

Growing International Consolidation of the For-Profit Post-Secondary Education Sector

With the global economy in recession, one of the historically counter-cyclical sub-sectors within business services, for-profit post-secondary education, continues to perform well. While some not-for-profits have halted construction and are undergoing cutbacks due to the declining economy, for-profit institutions are seeing higher enrollments and profit margins while gaining job market and political acceptance. Student headcounts are accelerating from both those who have lost jobs and those who seek to improve their professional prospects by matching new skills to the rapidly changing economy. Due to these dynamics, the sector has made exceptional gains as an asset class during the current market and economic downturn. It has also been among the only sectors that have been able to float successful IPO and secondary stock issuances during this period.

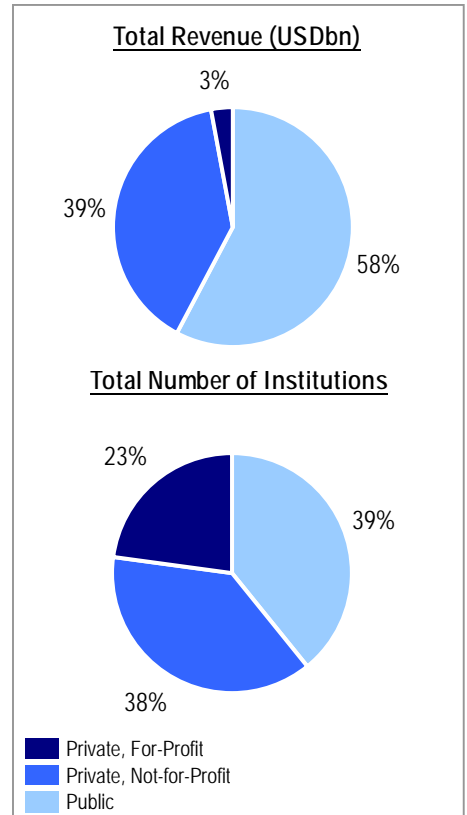
U.S. Market Overview

The post-secondary education sector in the U.S. is dominated by large public institutions (mostly state-funded

universities) and not-for-profit private institutions, which command 97% of the sector's revenue. The smaller and more fragmented group of private for-profit institutions accounts for only 3% of sector revenue, despite making up nearly one-quarter of the total number of institutions.

For-profit schools have penetrated the secondary education market by taking share from other types of institutions. They have proven successful in serving non-traditional students (including part-time students, students over 25 years of age, and certain minorities) whose needs were historically not well met by more traditional schools. For-profit institutions often cater to these groups by specifically focusing on distant learning, which allows highly flexible scheduling, provides online access to students who would not otherwise have access, and makes more courses available. Furthermore, for-profit schools tend to focus more on practical training, professional certifications, and employment.

Figure 1: U.S. Market Size



(Continued on page 4)

Source: NCES "Education in 2009"

The American Recovery and Reinvestment Act: Can Business Services Benefit?

Signed into law on February 17, 2009, the American Recovery and Reinvestment Act ("ARRA") is arguably the most comprehensive government spending plan ever enacted. The ARRA is unparalleled in its scale, representing 5% of U.S. Gross GDP, more than double the percentage of GDP that the "New Deal," comprised during its time. The \$787 billion package, broken down by \$575 billion in direct spending and \$212 billion in tax relief, is intended to stimulate the economy through investment in the country's physical and human infrastructure. The scope of this

act is broad, providing for spending in military, energy, education, telecommunications, information technology, environmental services, transportation, and construction to facilitate sustainable economic development. Companies serving these end markets have a significant external catalyst for demand in their businesses.

The implementation of this Act is both swift and widespread; many provisions of the legislation identify milestones to be achieved within one year. At first glance, the ARRA appears to be primarily

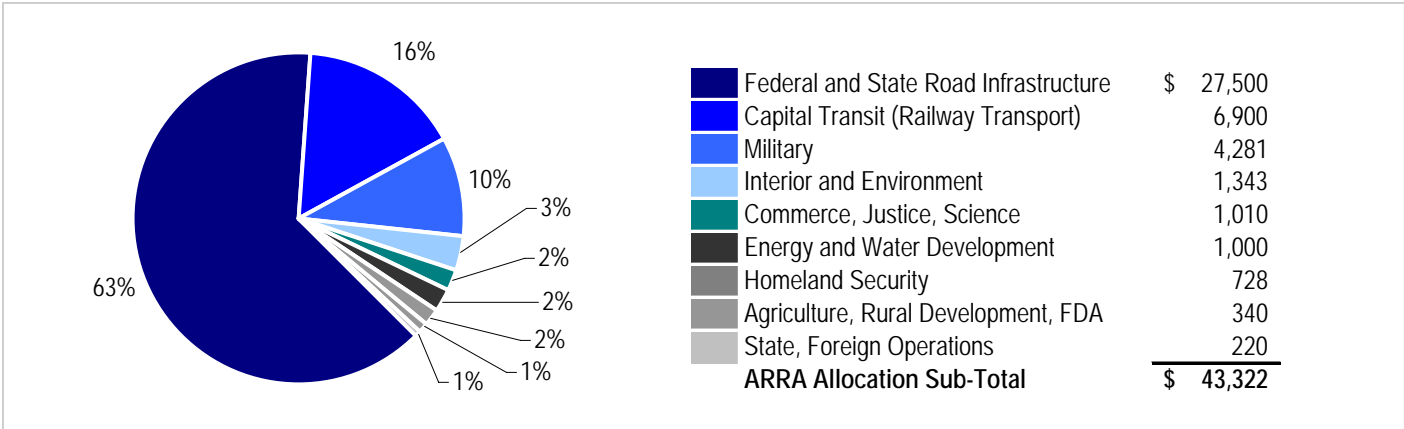
focused on providing stimulus through manufacturing-based businesses. However distinct opportunities exist for business services companies to benefit from ARRA programs.

Which business services sectors have a mandate? We explore three industry sectors: engineering services, information technology services, and education and professional training, each of which we believe are poised to benefit from the influx of ARRA funds.

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The American Recovery and Reinvestment Act: Can Business Services Benefit? *(continued from page 1)*

Figure 2: Summary of ARRA Infrastructure Funding (\$ in millions)



Source: American Society of Civil Engineers

Engineering Services

ARRA is providing the construction industry with the impetus to modernize the U.S. transportation network and government facilities. Funding highlights include \$27.5 billion to highway repair, nearly \$7 billion to expand railway transit, and over \$6 billion towards refurbishment of government facilities (see Figure 2). This spending comes as little surprise given the notoriously dismal state of U.S. Infrastructure (see Figure

Figure 3: U.S. Infrastructure Report Card

	Grade	
	2005	2009
Aviation	D+	D
Bridges	C	C
Dams	D	D
Drinking Water	D-	D-
Energy	D	D+
Hazardous Waste	D	D
Inland Waterways	D-	D-
Levees	C-	D-
Public Parks	C-	C-
Rail	D	C-
Roads	D	D-
Schools	D	D
Solid Waste	C+	C+
Transit	D+	D
Wastewater	D-	D-
Average Grade	D	D
5-year Investment Needed (\$ in trillions)	\$ 1.6	\$ 2.2

Source: American Society of Civil Engineers

3). Against this backdrop, engineering services providers stand to receive substantial indirect benefits through construction funding. Serving functions such as inspection, certification, design, commissioning, feasibility studies, and consultation, these companies will play a vital role in supporting development.

Investments in smart grid technology are also anticipated. In spring 2009, the Obama Administration outlined funding for smart grid initiatives through ARRA grants, articulating that “we need an upgraded electrical grid to take full advantage of the vast renewable resources in this country – to take the wind from the Midwest and the sun from the Southwest and power areas across the country.” A variety of engineering and technology companies such as EnerNOC, Comverge, Trilliant and IBM Global Services, who have invested in developing this support sector, are well positioned to take advantage.

The provisions for allocation to such infrastructure projects are expected to come in several forms: state and federal programs, individual grants, and borrowing facilities. Companies that can provide the largest breadth of construction and technology support services will be well positioned in this sector. Furthermore, as is typical to the construction industry, projects will likely flow on a seasonal basis within each geographic region. Projects located in increasingly remote and weather-affected regions or those with accelerated timelines, as exemplified by

the “use-it-or-lose-it” stipulations of some provisions, represent an opportunity for higher margin engagements.

Information Technology Services

Two major Information Technology initiatives are outlined under ARRA: Health Information Technology (“HIT”) development and broadband expansion. Both of these initiatives represent an investment in the U.S. information systems infrastructure. Base funding will be provided through the establishment of state and federal government agencies to facilitate growth, such as the National Telecommunications and Information Administration (“NTIA”) and the Office of the National Coordinator for Health Information Technology. Further funding will be provided through competitive grants to create incentives for companies to become involved in this sector.

The HIT initiative is a part of a larger focus by the government to increase investment in the healthcare industry. HIT is a specific objective outlined by the current administration, with \$19 billion allocated within the ARRA itself and a potential for an additional \$50 billion in follow-on funding. Highlighting one area of benefit, is a recent Reuters study on the potential effects of HIT to the healthcare industry as exemplified by e-prescriptions. ARRA will nearly double e-prescribing adoption as compared to the recent Medicare Improvements for Patients and Providers Act of 2008 (“MIPPA”) levels in 5 years.

Companies such as Surescripts, co-owned with CVS Caremark, Express Scripts and Medco, as well as the EHR Stimulus Alliance, which includes Allscripts, have invested heavily in this space and are well positioned to expand their dominant position. Further opportunity exists for companies that can support the expansion of this and other e-medical records functions.

Broadband investment targets the expansion of access in unserved and underserved regions of the U.S. through over \$7 billion in internet funding (see Figure 4 for a summary of funding programs). This initiative will coincide with a national proliferation of broadband deployment, whereby the ultimate aim is to move towards broadband ubiquity in the U.S. This broadband sponsorship is based on the government view that “every \$1 in broadband investment returns 10 times” (Sonnenschein, Nath & Rosenthal). In addition to the purchase and physical deployment of hardware to develop broadband and HIT networks, considerable human capital and services organizations will be required to install and maintain these systems. IT services firms with large healthcare practices and experience in both ERP and network implementation projects such as CSC, ACS, Accenture, and IBM are likely to see increased revenue opportunities.

Education / Professional Training

Modernization and expansion of the U.S. educational system is a priority for the current administration. This vision encompasses not only the traditional

units (elementary / secondary schools) of the educational network, but also professional training fields intended to redirect excess capacity from declining industries to growth sectors, such as renewable energy (e.g. clean or green tech) and healthcare related professions.

More than \$7 billion of specific training provisions are laid out within the ARRA, ranging from programs to promote local workforce training to grants for high growth sectors. The channels through which the funds will be dispersed are largely via individual grants and government (state or federal) administrated programs.

Companies within the education services sector can take advantage of ARRA by understanding what educational curricula will draw the greatest number of new participants. Many of the for-profit education companies, such as DeVry, Apollo Group, and ITT Educational Services focus on career training/ retraining, which will be a major component of increased demand over the short term. Specifically, those companies who provide for clean tech, alternative energies or environmental certification/education may find not only a limited number of competitors in this space, but also direct funding from ARRA. Stimulus to this sector is not expected to be geographic; all regions can expect to see funding and/or stimulus programs available.

Looking forward, there is significant opportunity for business services companies to increase revenue through

enablement and support of ARRA programs. Given the federal government's desire to create near term stimulus to the economy, those firms with existing capacity to commit to extensive project mandates as well as the ability to act on an accelerated schedule will be particularly well positioned to benefit from ARRA funded programs. Companies should anticipate very short turn-around times for proposals submitted in response to ARRA program announcements. Additionally, companies receiving ARRA funding should also expect scrutiny in exchange for these opportunities. This include requests from state and federal agencies for just-in-time documentation and other approval requirements as well as detailed budget reporting for ARRA funds — possibly above and beyond normal operating standards. This heightened inquiry regarding progress and financial reporting, including such ancillary information such job retention and creation, is expected to become a routine part of ARRA projects for the next several years.

As of May 15, 2009, weekly detailed agency reports on funds allocation and performance planning are now made available through www.recovery.gov. By July 15, agencies begin to report on use of funds, which are currently being deployed. Speed to market, needless to say, will be a priority for companies eager to participate in ARRA programs.

Figure 4: Examples of ARRA Broadband Spending

Program	Administrator	Amount (\$ in billions)	Intended Benefits
Distance Learning, Telemedicine, and Broadband Program	USDA – Rural Utilities Services	\$2.5	<ul style="list-style-type: none"> Sufficient access to high speed broadband in rural areas in order to facilitate economic development Provide consumers with service provider choice
Broadband Technologies Opportunities Program	NTIA	\$4.4	<ul style="list-style-type: none"> Broadband for educational, medical, and public institutions Stimulate economic growth, and job creation
Broadband Inventory Map	NTIA	\$0.4	<ul style="list-style-type: none"> Creation of a national broadband inventory map identifying coverage, rates, and usage of broadband

Source: H. R. 1: The American Recovery and Reinvestment Act: Key Provisions of Note”, Sonnenschein Nath & Rosenthal, LLP, February 16, 2009
 Note: NTIA is the National Telecommunication and Information Administration

Growing International Consolidation of the For-Profit Post-Secondary Education Sector *(continued from page 1)*

U.S. Consolidation

The number of college degrees granted by the for-profit post-secondary education sector has grown at a compound annual rate of 12.5% over the past decade, driving what is now a \$14 billion industry. As such, it now supports several large, publicly traded companies as well as a number of private-equity backed platforms.

For-profit post-secondary education providers have proven that they can maintain enrollment, run efficiently, and earn profits in the United States. Their customer-oriented approach has been successful because it meets the demand for options outside of daytime, face-to-face classes offered by traditional colleges and universities.

The number of for-profit post-secondary institutions has increased rapidly – by more than 60% over the past decade. Meanwhile, the number of public and not-for-profit institutions has declined modestly, indicating for-profits are taking

market share. A wave of consolidation has begun in recent years, with many smaller privately-held schools being sold to private equity and large strategic acquirers that are able to make necessary investments into student acquisition and distance learning technology.

International Consolidation

Needing to continue to drive growth to support their valuation levels, large U.S.-based entities have looked to other global economies where the conditions are becoming more accommodating to for-profit models. The demand for post-secondary education is growing rapidly around the world, caused by a number of factors similar to those seen in the United States over the past several decades. These include:

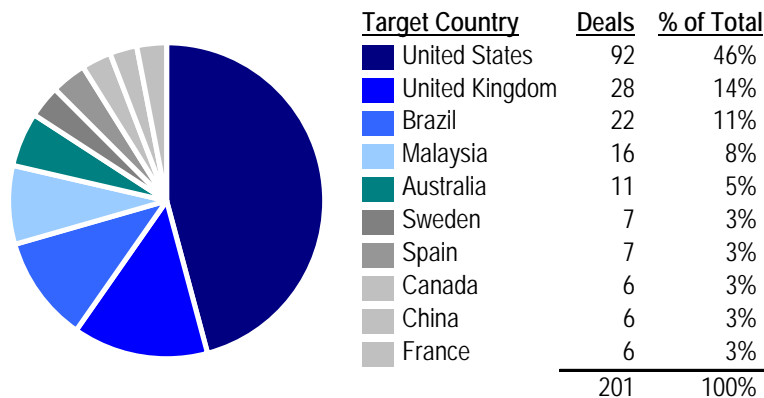
- Growing middle class – Emerging market economies are producing larger populations of middle class individuals who can afford advanced education and who desire to seek

additional career opportunities for themselves and their children. This is especially true in regions with growing youth populations such as Latin America and Asia.

- Human capital needs of service economies – As businesses and economies around the world become increasingly reliant on the services sector, they require significant investment in human capital. Advanced education and training is needed to produce these knowledgeable professionals.
- Governments are unable to properly fund public universities – In many countries worldwide, public universities are under-funded by national and local governments, and are unable to meet growing demand. This, in turn, offers opportunities for private institutions to build capacity.

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Figure 5: Sector M&A Transactions — Top Target Countries (\$ in billions)



Market	Country	GDP	Gross Enrollment Rate				Comments
			2000	2002	2004	2006	
Developed	U.S.	\$ 14.330	69%	80%	82%	82%	Most developed for-profit higher education market (scale, market positioning, availability of capital)
Developed	U.K.	\$ 2.787	58%	63%	60%	59%	2004 legislation to permit for-profit degree-granting schools and universities
Advanced Emerging	Brazil	\$ 1.665	16%	20%	24%	n/a	Legislative trend toward social inclusion in higher education for disadvantaged students
Secondary Emerging	Malaysia	\$ 0.215	26%	28%	31%	n/a	For-profit universities part of state plans for higher education self-sufficiency and regional hub status
Developed	Australia	\$ 1.069	66%	76%	72%	73%	UK-style legislation to permit for-profit degree-granting schools and universities (2005)

Source: UNESCO; Eduventures, LLC

For-Profit Post-Secondary Education Sector Comparables

Market Statistics as of June 30, 2009 (\$ in millions, except per share data)

	Stock Price	% of 3-yr High	Market Cap	Enterprise Value	EV / LTM		
					Revenue	EBITDA	EBIT
Apollo Group Inc.	\$ 71.12	79%	\$ 11,438	\$ 10,564	3.0x	10.4x	11.3x
ITT Educational Services Inc.	100.66	75%	3,858	3,642	3.4x	9.6x	10.1x
DeVry, Inc.	50.04	77%	3,575	3,413	2.5x	13.0x	15.8x
Strayer Education Inc.	218.11	91%	3,057	2,973	7.0x	19.8x	21.4x
Career Education Corp.	24.89	68%	2,242	1,744	1.0x	9.9x	16.5x
Corinthian Colleges Inc.	16.93	78%	1,473	1,382	1.1x	9.7x	15.0x
Capella Education Co.	59.96	80%	1,002	856	3.0x	14.8x	18.9x
American Public Education, Inc.	39.55	74%	718	665	5.7x	19.8x	22.9x
Lincoln Educational Services Corporation	20.93	96%	560	593	1.4x	9.1x	12.7x
Universal Technical Institute Inc.	14.93	55%	352	283	0.8x	13.6x	88.9x
Median		78%			2.8x	10.2x	15.4x
Mean		78%			2.9x	12.1x	15.0x
Adjusted Mean		77%			2.5x	10.8x	14.7x

Operating Statistics as of June 30, 2009

	LTM Growth			3-Year Growth			EBITDA	EBIT
	Revenue	EBITDA	EBIT	Revenue	EBITDA	EBIT	Margin	Margin
Apollo Group Inc.	20%	35%	37%	13%	8%	7%	29%	27%
ITT Educational Services Inc.	19%	33%	35%	15%	28%	29%	36%	34%
DeVry, Inc.	28%	33%	37%	18%	35%	57%	20%	16%
Strayer Education Inc.	27%	33%	33%	22%	21%	22%	36%	33%
Career Education Corp.	(3%)	(13%)	(17%)	(2%)	(27%)	(35%)	10%	6%
Corinthian Colleges Inc.	21%	75%	150%	8%	10%	11%	12%	7%
Capella Education Co.	19%	37%	41%	22%	43%	53%	20%	16%
American Public Education, Inc.	50%	63%	66%	61%	112%	135%	29%	25%
Lincoln Educational Services Corporation	23%	45%	61%	11%	10%	10%	16%	11%
Universal Technical Institute Inc.	(2%)	(46%)	(84%)	1%	(32%)	(61%)	6%	1%
Median	21%	33%	35%	15%	21%	22%	20%	16%
Mean	18%	32%	48%	12%	13%	17%	23%	19%
Adjusted Mean	22%	33%	35%	14%	20%	21%	22%	19%

Selected Notable Transactions (\$ in millions)

Closed	Target	Target Description	Acquirer	Enterprise Value	EV / LTM	
					Rev.	EBITDA
Pending	BPP Holdings plc (UK)	Professional education and training in the UK, Ireland, and Netherlands	Apollo Global (US)	\$ 550	2.0x	11.2x
Apr-09	Wall Street English (China)	Provides English language training courses for business professionals in China	Pearson plc (UK)	145	n/a	n/a
Apr-09	Faculdades Nordeste (Brazil)	Provider of private post-secondary education in northeastern Brazil	DeVry (US)	n/a	n/a	n/a
Sep-08	U.S. Education Corporation (US)	Career-focused, outcome-based, and postsecondary healthcare education and training	DeVry (US)	290	2.0x	11.7x
Aug-08	INTI Universal Holdings (Malaysia)	Manages higher education institutions and provides corporate training	Laureate Education, Inc. (US)	62	1.8x	10.8x
Aug-08	ULA (Mexico)	Accredited, private university with campuses throughout Mexico	Apollo Global (US)	47	n/a	n/a
Apr-08	UNIACC (Chile)	Accredited arts and communications university - the first in Chile to teach a fully online program	Apollo Global (US)	53	n/a	n/a

Growing International Consolidation of the For-Profit Post-Secondary Education Sector *(continued from page 4)*

As countries around the world are slowly relaxing the regulations that have historically prohibited commercial competition in the education sector, cross-border M&A activity has followed. The most attractive acquisition candidates are those institutions located in countries where enrollment rates are growing, the political environment is supportive of commercial competition, and the economy is stable and can support foreign investment.

Much of the global cross-border acquisition activity over the past 10 years has involved regional players acquiring smaller institutions in neighboring countries. Countries frequently targeted include those with developed economies that are able to support foreign investment, and a regulatory environment that allows private institutions to compete.

Nearly all of the top for-profit post-secondary education firms in the United States have achieved their market-leading positions through acquisition, some with significant investments outside of the country. For example, Laureate Education, owned by KKR, currently has operations in 20 countries, including Latin America (Brazil, Caribbean, Chile, Costa Rica, Ecuador, Honduras, Mexico, Panama, Peru) and Europe (Cyprus, France, Germany, Netherlands, Spain, Switzerland, Turkey) and Asia/Oceania (Australia, China, India, Malaysia). Apollo Global, a \$1 billion joint venture between Apollo Group and Carlyle formed in 2007, is initially focusing on Latin America, China, India, and Europe. Its acquisitions include Universidad Latinoamericana (Mexico), UNIACC (Chile), and it recently announced its acquisition of BPP Holdings, the first U.K.-based, private-

sector school with degree-granting ability.

Private equity groups have increased their investing in post-secondary education, perhaps attracted by the countercyclical nature of the sector and the shift to asset-light business models of distance learning. So far, they have tended to focus on continued U.S. consolidation. Examples include the Summit Partners acquisitions of TUI Learning in late 2007 and Heald College in June 2009, Parthenon Capital's acquisition of Bryant & Stratton College in early 2008, and Caltius Capital's acquisition of Platt College in mid-2008. As private equity platforms gain scale and the U.S. opportunity for consolidation further matures, we expect to see heightened competition for quality overseas acquisitions.

About Lincoln International

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