competitor closures Capella has not seen a significant surge in enrollment

- Nearly 100 fewer for-profit colleges operated in 2015 compared to in 2012, total for-profit enrollment fell 7.4% in 2015²
- Capella's relatively flat total enrollment growth reflects slow market share growth in a rapidly declining industry
- Management expects 2-3% total enrollment growth



1. Company Filings
 2. NSC News, May 14, 2015

External Analysis



WESTERN INVESTMENT CLUB

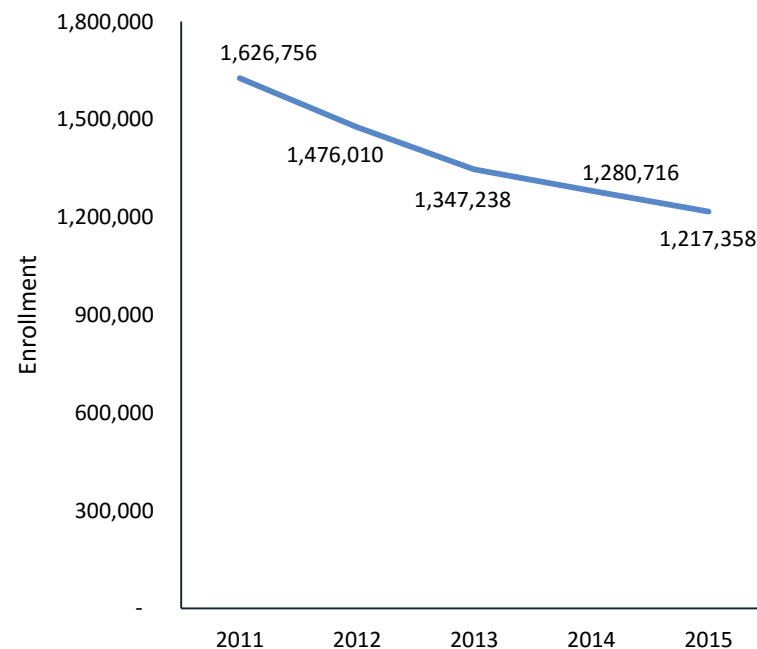
External Analysis

Donald Trump's Presidential Election may have a positive impact on the industry

Impact of the U.S. Election

- Donald Trump is expected to make a positive impact on the industry due to:
 - Republican campaign loosening up on regulations for for-profit universities
- A lot of uncertainty under the Trump campaign
 - Beneficial to capitalize on the current stock price at a current 6 year high
- National Center for Education Statistics (NCES) recorded 20.6 million postsecondary learners in fall of 2012 and is projecting 23.8 million by 2023
 - CAGR of 1.45%, driven by the measurable personal income due to postsecondary education
- In the U.S, 62.8% of adults do not possess a postsecondary degree
 - Of the fall 2012 NCES statistics, 41% of total enrollment were from adults

Enrollment at Four-Year For-Profit Colleges



Valuation



WESTERN INVESTMENT CLUB

Valuation

Comparable Companies Analysis

Trading Multiples

	Capitalization		EV/EBITDA			P/E		
	Equity Value	Enterprise Value	TTM	2016E	2017E	TTM	2016E	2017E
Strayer Education	\$ 757	\$ 639	7.3 x	8.4 x	7.3 x	19.9 x	20.9 x	18.1 x
American Public Education	354	234	3.1 x	3.6 x	4.2 x	13.2 x	11.9 x	15.2 x
Grand Canyon Education	2,602	2,495	9.4 x	8.9 x	8.0 x	18.7 x	17.6 x	16.2 x
DeVry Education Group	1,747	1,684	16.9 x	5.6 x	5.1 x	11.1 x	10.9 x	10.1 x
Bridgepoint Education	424	122	NMF	5.2 x	6.0 x	NMF	57.2 x	50.8 x
Capella Education Company	\$ 949	\$ 834	9.3 x	9.2 x	8.7 x	25.7 x	23.3 x	21.9 x
Mean	\$ 1,177	\$ 1,035	9.2 x	6.3 x	6.1 x	15.7 x	23.7 x	22.1 x
Median	\$ 757	\$ 639	8.3 x	5.6 x	6.0 x	15.9 x	17.6 x	16.2 x

- Currently, Capella is trading at a slight premium to its peers, based on forward-looking EV/EBITDA and P/E multiples
- Capella has similar return metrics to its peers
- The entire industry has recently had prices appreciate as a result of the election results



Valuation

Discounted Cash Flow Analysis

(\$ in thousands of USD)	2015A	2016E	2017E	2018E	2019E	2020E	2021E
Unlevered Free Cash Flow	\$ 40,733	\$ 57,155	\$ 57,078	\$ 56,478	\$ 55,903	\$ 54,210	\$ 55,448
Discount Factor		0.96	0.87	0.80	0.73	0.66	0.61
PV of Free Cash Flows	\$ 54,619	\$ 49,812	\$ 45,012	\$ 40,688	\$ 36,033	\$ 33,657	

Weighted Average Cost of Capital

Target Capital Structure

% Equity	100.0 %
% Debt	0.0 %

Cost of Equity

Risk-Free Rate	2.2 %
Equity Risk Premium	5.0 %
Beta	1.46

Cost of Equity 9.5 %

WACC 9.5 %

Sensitivity On Implied Upside

WACC	Exit Multiple				
	3.5 x	4.0 x	4.5 x	5.0 x	5.5 x
7.5 %	(29.2%)	(25.3%)	(21.4%)	(17.4%)	(13.5%)
8.5 %	(29.9%)	(26.0%)	(22.1%)	(18.2%)	(14.2%)
9.5 %	(30.6%)	(26.7%)	(22.8%)	(18.8%)	(14.9%)
10.5 %	(31.3%)	(27.3%)	(23.4%)	(19.5%)	(15.6%)
11.5 %	(31.9%)	(28.0%)	(24.1%)	(20.1%)	(16.2%)

Enterprise Value

Terminal Year EBITDA	\$ 122,916
Exit Multiple	4.5 x
Terminal Value	\$ 553,123

Sum of Present Value Free Cash Flow s	\$ 259,822
Present Value of Terminal Value	\$ 335,750

Enterprise Value \$ 595,572

Terminal Value % of Enterprise Value 56.4 %

Enterprise Value	\$ 595,572
Plus: Cash & Cash Equivalents	140,471
Less: Debt	-
Less: Preferred Equity	-
Less: Non-Controlling Interests	-

Implied Equity Value \$ 736,043

Diluted Shares Outstanding 11,465

Implied Share Price \$ 64.20

Current Share Price \$ 83.05

Implied Upside (22.7%)



Investment Recommendation

Buy Capella

Current Share Price: \$83.05
Initial Target Share Price: \$68.89
Projected Downside: 22.7%

Recommendation:
Sell Capella at \$83.05

