Ira Sohn Conference

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FrontPoint Partners

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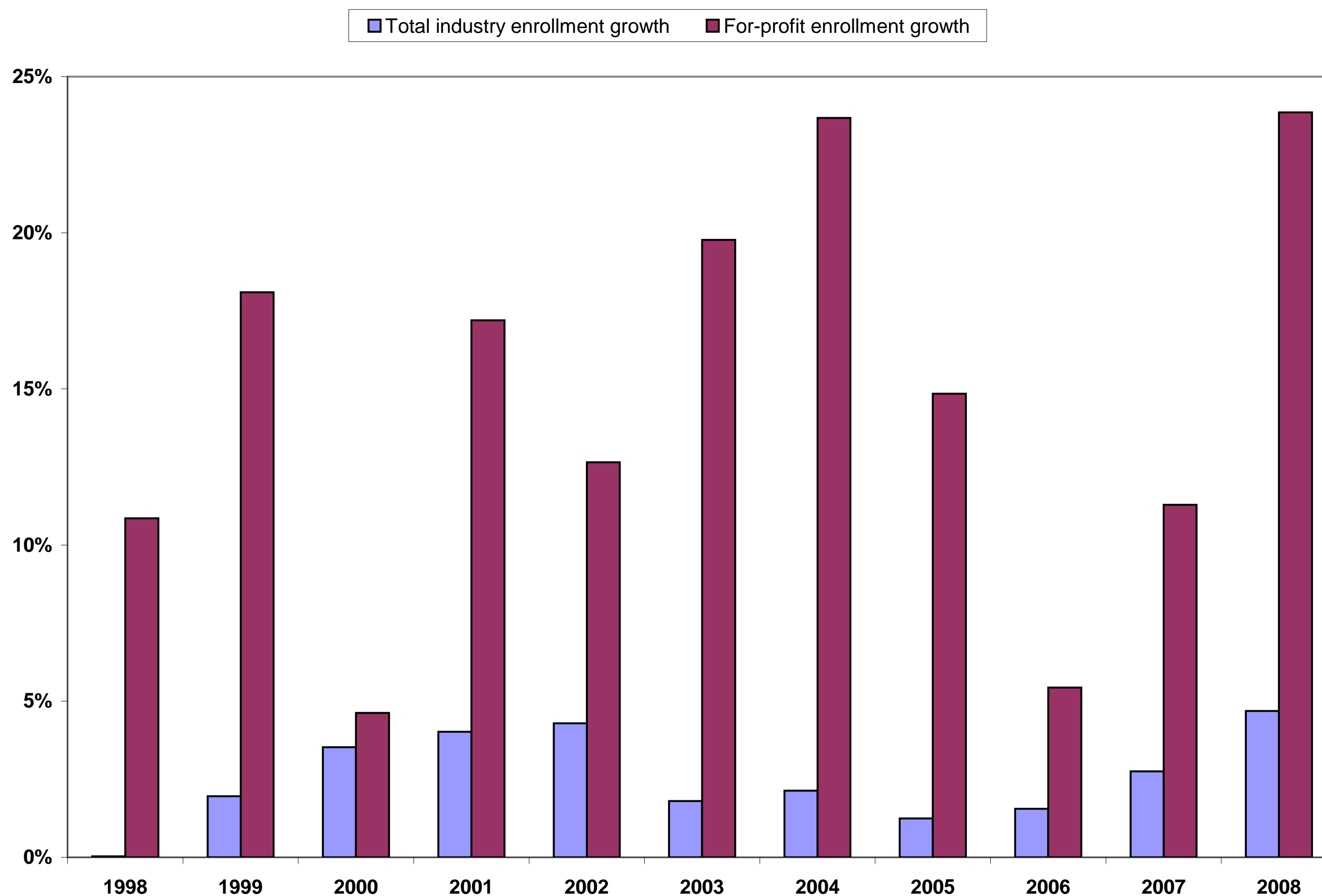
For Profit Education:

Subprime goes to College

Background: Not your typical growth story…

In the last 10 years, the for-profit education industry has grown at 5-10 times the historical rate of traditional post-secondary education



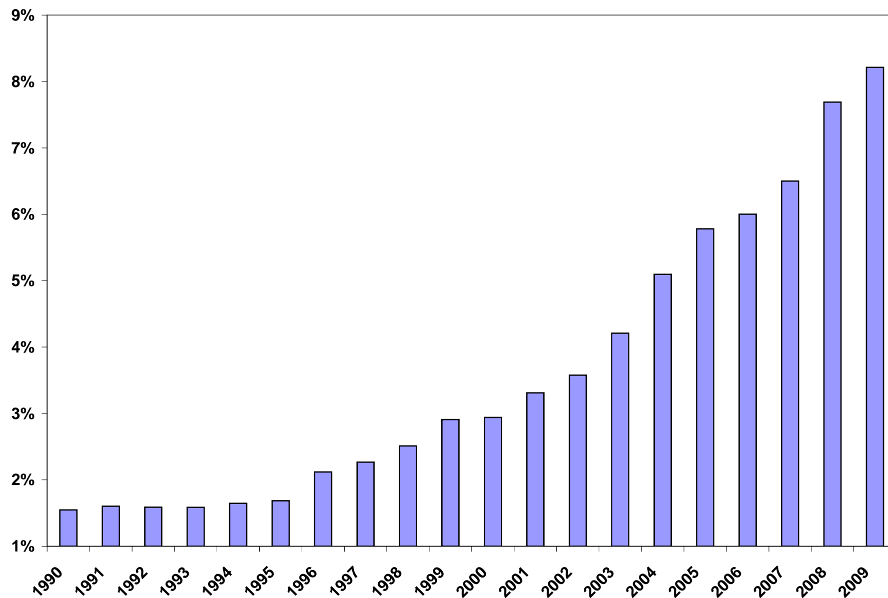
Source: National Center for Education Statistics, 2009

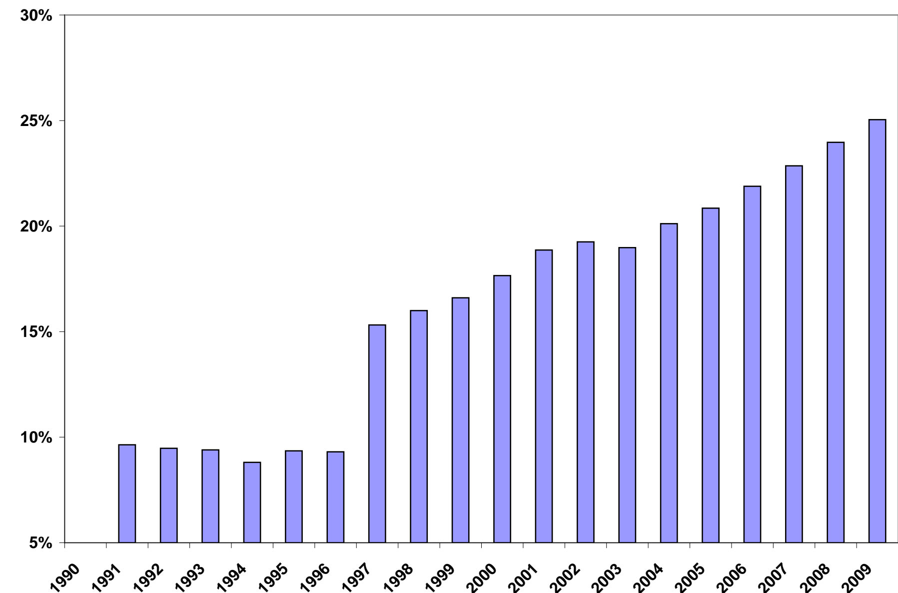
Which has drastically accelerated the for-profit's share of total US post-secondary enrollments and led to the rapid growth of for-profit institutions

In 1990…

< 1% of all students attended for-profit colleges…

< 10% of all schools were for-profit…





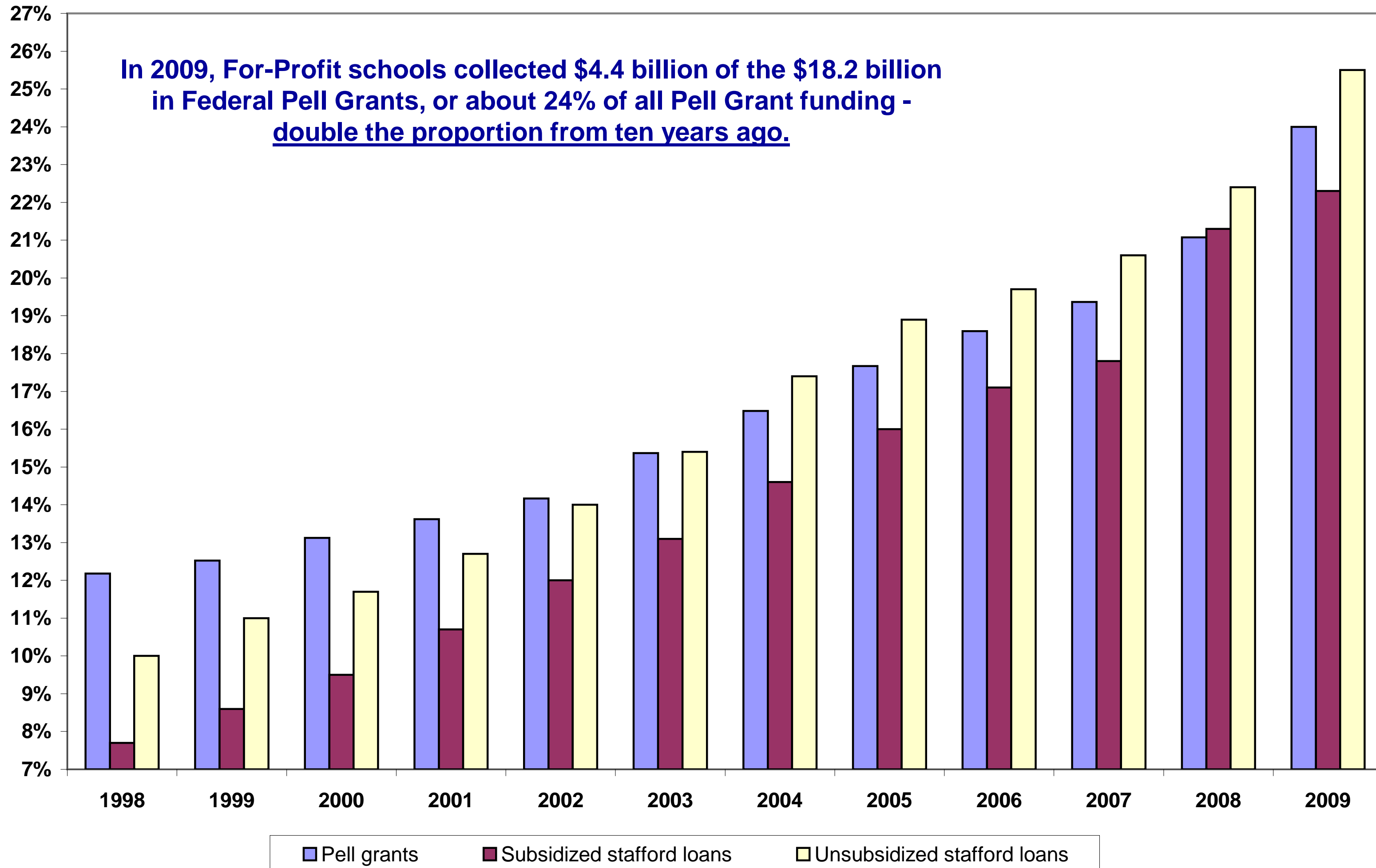
In 2009…

almost 10% of students attend for-profit colleges

25% of schools are for-profit institutions

Source: National Center for Education Statistics, 2009

Despite being less than 10% of total enrollments, for-profits now claim nearly 25% of the $89 billion of Federal Title IV student loans and grant disbursements



Source: College Board, NCLC

How is this possible?! The for-profit industry has bought almost every lobbyist and has infiltrated the highest levels of government…a prime example

Sally Stroup was a pivotal player in the deregulation of the for-profit industry…
because she worked for the for-profit industry

Sally Stroup Biography:

- **2001 – 2002: Director of Industry and Government Affairs for the Apollo Group** *(top lobbyist for APOL)*
- **2002 – 2006: Assistant Secretary for Postsecondary Education, U.S. Dept of Education** *(top postsecondary education position)*
- **2006 – 2008: GOP Deputy Staff Director, U.S. House of Representatives Committee on Education and Labor** *(largest recipient of political contributions from for-profit education industry)*
- **2008 – Present: GOP Staff Director, U.S. House of Representatives Committee on Education and Labor**

…and not surprisingly, her colleagues at the Dept of Education were all driven by similar goals

Name	Former DOE position	Current Lobbying Firm	For-profit Education client
William Hansen	Deputy Secretary of Eductaion, 2001 - 2003	Chartwell Education Group	APOLLO GROUP
Jonathan Vogel	Deputy Counsel to the Department of ED, 2002 - 2005	Sonnenschein, Nath & Rosenthal	GRAND CANYON UNIVERSITY
Lauren Maddox	DOE Asst Sec for Communications, 2006 - 2008	Podesta Group	CAREER EDUCATION CORP
Rebecca Campoverde	DOE Asst Sec for Congressional & Legislative affairs, 2005 - 2008	Kaplan, Inc.	KAPLAN, INC
Victor F. Klatt III	GOP Staff Director for House ED and Labor, 2005 - 2008	Van Scoyoc Associates	APOLLO GROUP

From 1987 through 2000, the amount of total Title IV dollars given to for-profit schools fluctuated between $2 billion and $4 billion dollars…

Total Federal disbursements of Title IV Stafford Loans and Pell Grants, 1987 - 2009

Dollars in billions

Year	Total Pell Grants	Total Stafford Loans	For profit Pell Grants	For profit Stafford Loans	Total For profit	For profit share Pell Grants	For profit share Stafford Loans
1987	$3.5	$7.3	$0.9	$1.8	$2.7	25%	25%
1988	$3.8	$8.0	$1.0	$2.1	$3.1	27%	27%
1989	$4.5	$8.2	$1.1	$2.3	$3.4	24%	28%
1990	$4.8	$8.3	$1.1	$1.9	$3.0	23%	23%
1991	$4.9	$8.8	$1.1	$1.5	$2.6	22%	17%
1992	$5.8	$9.5	$1.2	$1.3	$2.5	21%	14%
1993	$6.2	$9.9	$1.1	$1.0	$2.1	18%	10%
1994	$5.7	$14.1	$0.9	$1.4	$2.3	15%	10%
1995	$5.5	$19.9	$0.7	$2.0	$2.7	13%	10%
1996	$5.5	$22.8	$0.7	$1.9	$2.6	13%	8%
1997	$5.8	$25.1	$0.7	$2.2	$2.9	12%	9%
1998	$6.3	$26.3	$0.8	$2.3	$3.0	12%	9%
1999	$7.2	$27.2	$0.9	$2.6	$3.5	13%	10%
2000	$7.2	$28.4	$0.9	$3.0	$3.9	13%	10%
2001	**$8.0**	**$29.5**	**$1.1**	**$3.4**	**$4.5**	**14%**	**12%**
2002	**$10.0**	**$32.1**	**$1.4**	**$4.1**	**$5.6**	**14%**	**13%**
2003	**$11.6**	**$36.5**	**$1.8**	**$5.2**	**$7.0**	**15%**	**14%**
2004	**$12.7**	**$41.6**	**$2.1**	**$6.6**	**$8.7**	**16%**	**16%**
2005	**$13.1**	**$45.7**	**$2.3**	**$7.9**	**$10.3**	**18%**	**17%**
2006	**$12.7**	**$48.0**	**$2.4**	**$8.8**	**$11.2**	**19%**	**18%**
2007	**$12.8**	**$49.4**	**$2.5**	**$9.5**	**$12.0**	**19%**	**19%**
2008	**$14.7**	**$56.8**	**$3.1**	**$12.4**	**$15.5**	**21%**	**22%**
2009	**$18.2**	**$70.9**	**$4.4**	**$17.0**	**$21.4**	**24%**	**24%**

Pell Grants quadrupled from $1 billion to $4 billion

Total Title IV aid grew from under $4 billion in 2000 to over $21 billion in 2009

…but with the leniency shown to the industry under the Bush Administration, the dollars that flowed to the industry exploded to over $21 billion, a 450% increase

Source: College Board

At the current pace of growth, For-profit schools will claim 20% of enrollments, represent 40% of schools and draw over 40% of all Title IV aid in 10 years

For-profit share of enrollment, schools, Pell grants and Loans, 2009 - 2020

	For-profits % share of:					Total Title IV disbursements ($ billions)	
Year	Total Enrollment	Total Schools	Pell Grants	Stafford Loans	Total Title IV	Non-profits	For-profits
2007	7%	23%	19%	19%	19%	$50.2	$12.0
2008	8%	24%	21%	22%	22%	$56.0	$15.5
2009	**8%**	**25%**	**24%**	**24%**	**24%**	**$67.6**	**$21.4**
2010	9%	26%	25%	25%	25%	$71.9	$24.3
2011	10%	27%	26%	27%	27%	$76.5	$27.7
2012	10%	29%	27%	28%	28%	$81.2	$31.5
2013	11%	30%	28%	30%	29%	$86.2	$35.8
2014	12%	31%	30%	31%	31%	$91.4	$40.8
2015	13%	32%	31%	33%	32%	$96.9	$46.4
2016	14%	34%	32%	35%	34%	$102.5	$52.8
2017	16%	35%	33%	36%	36%	$108.4	$60.1
2018	17%	37%	35%	38%	38%	$114.4	$68.5
2019	18%	39%	36%	40%	40%	$120.6	$77.9
2020	**20%**	**40%**	**38%**	**43%**	**42%**	**$126.9**	**$88.8**

Key Assumptions for Projections

- Total post-secondary enrollment grows at 1.5% per year
- For-profit enrollment grows at 10% per year (10-yr avg is 14.4% annually)
- Total post-secondary institutions grow at 1.5% per year; For-profit institutions grow at 6% per year (both long-term avg since 1990)
- Avg grant and loan amounts per student grows at 5-yr historical avg growth rates, by institution type

Based on current financials of For-profit institutions, less than 30% of the incremental $67 billion (annually) in Title IV dollars will go towards educating students…

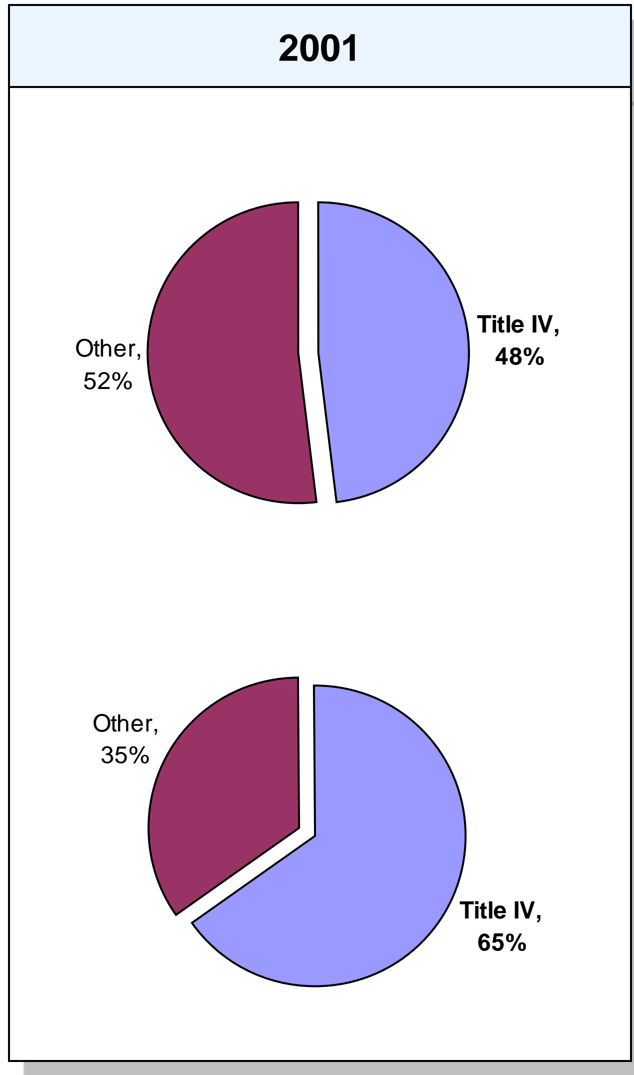
…nearly $50 billion (annually) will go toward non-faculty and executive compensation and company profits

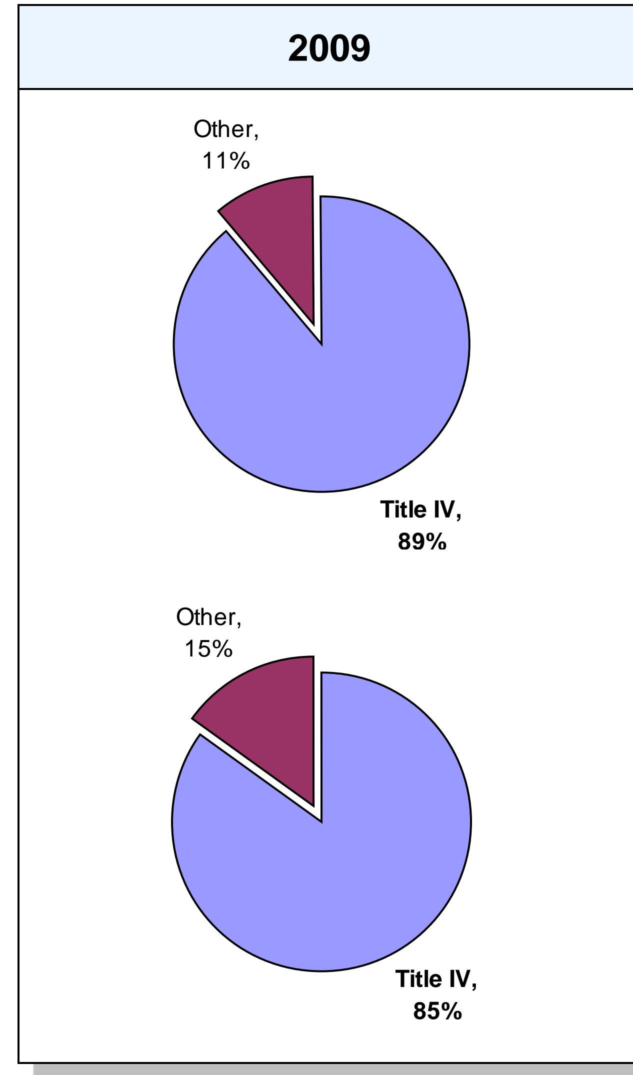
Source: College Board, US Dept of Education, industry estimates

At many major for-profit institutions, federal Title IV loan and grant dollars now comprise close to 90% of total revenues

Apollo Group

ITT Technical Institute



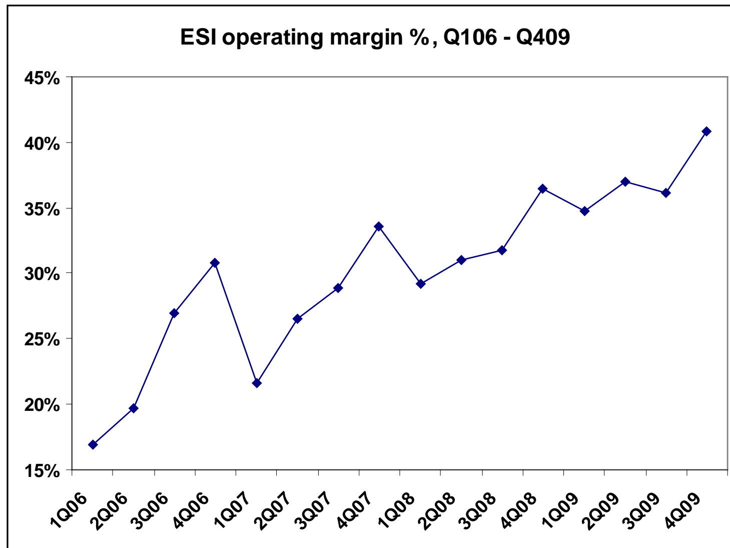


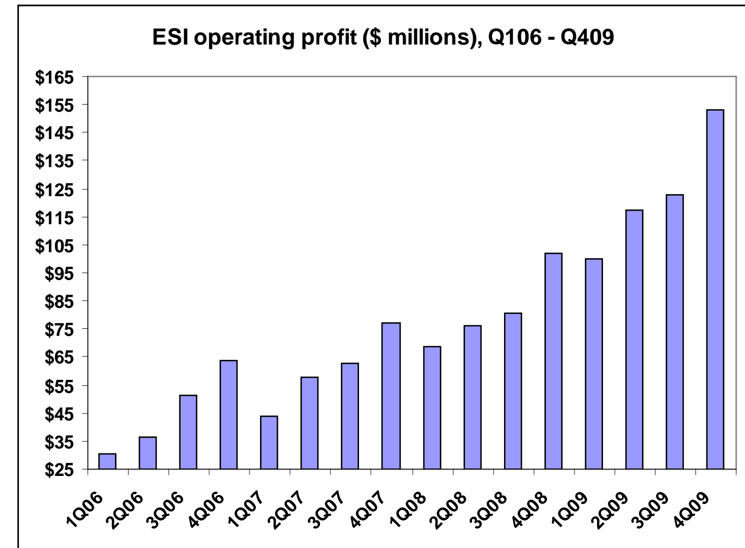
Note: Title IV figures include 2008 unsubsidized loan limit increases on a pro-forma basis

Source: Company-reported financials

This growth has driven even more spectacular company profitability and wealth creation for industry executives and shareholders

ITT Technical Institute (ESI) Profitability has grown 5-fold since 2006





The top 5 executives at ESI, Corinthian colleges (COCO) and Apollo Group (APOL) collectively earned over $130 million from 2007-2009

Top 5 executives total compensation

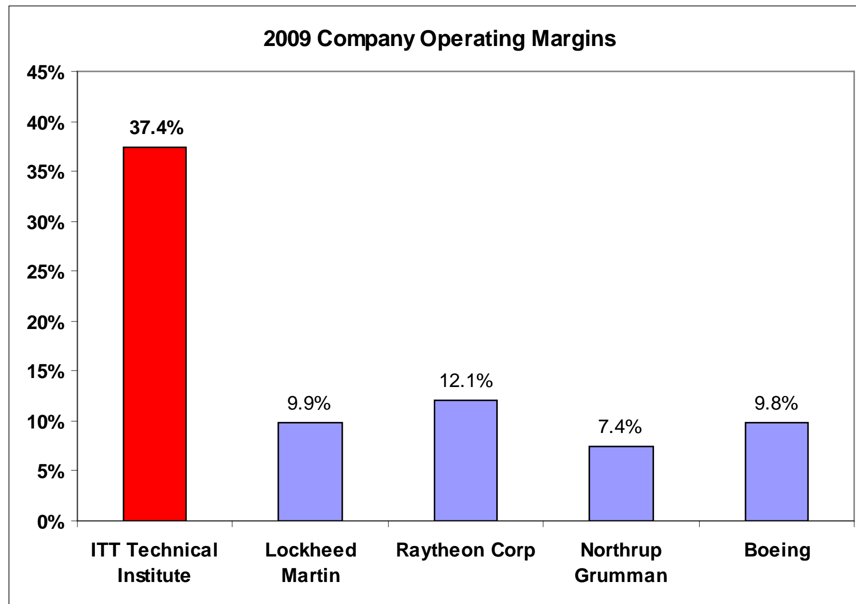
	ESI	COCO	APOL	Total
2007	$9,834,695	$4,938,982	$10,441,170	$25,214,847
2008	$8,923,791	$8,849,386	$26,766,979	$44,540,156
2009	$14,366,540	$11,222,377	$34,707,377	$60,296,294
3-yr total comp	**$33,125,026**	**$25,010,745**	**$71,915,526**	**$130,051,297**

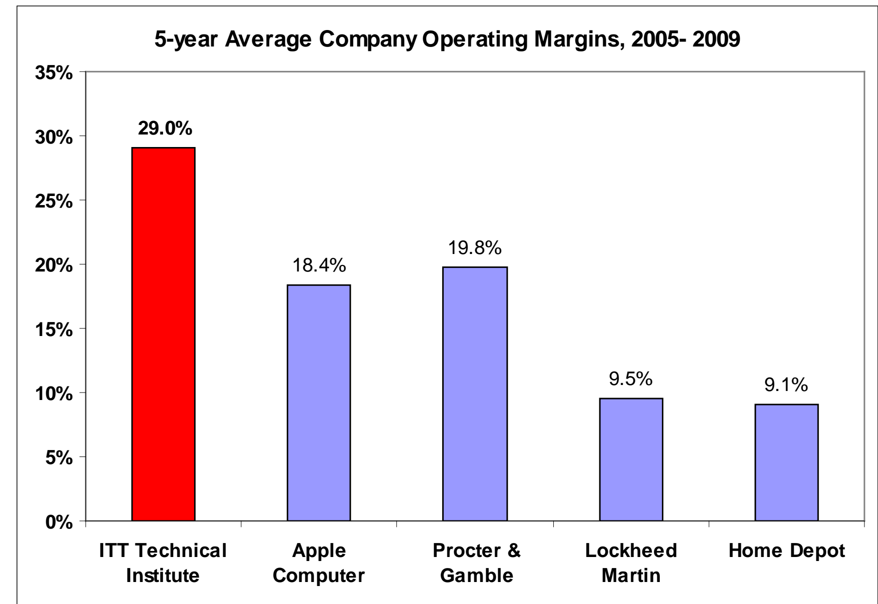
Total comp = salary, bonus, stock awards, option awards, non-equity incentives

Source: Company-reported financials and proxy statements

Now many of the US for-profit education companies are among the most profitable businesses in the world

Other industries of strategic importance to the U.S. which are funded by taxpayer dollars are restricted to lower operating margins on contracts…





So how can Title IV-funded education companies earn substantially more money than nearly every other major US business?

Source: Company-reported financials and proxy statements

This growth however, is primarily a function of government largesse, as Title IV has accounted for more than 100% of the revenue growth of these companies

Apollo Group (APOL)	2007	2008	2009
Total revenues	$2,724	$3,141	$3,974
Year-year growth		$417	$833
% revenue from Title IV*	**65%**	**77%**	**89%**
Title IV revenues	$1,770	$2,419	$3,537
Year-year growth		**$648**	**$1,119**
% revenue growth from Title IV		**155%**	**134%**

Corinthian Colleges (COCO)	2007	2008	2009
Total revenues	$919	$1,069	$1,308
Year-year growth		$149	$239
% revenue from Title IV*	**75%**	**81%**	**89%**
Title IV revenues	$691	$866	$1,163
Year-year growth		**$174**	**$297**
% revenue growth from Title IV		**117%**	**124%**

ITT Technical Institute (ESI)	2007	2008	2009
Total revenues	$758	$870	$1,015
Year-year growth		$112	$146
% revenue from Title IV*	**63%**	**73%**	**85%**
Title IV revenues	$477	$635	$863
Year-year growth		**$157**	**$228**
% revenue growth from Title IV		**141%**	**157%**

Dollars in millions

**Title IV % includes 2008 Stafford unsubsidized loan limit increases*

More than 100% of the revenue growth of APOL, COCO and ESI is driven by an increase in Federal Title IV dollars…

…and of this incremental $1.1 billion in Title IV and $833 million in revenues,

ONLY $99 million or 9% was spent on educational expenses like faculty compensation and other instructional costs

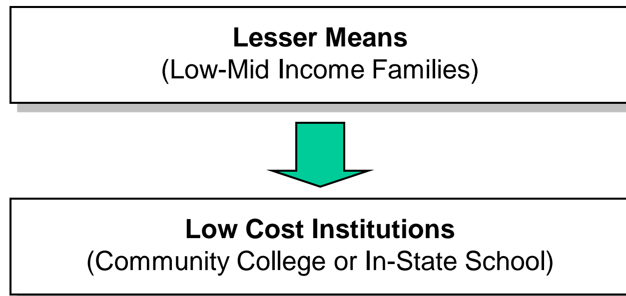
Source: Company-reported financials

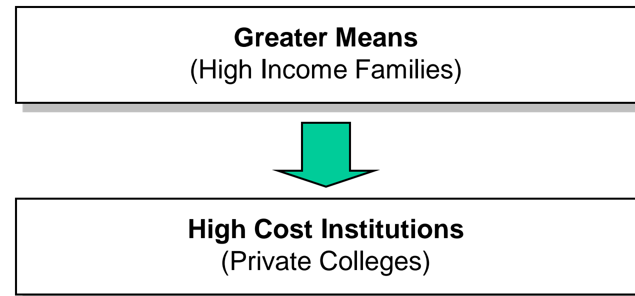
But how do they do it? How are for-profit schools grabbing such a growing share of Title IV dollars?

Traditional relationship – Matching Means with Costs

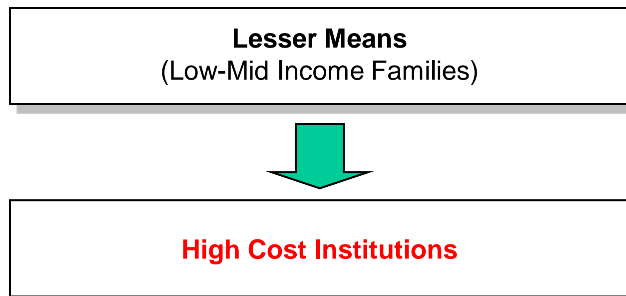
Families with greater needs *generally seek lower-cost institutions to maximize the available Title IV loans and grants, getting the most out of every dollar to reduce out-of-pocket expenses and minimize heavy debt burdens…*

Families with greater financial resources *often seek higher-cost institutions because they can afford to pay in excess of what Title IV loans cover. These families typically are not eligible for grants because of their higher-income status.*





For-profit Model – Max Cost with Minimal Means



The for-profit model has consciously separated the traditional relationship between costs and means. They seek to recruit those with the greatest financial needs and put them in the highest-cost institutions…and why?

This formula maximizes the amount of Title IV loans and grants their students can receive.

The business model: Churn ‘em and burn ‘em…

What results from this combination of profit-motive and lack of quality control is an expensive education that is highly questionable

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East Bay News

Everest College students angry over certification

Friday, March 19, 2010

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TAGS: hayward, protest, east bay news

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By Tomas Roman

HAYWARD, CA (KGO) -- Nearly three dozen Everest College students are furious they haven't received the medical certifications they paid for. They refused to go to class until they get some answers.

Whether they attend class or not, the students have to pay $100.

Some of the students have been attending school for eight months. Three weeks ago they found out that the college does not supply them with a certificate they were told they would get, in order to obtain the medical positions they want.

The students are all studying medical assisting and they paid $16,000 for an eight-month course. They were told the credits earned at the school do not transfer to any community or four-year college and that has many of them angry.

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News Article summary

- Students paid $16,000 for an eight-month course in medical assisting at an Everest College campus in Hayward, CA
- Students recently learned that:
  - **Credits earned at the school do not transfer** to any community or four-year college
  - **Degrees granted at the school are not recognized** by the American Association for Medical Assistants (AAMA)
  - **Hospitals will not interview students for potential jobs**
- **ABC7 talked to the state Medical Assistant's Education Review Board and found the Hayward Campus is one of several Everest operates in California that the board say is not accredited to credential medical assistants.**

Source: ABC News, KGO-TV San Francisco, CA, March 19, 2010

Even when assuming reported graduation rates (BIG ASSUMPTION), more than 50% of the student body still drops out every year

APOL	2006	2007	2008	2009
Beginning enrollment	278,300	282,300	313,700	362,100
+ New students	216,600	258,500	288,200	355,800
- Graduates / drop outs	(212,600)	(227,100)	(239,800)	(274,900)
Ending enrollment	282,300	313,700	362,100	443,000
Graduation rate	**28%**	**28%**	**28%**	**28%**
Graduates	61,390	72,338	78,484	83,440
Drop outs	**151,210**	**154,762**	**161,316**	**191,460**
Drops % of avg total enrollment	**54%**	**52%**	**48%**	**48%**

**Assume avg tenure btwn 3-4 years for graduates*

ESI	2006	2007	2008	2009
Beginning enrollment	42,985	46,896	53,027	61,983
+ New students	49,935	54,593	65,313	85,928
- Graduates / drop outs	(46,024)	(48,462)	(56,357)	(67,145)
Ending enrollment	46,896	53,027	61,983	80,766
Graduation rate	**44%**	**44%**	**44%**	**44%**
Graduates	18,449	19,774	21,983	25,302
Drop outs	**27,575**	**28,688**	**34,374**	**41,843**
Drops % of avg total enrollment	**61%**	**57%**	**60%**	**59%**

**Assume avg tenure btwn 2-3 years for graduates*

COCO	2006	2007	2008	2009
Beginning enrollment	66,114	60,964	61,332	69,211
+ New students	92,185	90,105	100,210	117,352
- Graduates / drop outs	(97,335)	(89,737)	(92,331)	(100,475)
Ending enrollment	60,964	61,332	69,211	86,088
Graduation rate	**33%**	**33%**	**33%**	**33%**
Graduates	20,968	20,179	21,540	25,624
Drop outs	**76,367**	**69,558**	**70,791**	**74,851**
Drops % of avg total enrollment	**120%**	**114%**	**108%**	**96%**

**Assume avg tenure btwn 1-2 years for graduates*

Assuming these graduation rates, every year 50%+ of APOL and ESI students drop-out annually.

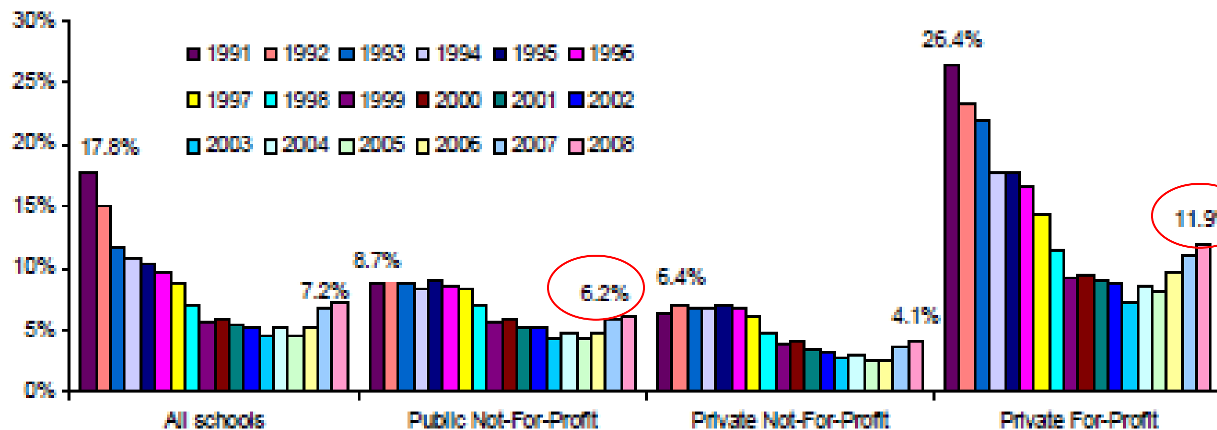
COCO recycles its entire enrollment annually.

- Graduation rate estimate based on reported National Center of Education Statistics data; figures represent average institutional graduation rates at top 5 largest institutions
- For reference, 2009 Dept of ED reported graduation rates for full-time, first time students at for-profit schools is between 14-22%; these graduation rates have been adjusted to include non first-time, full-time students, still may be largely overstated
- ***Former academic counselors of APOL, ESI and COCO claim that real graduation rates at many locations are in the single digits***

Source: Company-reported financials, IPEDS data (College Navigator), APOL student outcomes report 2009

Default rates - historical National Cohort Default rates by institution type

Outside of the mid-90's, when the regulatory environment was more stringent,
<u>default rates at For-profit schools are roughly 2x non-profit default rates</u>



Source: NCES industry data and chart taken from recent BMO capital markets research report

We are back to late-80's levels of lending to for-profit students, a key leading indicator for loan defaults…back then, fraud was commonplace and regulation was minimal

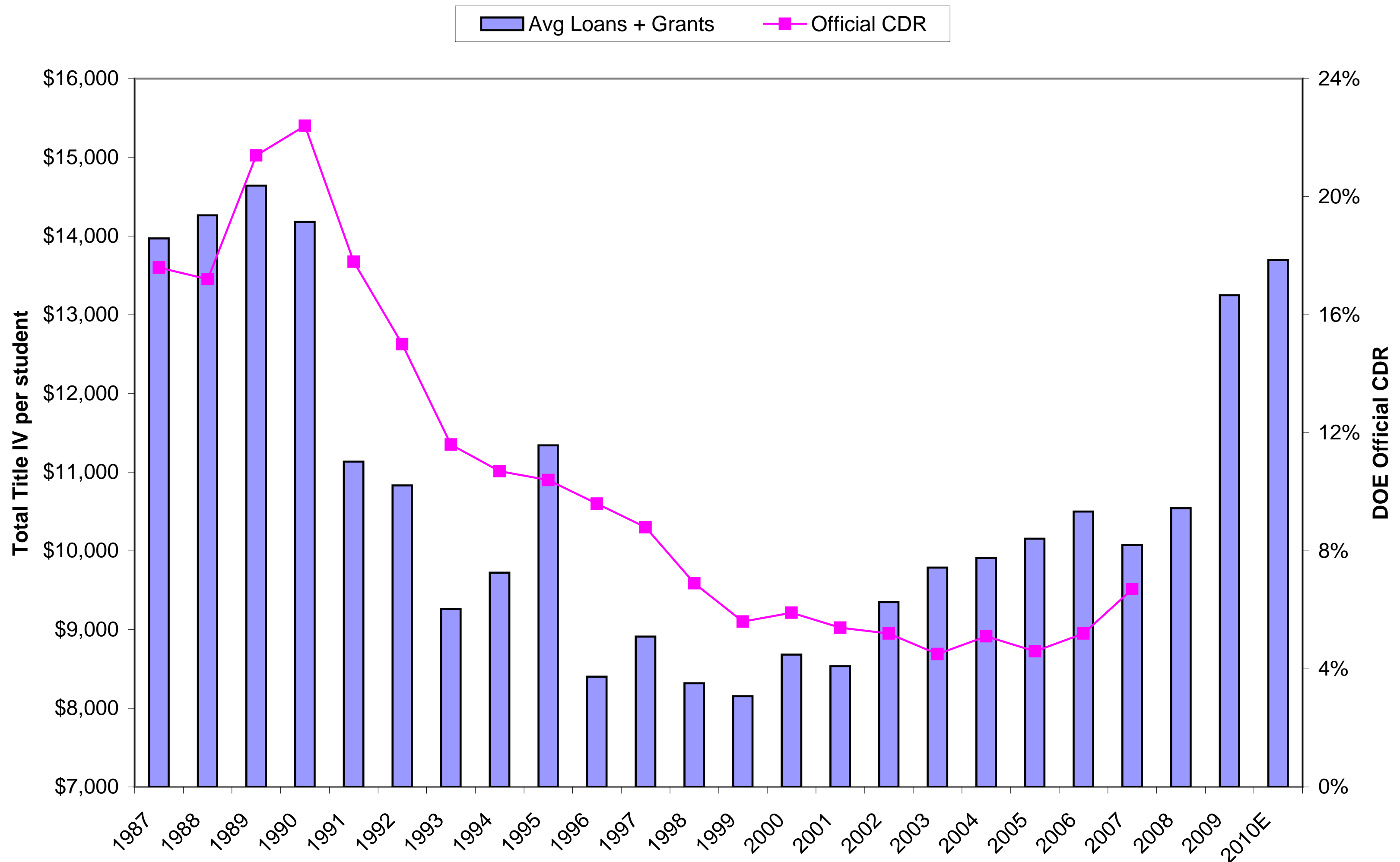
Traditional vs. For-profit disbursements of Title IV Stafford Loans and Pell Grants, 1987 - 2009

	For-profits % share of:					Average Pell Grant + Loans Per Student		
Year	Total Enrollment	Total Schools	Pell Grants	Stafford Loans	Total Title IV	All schools	Non-profit	For-profit
1987	**1%**	**10%**	**25%**	**25%**	**25%**	**$842**	**$643**	**$13,969**
1988	2%	10%	27%	27%	27%	$899	$670	$14,262
1989	2%	10%	24%	28%	27%	$933	$697	$14,640
1990	2%	10%	23%	23%	23%	$948	$740	$14,179
1991	2%	10%	22%	17%	19%	$954	$788	$11,133
1992	2%	9%	21%	14%	16%	$1,053	$895	$10,831
1993	2%	9%	18%	10%	13%	$1,120	$989	$9,263
1994	2%	9%	15%	10%	12%	$1,385	$1,246	$9,723
1995	2%	9%	13%	10%	11%	$1,780	$1,616	$11,339
1996	2%	9%	13%	8%	9%	$1,967	$1,827	$8,402
1997	2%	15%	12%	9%	9%	$2,131	$1,974	$8,910
1998	3%	16%	12%	9%	9%	$2,249	$2,093	$8,317
1999	3%	17%	13%	10%	10%	$2,329	$2,154	$8,152
2000	3%	18%	13%	10%	11%	$2,323	$2,130	$8,681
2001	3%	19%	14%	12%	12%	$2,351	$2,139	$8,533
2002	4%	19%	14%	13%	13%	$2,531	$2,278	$9,349
2003	4%	19%	15%	14%	14%	$2,848	$2,543	$9,786
2004	5%	20%	16%	16%	16%	$3,146	$2,783	$9,909
2005	6%	21%	18%	17%	17%	$3,364	$2,947	$10,153
2006	6%	22%	19%	18%	18%	$3,420	$2,968	$10,498
2007	7%	23%	19%	19%	19%	$3,407	$2,944	$10,074
2008	8%	24%	21%	22%	22%	$3,740	$3,173	$10,541
2009	**8%**	**25%**	**24%**	**24%**	**24%**	**$4,525**	**$3,744**	**$13,247**

We must take note that because For-profit students receive 3-5x as much Title IV aid as traditional students and are growing enrollment at 3x the pace of traditional schools, these early warning signs must be addressed now before the impact is felt in the coming years…

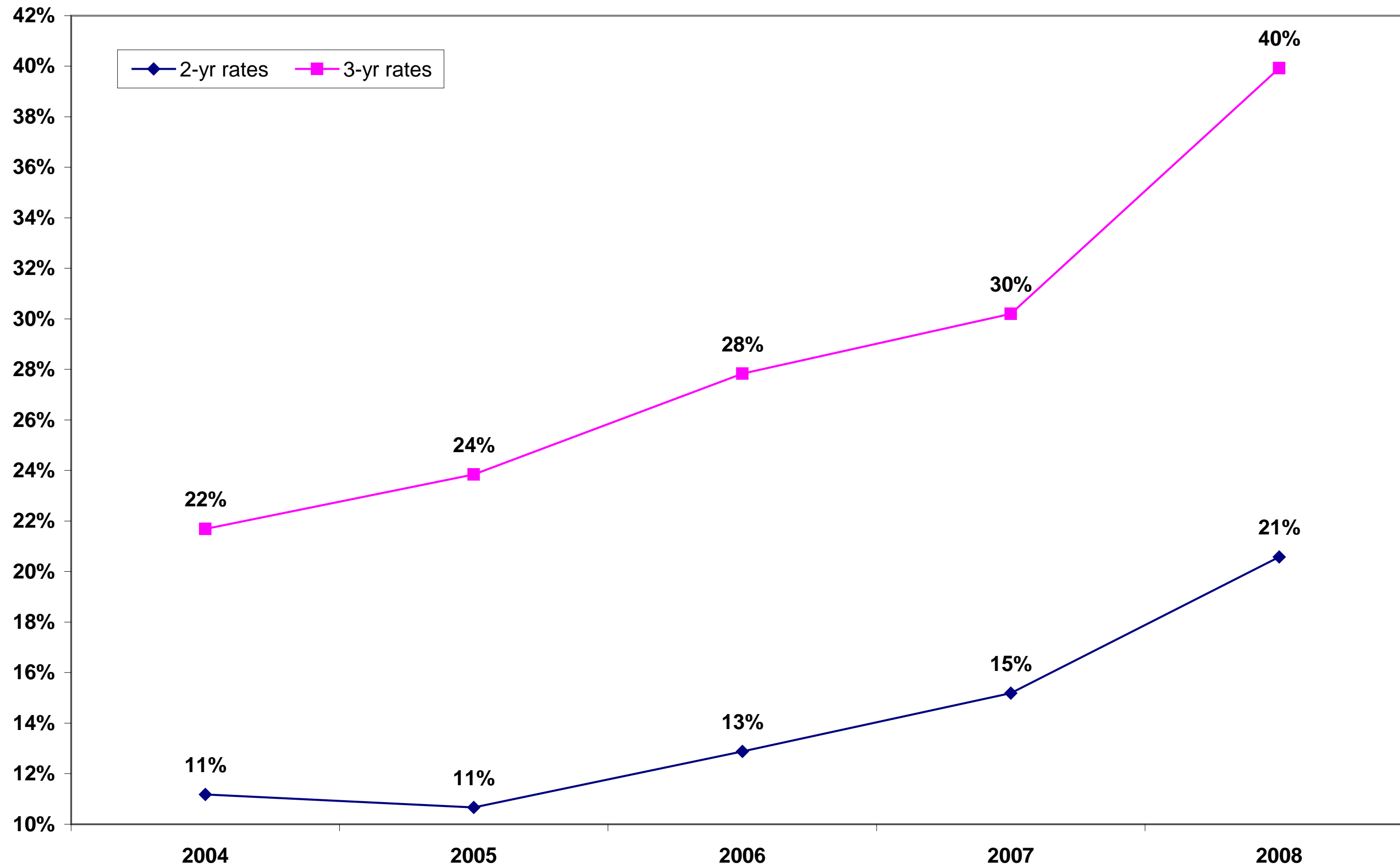
Source: College Board

If history is any guide, we will return to late-80's Cohort Default rates in 1-2 years, the worst period of recorded default rates in the history of the DOE



Source: College Board, US Dept of Education

Because of the excessive drop-out rates and high debt burdens of graduates, the credit statistics for government loans at for-profits are deteriorating at an alarming pace



Source: Company-reported financials; note: 2008 2-yr rates still preliminary, 3-yr rates estimated

Currently, for-profit institutions provision 50 – 60% on loans they make to their own students…these are students who already have Title IV loans

- Companies are provisioning for more than 50%+ loss on loans they make to students… which means they expect more than 1 out of every 2 loans to go bad
- But absent any regulatory threat, these companies could care less if they every loan they made went bad because the per-student profitability of their models is so high!
- Both companies would still be hugely profitable on a per-student basis even with a 100% losses on every loan they made

	ESI	COCO
Title IV loans, grants and private loans	$16,959	$14,443
Internal company loan per student	**$2,100**	**$1,770**
Tuition per student (2009)	$19,059	$16,213
Provision for loan losses (%)	**50%**	**58%**
Expected losses on internal loans	**($1,050)**	**($1,027)**
Operating profit per student	**$8,792**	**$4,282**
Multiple of expected losses	**8.4 x**	**4.2 x**

Note: OP / student equals change in operating profit over change in total enrollment

Loan loss provisions provided by companies

ESI earns more than 8 times the amount it expects to lose from internal loans to students.

COCO earns more than 4 times its expected loan losses.

Reported statistics…Cohort Default Rates (CDRs)

Cohort Default Rates (CDRs)

- CDRs are the percentage of a school's borrowers who enter repayment on a Federal Loan during a particular federal FY (Oct 1 to Sep 30), and default prior to the end of the next FY
- Effectively a 2-yr snapshot of the total students in default
- CDRs are an important measure of quality – if default rates breach the federally-mandated threshold of 25% (soon to be 30%), schools can lose eligibility to Title IV

Can easily be manipulated to mask true defaults

- Deferrals and forbearances used en mass to carry students over the 2 year reported timeframe
- Schools partner with Sallie Mae and other lenders to delay or manage down defaults through the 2 year timeframe in exchange for guaranteed loan volumes
- Schools pay down student government loans with internal money and collect directly from students

Reported statistics…the 90/10 rule

The 90/10 rule

- 90/10 says a for-profit may become ineligible to participate in Title IV programs if it derives more than 90% of its cash basis revenue from Title IV programs
- Applies only to for-profit institutions, effectively a cap on total Title IV dollars that can flow to a company as a percentage of revenues
- Intended to create a structural boundary for growth from Title IV dollars

Can also be manipulated

- Over-returning Title IV dollars to the government when students drop out and then billing students directly
- Pursue alternative government entitlement programs not counted under the Title IV umbrella (military educational loans grants)
- When all else fails, raise tuition! Students will have to find alternative (non-Title IV) funding sources to close the gap between tuition and the amount of total Title IV loans

Reported statistics…completions and placements

Completions (graduation stats)

- Company-reported metric that measures the number of students who complete a program (graduate) in 150% of normal time (for example, 6 years of graduation data for a 4-year bachelors program)
- Non-traditional student body doesn't graduate together, and often takes much longer than normal to complete, so hard to understand actual graduation by class
- No independent verification of graduates

Placements (employment stats)

- Company-reported metric that measures the number of students who are placed in a job they were trained for (gainful employment)
- This is gainful employment?
  - Trained nurses become janitors at hospitals
  - Homeland security degree grads become nighttime security guards at shopping malls
- And for those grads who cannot find employment…hire them! Most schools hire unemployed graduates internally to boost reported placement stats

As long as the government continues to flood the for-profit education industry with loan dollars,

AND

the risk for these loans is borne **SOLELY BY** students and the government…

THEN

the industry has every incentive to:

- **Grow at all costs**
- **Compensate employees based on enrollment**
- **Influence key regulatory bodies**
- **Manipulate reported statistics and other regulatory measures**

ALL TO MAINTAIN ACCESS TO THE GOVERNMENT'S MONEY.

“Its about the numbers. It will always be about the numbers.”

- Bill Brebaugh, head of University of Phoenix Corporate Enrollment

The entire business model of these companies is centered around growing enrollment - it is the single most important measure of growth and profitability, period.

Boiler room tactics:

- *“Every 6 months we get a review that looks at how many students we enrolled and what percentage of them finished their first class. As long as they finish their first class we get full credit and after that they are not our problem…”*
- *“We are under so much pressure we are forced to do anything necessary to get people to fill out an application…”*
- *It’s a boiler room – selling education to people who don’t really want it.”*
    - Ashford University (BPI) former enrollment counselor
- *“The EC [enrollment counselor] review matrix is all smoke and mirrors so we could fly under the radar of the DOE…”*
    - APOL former enrollment counselor

Actual APOL compensation table snapshot

Enrollments at Completion of Half - New EAs	Salary on Old Plan	Salary on New Plan	
0 to 30 enrollments	$28k	$14k to $20k	
31 to 44 enrollments	$28k	$20k to $28k	
45 enrollments	$29k	$29k	$640 per + 1 mo. O.T.
46 enrollments	$29k	$29k	
47 enrollments	$30k	$30k	
48 enrollments	$31k	$30k	$625 per + 1 mo. O.T.
49 enrollments	$32k	$31k	
50 enrollments	$33k	$32k	$640 per + 1 mo. O.T.
51 enrollments	$33k	$32k	
52 enrollments	$34k	$33k	
53 enrollments	$34k	$33k	
54 enrollments	$35k	$34k	
55 enrollments	$35k	$34k	$618 per + 2 mo. O.T.
56 enrollments	$36k	$35k	
57 enrollments	$36k	$35k	
58 enrollments	$37k	$36k	
59 enrollments	$37k	$36k	
60 enrollments	$38k	$37k	$633 per + 2 mo. O.T.
61 enrollments	$38k	$37k	
62 enrollments	$38k	$38k	
63 enrollments	$39k	$38k	
64 enrollments	$39k	$39k	
65 enrollments	$40k	$40k	$615 per + 3 mo. O.T.
66 enrollments	$40k	$41k	
67 enrollments	$40k	$42k	
68 enrollments	$40k	$43k	
69 enrollments	$40k	$44k	
70 enrollments	$40k	$46k	$643 per + 3 mo. O.T.
71 enrollments	$41k	$46k	

Source: Court documents, Hendow & Albertson vs. UOP, filed 2009

Accreditation…the inmates running the asylum

What is Accreditation and why is it important?

- Accreditation helps ensure that education provided by institutions of higher education meets acceptable levels of quality
- The Accreditation bodies are non-governmental (non-profit) peer-reviewing groups
- Schools must earn and maintain proper Accreditation to remain eligible to participate in Title IV Programs
- However, due to the peer-based composition of the Accreditation boards, they cannot function as a truly independent 3rd party review system
- In many instances, **for-profit institution's representatives sit on the boards of their own Accrediting body,** inevitably influencing the approval process and oversight of their own institutions!

The Accrediting Council for Independent Colleges and Schools (ACICS)

ACICS BOARD OF COMMISIONERS

6 of the 16 Board members of ACICS are for-profit representatives

Dr. Gary R. Carlson - Chair Elect
Vice President, Academic Affairs
ITT Technical Institute

Ms. Mary Hale Barry
Senior Vice President, Chief Academic Officer
Kaplan Higher Education

Ms. Jill DeAtley
Vice President of Regulatory Review
Career Education Corporation

Mr. Francis Giglio
Director of Compliance and Regulatory Services
Lincoln Educational Services

Mr. David M. Luce
Assistant Vice President, Accreditation and Licensing
Corinthian Colleges, Inc.

Mr. Roger Swartzwelder
Executive Vice President, General Counsel and Chief Compliance Officer
Education Corporation of America

**Not all 16 Board members shown*

We have seen this before…rating agencies and subprime mortgages.
Is for-profit Accreditation the new credit agency scandal?

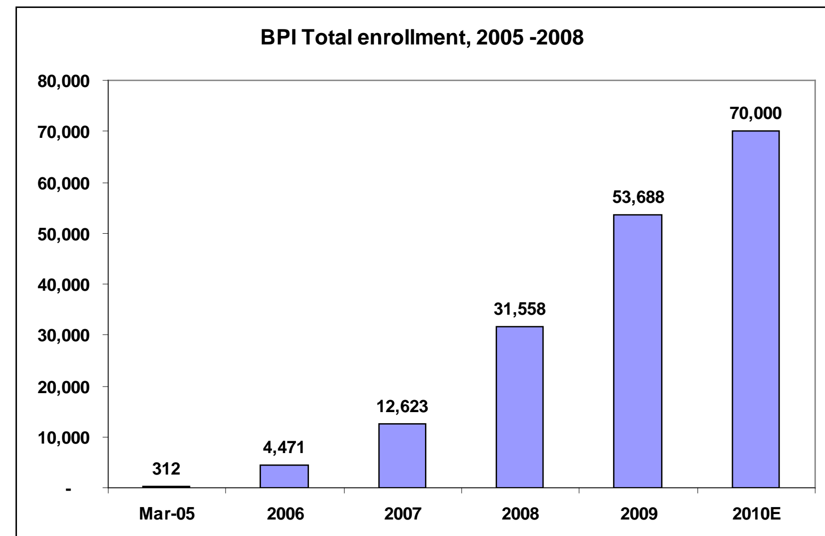
Accreditation…when you can't earn it, buy it

- **The latest trend of for-profit institutions is to acquire the dearly-coveted Regional Accreditation through the outright purchase of small, financially distressed non-profit institutions**
- Regional Accreditation is the highest stamp of quality (Harvard is Regionally Accredited), and usually takes 5-10 years to earn through a long peer review process of educational materials, curriculum, teachers, etc
- But who wants to wait 5 years?!
- Once acquired, these institutions can serve as a shell for the parent organization to funnel in thousands of students and continue the growth cycle…
- Past examples are Bridgepoint buying Regionally-Accredited Franciscan University of the Prairies (renamed Ashford University) and more recent examples are ITT Tech buying Daniel Webster, and Corinthian Colleges buying Heald College

Bridgepoint Education (BPI) – a perfect model…

Timeline

- MARCH 2005 - BPI acquires Regionally-Accredited Franciscan University of the Prairies and renames Ashford University. **Ground enrollment = 312**
- BPI flows students through online platform…grows enrollment by 50,000+ students in 4 years
- **Mgmt expects 70,000+ students by end of 2010**
- **99% students now online, yet school retains its Regional Accreditation**



Source: Company-reported financials

Summary and solutions: Its all about incentives…

Summary

- The pace of the growth of the for-profit education industry and their growing claim to Federal monies will require greater scrutiny to protect students and the integrity of Title IV lending
- The primary revenue and profitability driver for the for-profit companies is unrestricted access to Title IV loans and grants
- For-profit education companies are now among the most profitable businesses in the world due to government largesse
- Regulations built around company-reported statistics are ineffective, and the Accreditation process for for-profit schools and programs is compromised
- Disaggregation of risk from reward is the fundamental cause of all problems

Solutions – Gainful employment

- Gainful employment gets at part of the problem because it deals with debt loads, but verification is problematic
- Programs DO NOT have to be shut down for schools to remain compliant with new regulations
- Companies can restructure their business to accommodate the regulation and schools would become more affordable and student debt loads would be lower
- However, a gainful employment metric would structurally reset the earnings power of companies

Solutions – Gainful employment analysis impact (key assumptions)

1. Cost of programs based on reported cost / credit hour and program length
2. Percent of degree financed assumes Title IV % revenues less 10% (transfer credits and cash)
3. Debt service payment based on 7.5% interest rate (6.8% government loans / 12% private) and 10-yr repayment period
4. Starting salaries taken from applicable BLS codes, by program category and job type
5. Debt service / income ratio of 8% based on Gainful Employment proposed regulation
6. Student mix by program level and program type used to calculate total revenue impact
7. Cost cuts estimated on a per-school basis, based on disclosed cost categories and industry experts
8. EPS impacts and P/E ratios based on existing reported information, share counts, and current street EPS estimates
9. Scenario 1: Gainful Employment with no Offsetting Cost Cuts
10. Scenario 2: Gainful Employment with 5%-15% Cost Cuts

Gainful employment and APOL

APOL	**Scenario 1**	**Scenario 2**
Actual 2009 EPS	**$4.22**	**$4.22**
2009 EPS (adjusted)	**$1.32**	**$2.12**
2009 EPS impact	**-69%**	**-50%**
Street 2010 EPS Estimate	**$5.07**	**$5.07**
EPS Impact	($2.90)	($2.10)
2010 EPS (adjusted)	**$2.17**	**$2.97**
2009 EPS impact	**-57%**	**-41%**
Current P/E (2010 EPS)	10.8 x	10.8 x
2010 Pro-forma P/E	**25.4 x**	**18.5 x**

Note: P/E Ratios calculated as of 5/21/2010

Source: Company-reported financials, programs, tuition rates, and management conference calls. Street EPS estimates from Bloomberg. Projections based on program-level tuition adjustments to comply with 8% debt service/income ratio and scenario 2 applies 5-15% cost cuts across education and SG&A to offset revenue declines.

Gainful employment and ESI

ESI	Scenario 1	Scenario 2
Actual 2009 EPS	**$7.91**	**$7.91**
2009 EPS (adjusted)	**($0.22)**	**$2.02**
2009 EPS impact	**-103%**	**-74%**
Street 2010 EPS Estimate	**$11.05**	**$11.05**
EPS Impact	($8.13)	($5.89)
2010 EPS (adjusted)	**$2.92**	**$5.16**
2009 EPS impact	**-74%**	**-53%**
Current P/E (2010 EPS)	10.0 x	10.0 x
Pro-forma P/E	**37.6 x**	**21.3 x**

Note: P/E Ratios calculated as of 5/21/2010

Source: Company-reported financials, programs, tuition rates, and management conference calls. Street EPS estimates from Bloomberg. Projections based on program-level tuition adjustments to comply with 8% debt service/income ratio and scenario 2 applies 5-15% cost cuts across education and SG&A to offset revenue declines.

Gainful employment and COCO

COCO	Scenario 1	Scenario 2
Actual 2009 EPS	**$0.81**	**$0.81**
EPS (adjusted)	**($0.76)**	**$0.17**
EPS impact	**-194%**	**-79%**
Street 2010 EPS Estimate	**$1.67**	**$1.67**
EPS Impact	($1.57)	($0.64)
2010 EPS (adjusted)	**$0.10**	**$1.03**
2009 EPS impact	**-94%**	**-38%**
Current P/E (2010 EPS)	9.0 x	9.0 x
Pro-forma P/E	**153.5 x**	**14.6 x**

Note: P/E Ratios calculated as of 5/21/2010

Source: Company-reported financials, programs, tuition rates, and management conference calls. Street EPS estimates from Bloomberg. Projections based on program-level tuition adjustments to comply with 8% debt service/income ratio and scenario 2 applies 5-15% cost cuts across education and SG&A to offset revenue declines.

Gainful employment and EDMC

EDMC	Scenario 1	Scenario 2
Actual 2009 EPS	**$0.87**	**$0.87**
EPS (adjusted)	**($5.50)**	**($2.21)**
EPS impact	**-732%**	**-353%**
Street 2010 EPS Estimate	**$1.51**	**$1.51**
EPS Impact	($6.37)	($3.08)
2010 EPS (adjusted)	**($4.86)**	**($1.57)**
2009 EPS impact	**-422%**	**-204%**
Current P/E (2010 EPS)	14.6 x	14.6 x
Pro-forma P/E	**(4.5)x**	**(14.0)x**

Note: P/E Ratios calculated as of 5/21/2010

Source: Company-reported financials, programs, tuition rates, and management conference calls. Street EPS estimates from Bloomberg. Projections based on program-level tuition adjustments to comply with 8% debt service/income ratio and scenario 2 applies 5-15% cost cuts across education and SG&A to offset revenue declines.

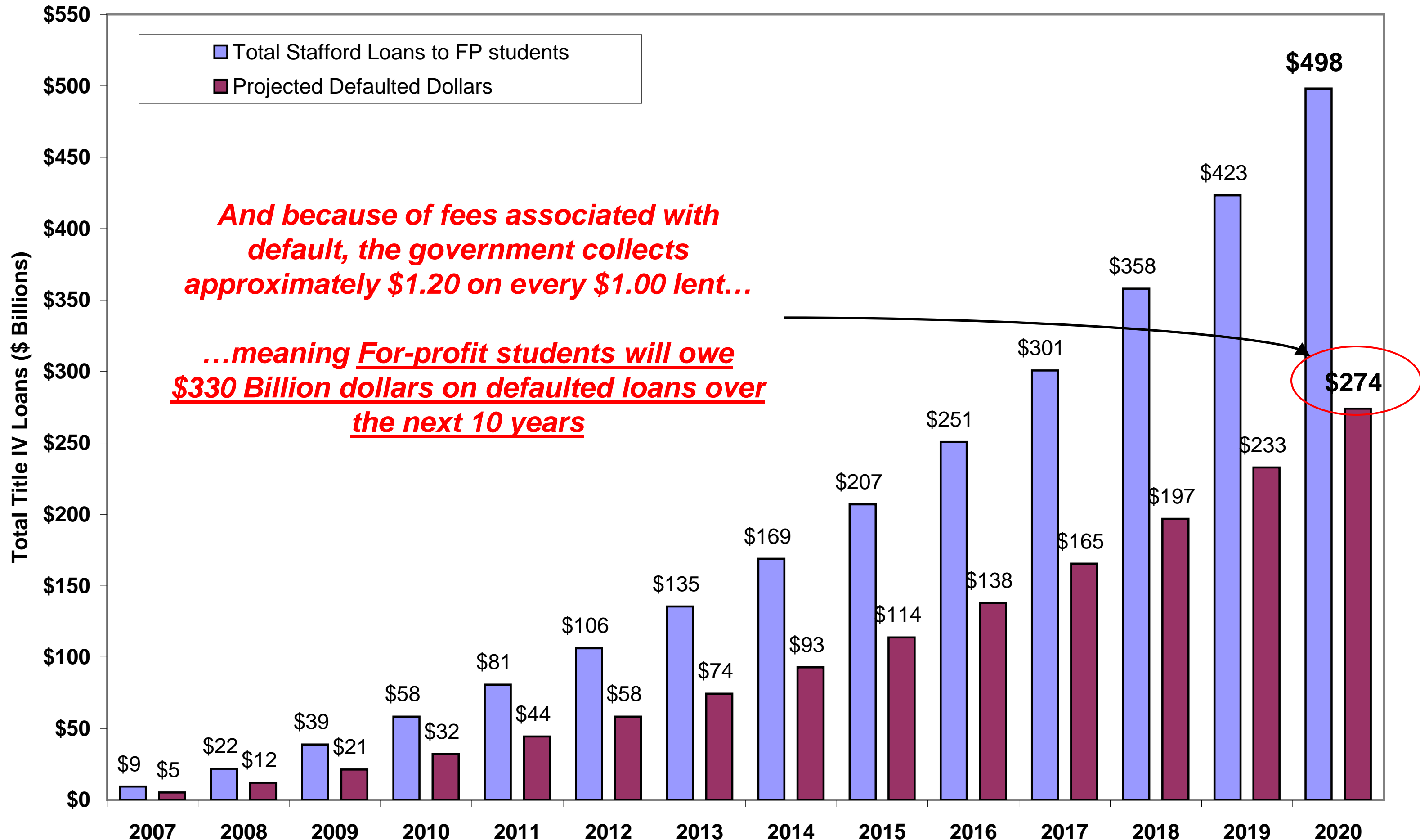
Gainful employment and WPO (Kaplan)

WPO (Kaplan)	Scenario 1	Scenario 2
Actual 2009 EPS	**$9.78**	**$9.78**
EPS (adjusted)	**($33.25)**	**($6.19)**
EPS impact	**-440%**	**-163%**
Street 2010 EPS Estimate		
EPS Impact		
2010 EPS (adjusted)		
2009 EPS impact		
Current P/E (2010 EPS)		
Pro-forma P/E		

Note: P/E Ratios calculated as of 5/21/2010

Source: Company-reported financials, programs, tuition rates, and management conference calls. Street EPS estimates from Bloomberg. Projections based on program-level tuition adjustments to comply with 8% debt service/income ratio and scenario 2 applies 5-15% cost cuts across education and SG&A to offset revenue declines.

If these trends continue, we believe the DOE will face nearly $275B in defaults over the next 10 years on a half-a-trillion dollars of lending to the For-Profit Industry



Source: College Board, National Center for Education Statistics, industry estimates

IRA SOHN CONFERENCE
Presentation by Steve Eisman
SUBPRIME GOES TO COLLEGE
May 26,2010

Good Afternoon. I would like to thank the Ira Sohn Foundation for the honor of speaking before this audience. My name is Steven Eisman and I am the portfolio manager of the FrontPoint Financial Services Fund. Until recently, I thought that there would never again be an opportunity to be involved with an industry as socially destructive and morally bankrupt as the subprime mortgage industry. I was wrong. The For-Profit Education Industry has proven equal to the task.

The title of my presentation is "Subprime goes to College". The for-profit industry has grown at an extreme and unusual rate, driven by easy access to government sponsored debt in the form of Title IV student loans, where the credit is guaranteed by the government. Thus, the government, the students and the taxpayer bear all the risk and the for-profit industry reaps all the rewards. This is similar to the subprime mortgage sector in that the subprime originators bore far less risk than the investors in their mortgage paper.

In the past 10 years, the for-profit education industry has grown 5-10 times the historical rate of traditional post secondary education. As of 2009, the industry had almost 10% of the enrolled students but claimed nearly 25% of the $89 billion of Federal Title IV student loans and grant disbursements. At the current pace of growth, for- profit schools will draw 40% of all Title IV aid in 10 years.

How has this been allowed to happen?

The simple answer is that they've hired every lobbyist in Washington D.C. There has been a revolving door between the people who work or lobby for this industry and the halls of government. One example is Sally Stroup. She was the head lobbyist for the Apollo Group – the largest for-profit company in 2001-2002. But from 2002-2006 she became Assistant Secretary of Post-Secondary Education for the DOE under President Bush. In other words, she was directly in charge of regulating the industry she had previously lobbied for.

From 1987 through 2000, the amount of total Title IV dollars received by students of for-profit schools fluctuated between $2 and $4 billion per annum. But then when the Bush administration took over the reigns of government, the DOE gutted many of the rules that governed the conduct of this industry. Once the floodgates were opened, the industry embarked on 10 years of unrestricted massive growth.

Federal dollars flowing to the industry exploded to over $21 billion, a 450% increase.

At many major-for profit institutions, federal Title IV loan and grant dollars now comprise close to 90% of total revenues, up significantly vs. 2001. And this growth has

driven even more spectacular company profitability and wealth creation for industry executives. For example, ITT Educational Services (ESI), one of the larger companies in the industry, has a roughly 40% operating margin vs. the 7%-12% margins of other companies that receive major government contracts. ESI is more profitable on a margin basis than even Apple.

This growth is purely a function of government largesse, as Title IV has accounted for more than 100% of revenue growth. Here is one of the more upsetting statistics. In fiscal 2009, Apollo, the largest company in the industry, grew total revenues by $833 million. Of that amount, $1.1 billion came from Title IV federally-funded student loans and grants. More than 100% of the revenue growth came from the federal government. But of this incremental $1.1 billion in federal loan and grant dollars, the company only spent an incremental $99 million on faculty compensation and instructional costs – that's 9 cents on every dollar received from the government going towards actual education. The rest went to marketing and paying the executives.

But leaving politics aside for a moment, the other major reason why the industry has taken an ever increasing share of government dollars is that it has turned the typical education model on its head. And here is where the subprime analogy becomes very clear.

There is a traditional relationship between matching means and cost in education. Typically, families of lesser financial means seek lower cost institutions in order to maximize the available Title IV loans and grants – thereby getting the most out of every dollar and minimizing debt burdens. Families with greater financial resources often seek higher cost institutions because they can afford it more easily.

The for-profit model seeks to recruit those with the greatest financial need and put them in high cost institutions. This formula maximizes the amount of Title IV loans and grants that these students receive.

With billboards lining the poorest neighborhoods in America and recruiters trolling casinos and homeless shelters (and I mean that literally), the for-profits have become increasingly adept at pitching the dream of a better life and higher earnings to the most vulnerable of society.

But if the industry in fact educated its students and got them good jobs that enabled them to receive higher incomes and to pay off their student loans, everything I've just said would be irrelevant.

So the key question to ask is – what do these students get for their education? In many cases, NOT much, not much at all.

Here is one of the many examples of an education promised and never delivered. This article details a Corinthian Colleges-owned Everest College campus in California whose students paid $16,000 for an 8-month course in medical assisting. Upon nearing

completion, the students learned that not only would their credits not transfer to any community or four-year college, but also that their degree is not recognized by the American Association for Medical Assistants. Hospitals refuse to even interview graduates.

But let's leave aside the anecdotal evidence of this poor quality of education. After all the industry constantly argues that there will always be a few bad apples. So let's put aside the anecdotes and just look at the statistics. If the industry provided the right services, drop out rates and default rates should be low.

Let's first look at drop out rates. Companies don't fully disclose graduation rates, but using both DOE data, company-provided information and admittedly some of our own assumptions regarding the level of transfer students, we calculate drop out rates of most schools are 50%+ per year. As seen on this table, the annual drop out rates of Apollo, ESI and COCO are 50%-100%

How good could the product be if drop out rates are so stratospheric? These statistics are quite alarming, especially given the enormous amounts of debt most for-profit students must borrow to attend school.

As a result of these high levels of debt, default rates at for profit schools have always been significantly higher than community colleges or the more expensive private institutions.

We have every expectation that the industry's default rates are about to explode. Because of the growth in the industry and the increasing search for more students, we are now back to late 1980s levels of lending to for profit students on a per student basis. Back then defaults were off the charts and fraud was commonplace.

Default rates are already starting to skyrocket. It's just like subprime – which grew at any cost and kept weakening its underwriting standards to grow.

By the way, the default rates the industry reports are artificially low. There are ways the industry can and does manipulate the data to make their default rates look better.

But don't take my word for it. The industry is quite clear what it thinks the default rates truly are. ESI and COCO supplement Title IV loans with their own private loans. And they provision 50%-60% up front for those loans. Believe me, when a student defaults on his or her private loans, they are defaulting on their Title IV loans too.

Let me just pause here for a second to discuss manipulation of statistics. There are two key statistics. No school can get more than 90% of its revenue from the government and 2 year cohort default rates cannot exceed 25% for 3 consecutive years. Failure to comply with either of these rules and you lose Title IV eligibility. Lose Title IV eligibility and you're company's a zero.

Isn't it amazing that Apollo's percentage of revenue from Title IV is 89% and not over 90%. How lucky can they be? We believe (and many recent lawsuits support) that schools actively manipulate the receipt, disbursement and especially the return of Title IV dollars to their students to remain under the 90/10 threshold.

The bottom line is that as long as the government continues to flood the for profit education industry with loan dollars AND the risk for these loans is borne solely by the students and the government, THEN the industry has every incentive to grow at all costs, compensate employees based on enrollment, influence key regulatory bodies and manipulate reported statistics – ALL TO MAINTAIN ACCESS TO THE GOVERNMENT'S MONEY.

In a sense, these companies are marketing machines masquerading as universities. And when the Bush administration eliminated almost all the restrictions on how the industry is allowed to market, the machine went into overdrive. Let me quote a bit from a former employee of BPI.

"*Ashford is a for profit school and makes a majority of its money on federal loans students take out. They conveniently price tuition at the exact amount that a student can qualify for in federal loan money. There is no regard to whether a student really belongs in school, the goal is to enroll as many as possible. They also go after GI bill money and currently have separate teams set up to specifically target military students. If a person has money available for school Ashford finds a way to go alter them. Ashford is just the middle man, profiting off this money, like milking a cow and working the system within the limits of what's technically legal, and paying huge salaries while the student suffers with debt that can't even be forgiven by bankruptcy. We mention tuition prices as little as possible .. this may cause the student to change their mind.*

While it is illegal to pay commissions for student enrollment, Ashford does salary adjustments, basically the same thing. We are given a matrix that shows the number of students we are expected to enroll. We also have to meet our quotas and these are high quotas.

Because we are under so much pressure, we are forced to do anything necessary to get people to fill out an application – our jobs depend on it.

It's a boiler room – selling education to people who really don't want it."

This former employee then gives an example of soliciting a sick old lady to sign up for Ashford to meet his quota.

"The level of deception is disgusting – and wrong. When someone who can barely afford to live and feed kids as it is, and doesn't even have the time or education to be able to enroll, they drop out. Then what? Add $20,000 of debt to their problems – what are they gonna do now. They are officially screwed. We know most of these people will drop out, but again, we have quotas and we have no choice."

How do such schools stay in business? The answer is to control the accreditation process. The scandal here is exactly akin to the rating agency role in subprime securitizations.

There are two kinds of accreditation -- national and regional. Accreditation bodies are non-governmental, non-profit peer-reviewing groups. Schools must earn and maintain proper accreditation to remain eligible for Title IV programs. In many instances, the for-profit institutions sit on the boards of the accrediting body. The inmates run the asylum.

Historically, most for profit schools are nationally accredited but national accreditation holds less value than regional accreditation. The latest trend of for profit institutions is to

acquire the dearly coveted Regional Accreditation through the outright purchase of small, financially distressed non-profit institutions and then put that school on-line. In March 2005, BPI acquired the regionally accredited Franciscan University of the Prairies and renamed it Ashford University. Remember Ashford. The former employee I quoted worked at Ashford. On the date of purchase, Franciscan (now Ashford) had 312 students. BPI took that school online and at the end of 2009 it had 54,000 students.

SOLUTIONS

While the conduct of the industry is egregious and similar to the subprime mortgage sector in just so many ways, for the investment case against the industry to work requires the government to do something -- whereas in subprime all you had to do was wait for credit quality to deteriorate.

So what is the government going to do? It has already announced that it is exploring ways to fix the accreditation process. It will probably eliminate the 12 safe harbor rules on sales practices implemented by the Bush Administration. And I hope that it is looking at everything and anything to deal with this industry.

Most importantly, the DOE has proposed a rule known as Gainful Employment. In a few weeks the DOE will publish the rule. There is some controversy as to what the proposed rule will entail but I hope that the DOE will not backtrack on gainful employment. Once the rule is published in the federal registrar, the industry has until November to try to get the DOE to back down.

The idea behind the gainful employment rule is to limit student debt to a certain level. Specifically, the suggested rule is that the debt service-to-income-ratio not exceed 8%. The industry has gotten hysterical over this rule because it knows that to comply, it will probably have to reduce tuition.

Before I turn to the impact of the rule, let me discuss what happened last week. There was a news report out that Bob Shireman, the Under Secretary of Education in charge of this process was leaving. This caused a massive rally in the stocks under the thesis that this signaled that the DOE was backing down from gainful employment. This conclusion is absurd. First, of all, inside D.C. it has been well known for a while that Shireman always intended to go home to California after a period of time. Second, to draw a conclusion about the DOE changing its policy because Shireman is leaving presupposes that one government official, one man, drives the entire agenda of the U.S. government.

I cannot emphasize enough that gainful employment changes the business model. To date that model has been constant growth in the number of students coupled with occasional increases in tuition. Gainful employment will cause enrollment levels to grow less quickly. And the days of raising tuition would be over; in many cases, tuition will go down.

To illustrate the impact of gainful employment, I've chosen 5 companies, Apollo, ESI, COCO, EDMC and the Washington Post. Yes, the Washington Post, whose earnings are all driven by this industry.

Assuming gainful employment goes through, the first year it would impact would obviously be 2011. However, because the analysis is so sensitive to tuition levels per school, it's best to have as much information as possible. So for analytical purposes, we are going to show the impact on actual results in fiscal 2009 and this year's estimates under the assumption that gainful employment was already in effect.

We employ 2 scenarios. Scenario 1 is static. It takes actual results and then reduces tuition costs to get down to the 8% level. Scenario 2 is dynamic. It assumes the same thing as scenario 1 but then assumes the companies can reduce costs by 5%-15%.

Results for each company depend largely on the mix of students, the duration of each degree and the price of tuition at each institution

For each company, I show the results under the two scenarios and the corresponding P/Es. Needless to say, the P/E multiples look quite a bit different under either scenario.

Apollo – In fiscal 2009, the company earned $4.22. The consensus estimate for fiscal 2010 is $5.07. Under scenario 1, fiscal 2009 and the fiscal 2010 estimate get cut by 69% and 57%, respectively. Under scenario 2, it gets cut 50% and 41%, respectively.

ESI – In fiscal 2009, the company earned $7.91. The consensus estimate for fiscal 2010 is $11.05. Under scenario 1, fiscal 2009 turns slightly negative and the fiscal 2010 estimate gets cut by 74%. Under scenario 2, fiscal 2009 declines by 75% and the 2010 estimate gets cut by 53%.

COCO – In fiscal 2009, the company earned $0.81. The consensus estimate for fiscal 2010 is $1.67. Under scenario 1, fiscal 2009 turns negative and the fiscal 2010 estimate gets cut by 94%. Under scenario 2, fiscal 2009 declines by 79% and the 2010 estimate gets cut by 38%.

EDMC -- In fiscal 2009, the company earned $0.87. The consensus estimate for fiscal 2010 is $1.51. Under scenario 1, fiscal 2009 and the fiscal 2010 estimate turns massively negative. Under scenario 2, fiscal 2009 and the fiscal 2010 estimate are also massively negative, just less massively than scenario 1. The principal reason why the numbers are so bad for EDMC is that they have a lot of debt and that debt has to be serviced and cannot be cut.

Washington Post – The Post's disclosure of Kaplan metrics is slight. Thus, analyzing the impact from gainful employment is much more difficult and we have confined our analysis solely to fiscal 2009. In fiscal 2009, WPO earned $9.78. Under scenario 1, a loss of $33.25 per share occurs. Under scenario 2, there is still a loss of $6.19. The

principal reason why the numbers are so bad for the Post is that more than 100% of its EBIDTA comes from this industry through its Kaplan division.

Let me just add one caveat to our analysis. Implementation of gainful employment could result in a cut in marketing budgets. Given the high drop out rates of this industry any such cuts could turn a growth industry into a shrinking industry. The numbers that I just showed do not assume that the industry shrinks but grows at a slower pace.

Under gainful employment, most of the companies still have high operating margins relative to other industries. They are just less profitable and significantly overvalued. Downside risk could be as high as 50%. And let me add that I hope that gainful employment is just the beginning. Hopefully, the DOE will be looking into ways of improving accreditation and of ways to tighten rules on defaults.

Let me end by driving the subprime analogy to its ultimate conclusion. By late 2004, it was clear to me and my partners that the mortgage industry had lost its mind and a society-wide calamity was going to occur. It was like watching a train wreck with no ability to stop it. Who could you complain to? -- The rating agencies? – they were part of the machine. Alan Greenspan? – he was busy making speeches that every American should take out an ARM mortgage loan. The OCC? -- its chairman, John Dugan, was busy suing state attorney generals, preventing them from even investigating the subprime mortgage industry.

Are we going to do this all over again? We just loaded up one generation of Americans with mortgage debt they can't afford to pay back. Are we going to load up a new generation with student loan debt they can never afford to pay back. The industry is now 25% of Title IV money on its way to 40%. If its growth is stopped now and it is policed, the problem can be stopped. It is my hope that this Administration sees the nature of the problem and begins to act now. If the gainful employment rule goes through as is, then this is only the beginning of the policing of this industry.

But if nothing is done, then we are on the cusp of a new social disaster. If present trends continue, over the next ten years almost $500 billion of Title IV loans will have been funneled to this industry. We estimate total defaults of $275 billion, and because of fees associated with defaults, for profit students will owe $330 billion on defaulted loans over the next 10 years.