

# World of Investing: Putting a value on education

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Back in 1995, I offered readers this prediction: The hottest industry in 2005 would be education. We're nearly there, and I am nearly right. According to the Value Line Investment Survey, which ranks 98 sectors using a formula that emphasizes momentum - a good synonym for heat - the hottest industry is homebuilding, but education services ranks second.

Value Line rates 13 education companies, and 7 of them rank in Group 1 - the inner circle to which only 100 stocks, out of 2,200 that the research firm analyzes, are admitted. Two other education companies rank in Group 2 (above average); not one in the sector is below average.

Education is still a small business - the companies rated by Value Line account for less than \$7 billion in sales - which means the sector still has a ways to go.

There are two reasons that education stocks have boomed while the rest of the market has stagnated. First, education expenditures always rise, year after year, so education stocks tend to be a safe haven in an economic downturn. Second, the business of education is growing as Americans become more dissatisfied with their children's schools and as workers seek to upgrade their skills to keep up with changing technology.

Right now, the best segment in education is postsecondary schools with a vocational bent. A degree of any sort is nearly always a pay-enhancer, and the companies that run these schools have a delightful competitive situation: They are up against public universities and community colleges that are not always well managed but keep ratcheting up tuition - which in 2003 was up an average of 14 percent.

The stock of Apollo Group, a for-profit chain of post-secondary campuses, most of them carrying the name University of Phoenix, has risen 57 percent so far this year. Apollo was started as a business in 1974 and went public in 1994. An investment of \$10,000 in Apollo's initial public offering is today worth \$934,000.

Or look at Corinthian Colleges, a company that went public in 1999. Since then, the stock, which went public at \$1.13, had gone to \$57.50 by Thursday's close. Corinthian runs colleges and corporate training centers in the United States and Canada in fields from criminal justice to health care to diesel repair and has increased its annual revenue in four years to \$517 million from \$133 million and its net profit to \$66 million from \$7 million. Earnings for the year that ends next June are projected to rise 38 percent, and Value Line expects annual increases averaging more than 30 percent through 2008.

On other hand, as with any fledgling industry, there were huge losers as well as huge winners. Education Alternatives, a company that specialized in managing public schools under contracts with the local education authorities, stumbled badly, changed its name to the TesseracT Group, then crashed.

While education remains small as a business, it is gigantic as a government endeavor, accounting for about \$800 billion in spending last year. Profit-making ventures are working around the edges - in software, publishing, curriculum development and in running postsecondary schools and institutions to upgrade workers' skills.

For now, the profit-makers are companies like Career Education, which runs career-oriented postsecondary schools that enroll 80,000 students in areas like design technology, health care and culinary arts.

Career Education also owns Katharine Gibbs Schools, which were once largely secretarial but are now teaching courses in areas like fashion merchandising and computer sciences. A former director of career services at Gibbs last month filed a suit against Career Education, claiming that she had been fired for

refusing to falsify student records. The company has denied the charge. Shares fell more than 10 percent in a day but then rebounded. S&P maintains its five-star rating for the company, which is projected to earn \$115 million this year on \$1.2 billion in revenue - up from a loss of \$500,000 on \$82 million in revenue in 1997.

Sylvan Learning Systems has changed its focus and is now practicing a variation on the Apollo-Corinthian-Career Education theme by concentrating on online higher education and on for-profit universities abroad. The company has acquired universities in Chile, Mexico, France and Spain and a hotel-management school in Switzerland. The stock - which had taken a big dive, losing two-thirds of its value from early 1999 to mid-2000 - has doubled in 2003, and the company is expected to make its first profit in four years.

Another revival story is Strayer Education, serving 20,000 students (about one-third of them online) in business and information technology programs. Strayer stock has risen almost 80 percent so far this year. Like most profitable education stocks, it is trading at a rich price-to-earnings ratio - in this case, 49 - but earnings, according to Value Line, are expected to grow 24 percent next year and about 20 percent annually through 2008.

Investors looking at education stocks have two choices: bet on the companies that have already accelerated, in the hope that their markets will continue to grow, or look for the laggards, which appear to have sound businesses but have generated little enthusiasm lately.

In the first category, Education Management, which provides postsecondary education to 59,000 people, mainly through its Art Institutes, which focus on careers in design, fashion and food. Shares have almost doubled since January, but the P/E ratio, based on estimates for next year's profits is 32 - not outrageous for a company that has been increasing earnings at more than 20 percent annually.

In the second category, look at DeVry, which was badly hurt by the technology collapse because so many of its courses were linked to that sector. DeVry's stock produced better returns than the market as a whole over the past five years, but it trailed competitors like Apollo. Now, Value Line projects earnings will rise at an annual rate of 14 percent through 2008, and shares trade at a decent valuation.

Another relatively unloved education stock is Renaissance Learning, which provides educational software to three out of five public schools in North America. The stock trades at less than half its high of 2001 despite rising earnings and cash flow stretching back to its 1997 IPO. According to Value Line, Renaissance "has decent turnaround potential" but is "still too risky for most investors."

The best approach to education-stock investing is to own a diversified portfolio. I am not aware of any mutual funds that package the sector, so you'll have to do it yourself. Buy a half-dozen, in different segments and with different prospects. You won't get complete diversification since you won't be aiming at younger students - the biggest market. That may have to wait until education stocks get even hotter.

<b>Head of the class</b>	
<i>Performance of leading education sector stocks over five years</i>	
Average annual return to Dec. 3, 2003	
Career Education	71.6%
Apollo Group-A	42.2
ITT Educational	27.9
Education Management	24.8
Strayer Education	23.7
Renaissance Learning	- 4.6
Source: Bloomberg	IHT

Of the stocks mentioned in this article, James K. Glassman owns Apollo Group. His e-mail address is [jglassman@aei.org](mailto:jglassman@aei.org).