Strayer Education, Inc. STRA

by Todd Young

Analyst Note 02-11-2010

Strayer STRA reported fourth-quarter and full-year results that showed continued growth in its enrollment base. Year-over-year, revenue increased 29% for both the quarterly and the full-year period. Total enrollment for its winter period increased 21%, which is in line with our expectations given its current campus opening schedule. Adding in an increase in revenue per student, driven by a 5% tuition increase, Strayer continues to be on track to produce mid-20% revenue growth in 2010. Operating margins for the quarter improved 110 basis points, to 35.6% compared to a year ago. For the year, margins improved 170 basis points, to 33.7%. Increased spending during the first quarter may drag on results some, but management expects its full-year 2010 results to be on track with previous expectations.

Strayer continues to add new corporate partnerships, whose count now stands at over 120. With about 25% of revenue estimated to come from corporate reimbursement, it is encouraging to see that the company is experiencing no significant downside impact from the economy, and is actually adding new partners. Additionally, management provided some commentary on the latest proposed regulations from the Department of Education. They haven't spent much time modeling the impacts of the various proposals, as the process remains fluid and in a constant state of flux. However, they don't expect the proposals to change the way they approach their tuition policy.

Thesis 11-02-2009

Strayer Education is one of the best-run companies in the for-profit education industry. Favorable industry dynamics, along with the company's focus on working adults, has helped the company establish a wide economic moat, in our opinion.

For-profit education companies operate in an industry with favorable dynamics. Traditional not-for-profit schools are unable to meet all of the demand for education, and for-profit education companies like Strayer have stepped in to fill this supply void. However, tuition pricing is typically set by the higher-cost-structured traditional schools, and government-aid limits are adjusted based on those prices. The intense demand and government-set-aid limits allow companies like Strayer, which have a lower cost structure, to provide educational services at prices similar to traditional schools. With the availability of financial aid and corporate tuition assistance, students tend to be price-inelastic, as up-front, out-of-pocket costs are low. This helps Strayer, and others, raise tuition at rates above inflation.

By focusing on working adults, Strayer has been able to grow in both strong and weak economic environments. Education tends to be countercyclical, and enrollment growth typically decelerates during stronger economic times.

Morningstar Rating
★★★

Stock Price
As of 02-11-2010
$204.32

Fair Value Estimate
$249.00

Consider Buying
$174.30

Consider Selling
$348.60

Fair Value Uncertainty
Medium

Economic Moat
Wide

Stewardship Grade
A

Bulls Say

- Online education is growing very rapidly, and Strayer is a key player with more than two thirds of its students taking at least one online course.
- Strayer has minimal exposure to private student lending with less than 3% of revenue coming from private student loans.
- With a majority of its students being part-time working adults above the age of 31, Strayer is less likely to have students drop out because of financial troubles.

Bears Say

- A weakening economy could put pressure on students who receive tuition assistance from their employers.
- Education is a highly regulated industry, and high student debt loads could attract adverse regulation.
- Strayer will need to increase spending as it opens new programs across the country. This will put pressure on profitability.

However, Strayer is more acyclical than some of its competitors. Unlike for-profit schools that focus on diploma and certificate programs, Strayer's students are older and are enrolled in undergraduate and graduate courses. In good economic times, these types of students are less prone to choose employment over schooling. Strayer's focus on online programs gives working adults the flexibility they need to work and pursue a degree at the same time.

Unlike trade-based schools, Strayer may not see the same enrollment acceleration during poor economic times, though consistent growth is beneficial. Adding physical campuses as well as additional online students has helped fuel an average 18% annual enrollment growth during the last five years. With roughly a 30% geographic penetration throughout the 50 states, Strayer has plenty of opportunities for continued growth. Its roughly 54,000 students represent only a small fraction of the more than 18 million students enrolled in higher education. Recently, Strayer has been adding around eight to 11 campuses a year, but it still operates physical campuses in only 15 states and Washington, D.C.

With one of the best management teams in the industry, a tempered growth strategy that doesn't get ahead of itself, and some of the best operating margins of any education company, Strayer sits at the top of its class.

Valuation

We are raising our fair value estimate to $249 from $232 because of increased growth assumptions. With 13 new campus openings slated for 2010 compared with our previous estimate of 10, we are raising our growth expectations. We have modeled top-line compound annual growth of 21% through 2013, with growth tapering off from 29% in 2009 until it reaches 16% in 2013. This growth contains both enrollment growth and tuition increases. Strayer typically adds 150 students per year to a new campus until it reaches a saturation point of roughly 1,000 students, on average. Because campuses opened in previous years contribute to a significant portion of enrollment growth, even if Strayer opened limited campuses in the next few years, the company could still experience double-digit revenue growth through 2012. This assumes the company could continue to add 150 students each year to its previously opened nonmature campuses. Given the scalability of Strayer's business model, we estimate operating margins increasing from 32% in 2008 to 34% by 2013. If Strayer only grew at a compound annual rate of 19% and margins averaged only 28%, our fair value estimate would drop to our Consider Buying price.

Risk

Although Strayer has typically been an acyclical company, a slowing economy could hurt it if revenue from corporate tuition assistance drops because of decreased corporate benefits or increased job losses for Strayer's corporate-assisted students. A stricter student-lending environment is also a concern for the overall industry. Additionally, any negative change in the perception of the quality of an online education could lower demand. Increased regulation could have a negative effect on Strayer and the industry as a whole. Cohort default rates should rise for all schools because of the weakened economy. However, Strayer's low cohort default rate of only 6% means this should have no significant impact.

Close Competitors	TTM Sales $Mil	Market Cap $Mil
Strayer Education, Inc.	**512**	**3,384**
* Capella Education Company	335	1,421
* Apollo Group, Inc.	4,274	9,663
* DeVry, Inc.	1,692	4,753

Bridgepoint Education, Inc.	377	1,093
* Grand Canyon Education, Inc.	262	1,066

* Morningstar Analyst Report Available

Data as of 12-31-09

Strategy

Strayer's strategy is to maintain enrollments in mature markets, add campuses in new markets, and expand its online programs. Strayer is also focused on expanding its corporate alliances. Company-financed employee education provides a very dependable stream of revenue that Strayer hopes to develop further.

Management & Stewardship

Strayer gets our highest grade for stewardship. Robert Silberman has been the CEO since 2001 and became the chairman in 2003. Splitting these roles and adding insight into how executive bonuses are calculated are the only significant practices we would like to see change. Strayer also has some strong positive attributes. At least 50% of a board member's compensation is made up of restricted stock. Also, management focuses on returns on invested capital as a primary metric in investment decisions. Additionally, management has demonstrated discipline in returning cash to shareholders in the absence of favorable investment opportunities. One example of management's long-term focus is its strict acceptance requirements. Strayer could easily add more students to its population by lowering its criteria. Management realizes that letting these students in, while providing a quick boost in revenue, would only hurt the reputation and quality of the Strayer's programs over the long term.

Profile

Strayer is a for-profit education company with 71 campuses in 15 states and Washington, D.C. It serves students in all 50 states and 30 different countries through its online programs. Focusing on business administration, accounting, information technology, health care, public administration, and education, Strayer has 94% of its students in degree programs. More than two thirds of students are enrolled in at least one online class, and more than 79% are part-time students.

Growth

Strayer is opening 13 new campuses in 2010. In 2009 it opened 11 campuses plus a second online center. This is an acceleration from the eight to nine campuses a year the company opened in the previous three years.

Profitability

With operating margins over 30%, Strayer has some of the best margins in the industry. Education is a very scalable business model, and as the company grows we expect margins to improve as the company leverages its cost structure.

Financial Health

Strayer is in excellent financial health. The company has no debt and received a rating of 3 from the Department of Education, which is the highest possible score for financial responsibility.

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