

CHANGE IN OWNERSHIP



“Are You Ready to Deal”
February 22, 2010



Presented at the

2010 Region IV PCCS

5th Annual Workshop

Atlanta, Georgia

February 22, 2010

***Ron Holt, Esq. Dunn & Davison, LLC
Kansas City, Missouri
(816) 292-7604 rholt@dunndavison.com***

Deal or No Deal – Is the Price Right?

- “I don’t do it for the money. I’ve got enough, much more than I’ll ever need...Some people paint beautifully on canvas or write wonderful poetry. I like making deals, preferably big deals. That’s how I get my kicks.” **Celebrity X**



Change in Ownership: **Agenda Today**



- I. **The Big Picture** - Investment Climate
- II. **Your Place in the Picture** – Can You Deliver What Buyers Want?
- III. **The Sale Process** – Timetable & Dynamics
- IV. **Due Diligence** – Being Ready to Go Under the Microscope and Look Good
- V. **Make or Break** – Major Deal Terms

I. The Big Picture:



**The Investment Climate:
How Schools Are Valued by Buyers**

Higher Education – A Good Buy in 2009

Major Deal Activity in 2009

- BC Partners (London) - ATI :\$500 MM
- Corinthian - Heald Colleges: \$395 MM (10.3x)
- Princeton Review – Penn Foster: \$170 MM (9.9x)
- Excellere – Medtech: \$82MM
- TA Associates – Vatterott
- Lincoln – Baran Institute Technology : \$28 MM

Higher Education – A Good Buy in 2009

- **IPOs:** Bridgepoint & Education Management
- Additional Offering - Lincoln
- **Nonprofit Conversions:** Myers to Chancellor (Signif Ptrs, Jack Welch, GE), Crichton (Signif Ptrs), College of Santa Fe to Laureate
- **Merger:** Natl Amer Univ – Camden Learning
- Many smaller deals:
- ITT – Daniel Webster U (regionally accredited)

DD Deal Experience in 2009



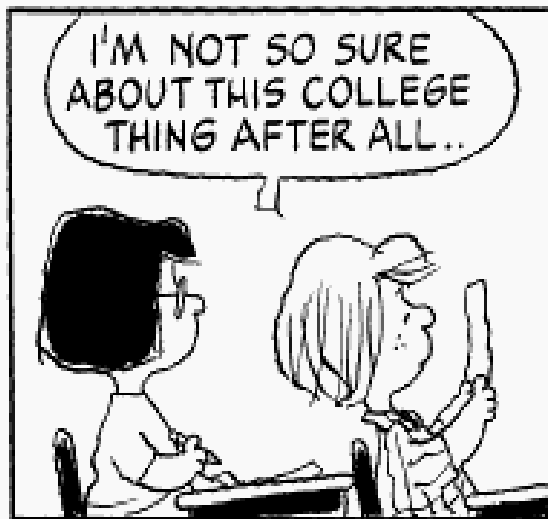
- **Three closed deals** : single campus; allied health; private equity & private investors
- **Three scrapped deals**: single campus, pricing or profitability issues, funding
- **Several ongoing deals from 2009 to 2010**: allied health, cosmetology and business; strategic buyers, private equity, private investors
- **Structure**: mostly cash w/o rollovers, some 'two step' deals, not all strict trailing EBITDA pricing

Colleges Still Have Good Fundamentals



1. Strong Base

- 18.8 MM postsecondary students, 1/3 + over age 24
- 70 million adults interested in more education, only 1/3 likely, *Degrees of Opportunity* (Capella)
- 90% believe learning worth time, energy & \$\$
- 90% fastest growing jobs: some post H.S. (CFHE)



Investment Climate - Fundamentals

2. More Growth

- NCES 2006 study predicts **high school enrollments grow 6%** to 2015, but growth **was 18%** from '90 to '03
- 18.8 MM total PSE students in 2010; projected 20.5 MM by 2017 – almost 14% being for profit
- **3d Qtr 09:** 24% growth for publics, was 15.7% 12 prior qtrs
- 60%+ of all HS grads enroll in some PSE program



Investment Climate - Fundamentals



3. Online 'Frontier'

- Title IV aid: available – but 50% growth watch, interaction and integrity requirements
- **20% of all students now take at least 1 course online**
- NCES study: online **growing 10 X** faster than traditional
- Eduventures: most companies investing in colleges want to develop online courses and “roll them out globally”



Investment Climate - Fundamentals

4. Tuition & Aid

- Tuition increasing at 6%+ per yr, **not** federal aid
- Over 90% students rely on some federal aid
- **Kanter:** “so much to offer in promoting opportunity”
- Increases in Sub/Unsub (extra \$2K), Pell (Yr round - \$5400), ACG , SMART (90-10 effect)
- Private ‘gap’ loans – mostly gone, school paper?



Investment Climate - Fundamentals

5. Equity Buyers

- Public for-profits averaging \$14-\$15 P/E in stock price and around 9 x EBITDA
- Litigation & regulatory problems: Apollo, Kaplan
- Surging enrollments – but placement concerns
- Private loans w/drawn from many schools



Copyright © 2001 Thaves, Distributed by Newspaper Enterprise Association, Inc.
Redistribution in whole or in part prohibited

Investment Climate - Fundamentals



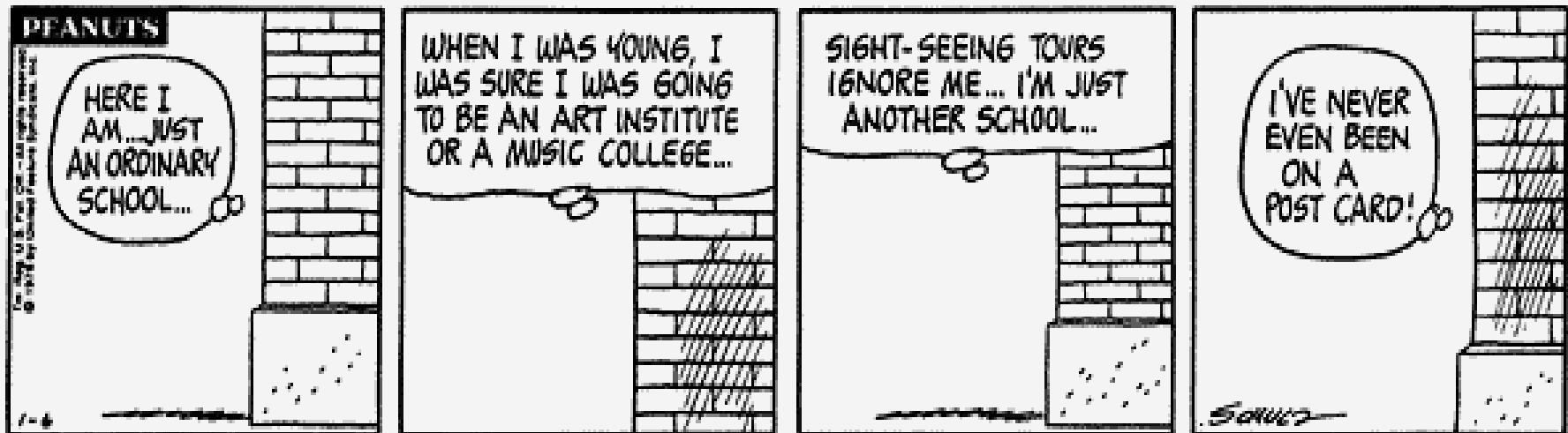
6. Regulatory Wild Cards

- Three Yr CDRs – manageable?
- 90-10 Challenges: non-degree schools
- Integrity NegReg: incentive comp, online watch
- Burdensome new consumer disclosures



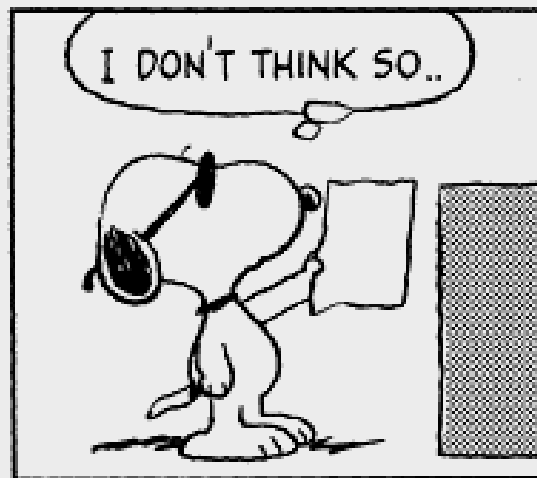
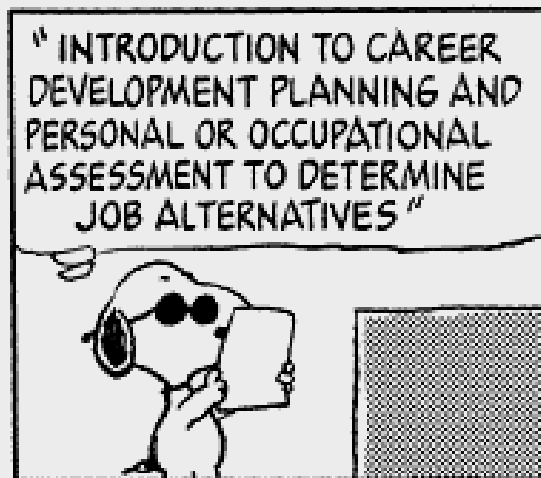
College Purchases - Selection Factors

- 1. MARKET** –geographic region & metro area population
 - *Buyer Needs
 - *Local Economy
 - *Advertising Costs
- 2. PLATFORM:** multiple campuses, degrees, ‘hot’ or unique programs, growth trends
- 3. FINANCIAL CONDITION:** gross revenues, profit margin, tuition levels (mkt), 2/3 yr trends, 12 month projection



College Purchases – Selection Factors

- 4. DELIVERY SYSTEM:** brick & mortar and/or online
- 5. MANAGEMENT:** experience, talent & longevity
- 6. BRAND RECOGNITION:** reputation & growth potential
- 7. REGULATORY COMPLIANCE:** historical record (90-10, CDRs, FR scores, incentive comp), consumer disclosures established systems & procedures



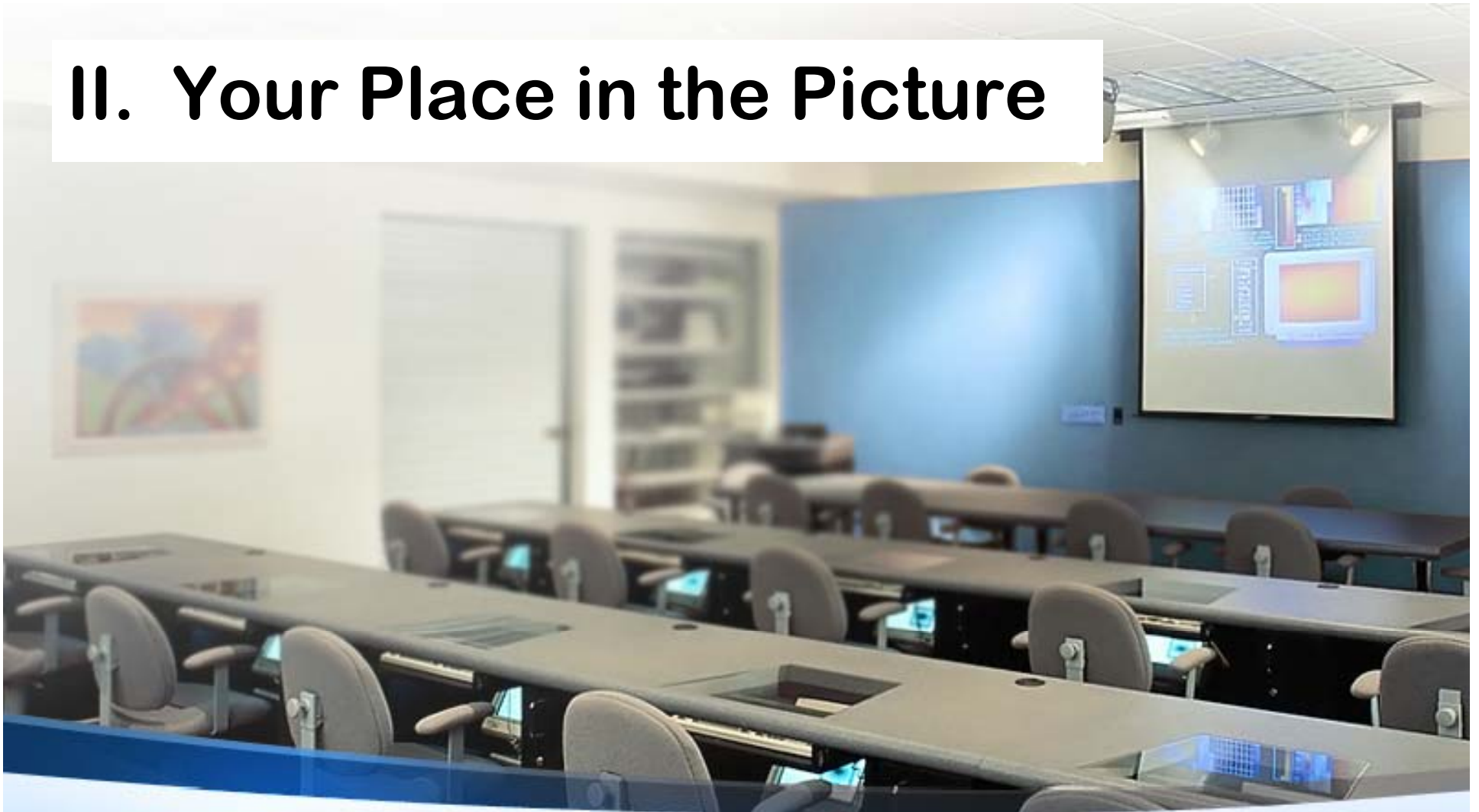
College Purchases - Pricing Factors

- **EBIDTA**: Earnings Before Interest, Depreciation, Taxes and Amortization (net cash)
- **Add-backs to Modify or 'Recast' EBIDTA**: seller family compensation, benefits and perks (e.g., auto leases, club dues)
- **Multiple of Modified EBIDTA**: represents buyer's assessment of risk & value over time, somewhat analogous to P/E for public stock
- **Two Step Deals**: minority purchase, mngmt agrmt and option for majority interest

College Purchases - Pricing Factors

- **Price:** Multiple X EBIDTA (or X Gross Revenue)
- **Creative Financing:** Promissory Notes and Tax-Beneficial Consulting Payments, Preferred Stock, Employment Bonuses
- **What Multiples Might a Motivated Buyer Pay?**
 - Platforms:** may be around 9-12
 - Multi-campus & strong programs:** possibly 5-9
 - Mom & Pops:** probably 3-5 or 1 X gross

II. Your Place in the Picture



**What You Have to Deal:
Can You Deliver The Basics?**

Basic Structural Issues: Can You Deliver What Buyers Want?

A. Ownership Entity: Assets or Stock

*Sub S or C corp, partnership or LLC – tax

*Sell minority position + option? Add programs?

*School platform:

- Opportunity for New Additional Location (AL)?
- Opportunity for new programs (degree/certificate)?



Basic Structural Issues: Can You Deliver What Buyers Want?

- B. Necessary Affiliates:** Operating assets/rights owned by other entity (e.g., tradename license)?
- C. Owner Consensus:** on selling goals
- D. Real Property Lease(s):** terms and assignability
- E. Regulatory Approvals:** Status of licensure, accreditation and Title IV eligibility.



Basic Structural Issues: Can You Deliver What Buyers Want?

- F. Essential Third-Party Contracts:** Externships, data management, outsourced operational functions, financial aid, default management.
- G. Key Employees:** Contracts? Loyalty?



Copyright © 2000 Thaves, Distributed by Newspaper Enterprise Association, Inc.
Redistribution in whole or in part prohibited

III. Sale Process



Process Timetable & Dynamics

Process Timetable & Dynamics



A. Initial Buyer – Seller Contacts & Negotiations

- Finding right buyer – can take weeks/months:
 1. Your contacts with area school owners
 2. Contacts with CPAs, lawyers, consultants
 3. Use of broker – investment summary/package
 4. Investment banking firm
 5. Use of auction approach (large platform)
- *Non-Disclosure Agreement (NDA) or Confidentiality Agreement*: basic enrollment & financial information
- Price negotiations - subject to due diligence

Sale Process Dynamics *(continued)*



B. Letter of Intent



- Term Sheet, LOI, LOU
- Consensus on Key Terms
- No-Shop Clause: 90-120 days
- Usually days/weeks to negotiate



Sale Process Dynamics *(continued)*

C. Purchase Agreement Negotiations

- Indemnification, Reps & Warranties: 3-5 yr look-back
- Non-compete, employment, consulting
- Buyer approval concerns
- Usually 4-6 weeks to negotiate



Sale Process Dynamics (continued)

D. Due Diligence – Demands (3 Yr sampling), Confidentiality, On-Site Review

- Contact with Senior Management
- Contact with Landlords, Key Contractors
- Starts during contract negotiations & continues after signing of formal purchase agreement

E. Regulatory Approvals

1. **State** – usually post-closing application

*Some are pre-closing: AZ, FL, NV, MD, NY

*Can be far in advance: NY – 90 days prior to close

*Can involve delays with bd/commn meetings

Sale Process Dynamics (continued)



E. Regulatory Approvals

2. Accrediting – Some pre-closing (NACCAS, ACCSC), all post-closing

- * Typical pre-close req is 30 or 45 days
- * Typical post-close req is 10 to 30 days

Example: ACCET

- 10 day prior notice; approval app 10 days after closing
- Same day balance sheet, business plan 3 yrs budgets
- Deal docs, ownership chart, organizational chart
- Resumes or profiles on 10% stockholders
- <http://www.accet.org/displaycommon.cfm?an=4>

Sale Process Dynamics (continued)

E. Regulatory Approvals (continued)

3. DOE: Region Team & Peer Review Board

- 45-day Pre-Acquisition Review, 34 CFR 600.20
- 2009-10 FSA Handbook, Vol. II, School. Elig., Chap. 5, pp 2-52 to 2-59
- <http://ifap.ed.gov/fsahandbook/attachments/0910FSAHbkVol2Ch5Updating.pdf>
- ‘Newco’: Letter of Credit, 18 mos. Growth Ban
- Need ‘clean’ pre-closing approval letter
- Same Day Audit & post-closing review period, 34 CFR 600.20 (g)-(h)

Sale Process Dynamics *(continued)*



F. Closing

1. Conditions – Lease & Contract Assignments, Preliminary Regulatory Approvals, Good Due Diligence Outcome
2. Employees – Notice of change
3. Notice to Students about change
4. Press Release?



Sale Process Dynamics

(continued)

LOI to LOSE: 4 – 6 Months

G. Post-Closing Period

1. DOE application within 10 days
2. Other regulatory applications and notices
3. **Post-Closing Audit – 60 days**
Possible Purchase Price Adjustment
4. Follow-up Inquiries from Peer Review Board
5. New Provisional PPA for Buyer



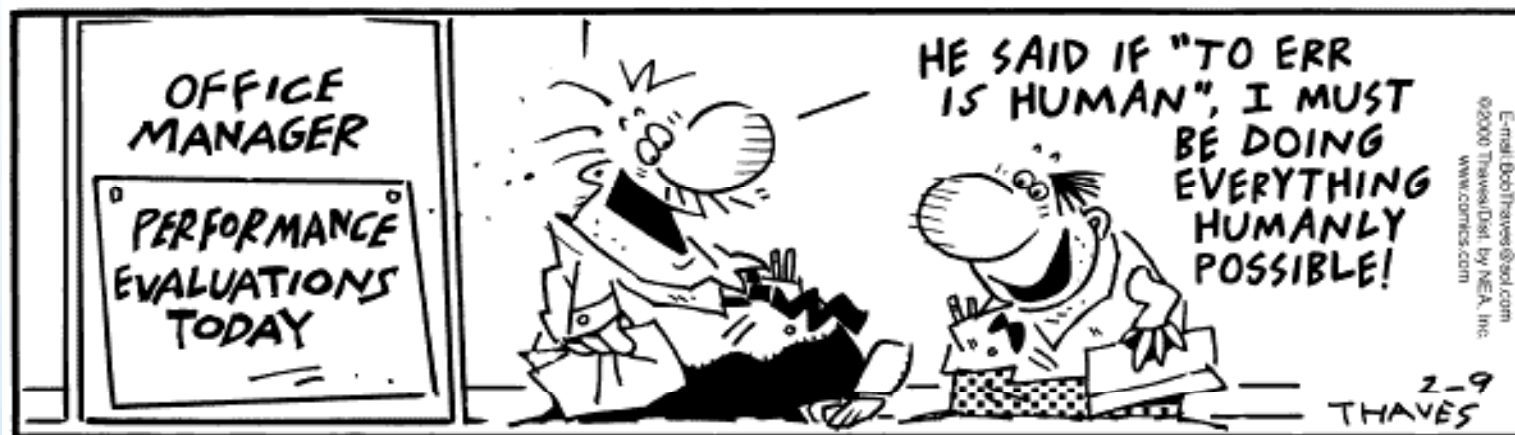
IV. Due Diligence



**Being Ready: Self-Evaluation of
Records and Compliance**

A. Due Diligence - Scope

- Expect due diligence to consume as much and more time and energy as a **program review**
- Scope is broader – Title IV, other regulatory (DOL – overtime), corporate, financial, employment, technology, intellectual property



Copyright © 2000 Thaves, Distributed by Newspaper Enterprise Association, Inc.
Redistribution in whole or in part prohibited

B. Compliance Audit – Outside Consultant



- Initial review: management
- Title IV review by CPAs, financial aid servicer, Title IV consultant



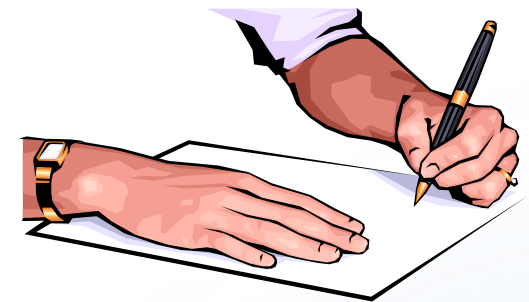
Copyright © 1999 United Feature Syndicate, Inc.
Redistribution in whole or in part prohibited

C. Title IV Review Issues:

1. 90/10 Compliance Record

a. Recent compliance margins.

- Will acquired school and its ratio be merged into existing buyer school, and if so, what result?



b. Calculation components:

- Full or partial recourse sales of institutional loans, or alternative third-party loans with guarantees.
- ‘Liquidation’ of receivables?

c. Institutional scholarships — restrictive criteria.



2. Refunds – Return of Title IV Fund (R2T4)

1. Excessive late refunds/refund letter of credit.
2. Substantial refund calculation errors: attendance schools, payment periods, determination of date of withdrawal, LOAs.



3. “Incentive Compensation”: Recruiters/Financial Aid Staff

1. Safe Harbors: **Going away? Past aggressive interpretations by target school?**
2. Particular areas of concern:
 - a. Frequency of salary adjustments for recruiters.
 - b. Valid and applied performance factors for recruiters other than success numbers
 - c. Bonus plans for specific groups or all employees
 - d. “Advance” graduation bonuses and pre-graduation retention bonuses.

“Incentive Compensation”

(continued)



- d. “Advance” graduation bonuses and pre-graduation retention bonuses.
- e. Split tuition with third-party whose recruiters get bonuses.
- f. Non-token gifts to students making referrals.



- 3. Gravity of questionable compensation practices/possible regulatory penalties and limitations: possible FCA cases



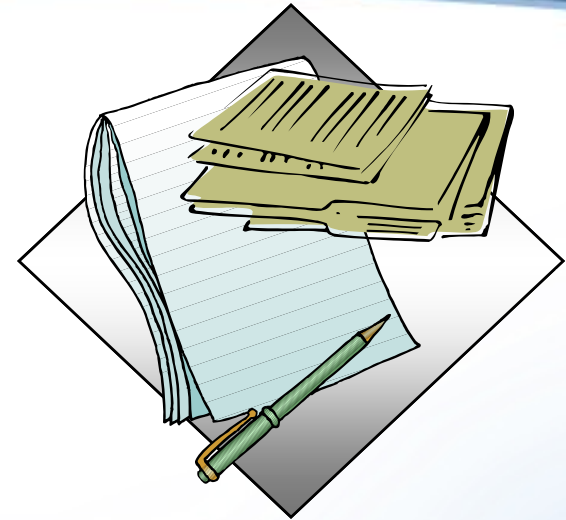
4. Substantial Verification Deficiencies

- Missing Tax Returns
- Lack of signed statements.



5. Dependency Overrides & Professional Judgment

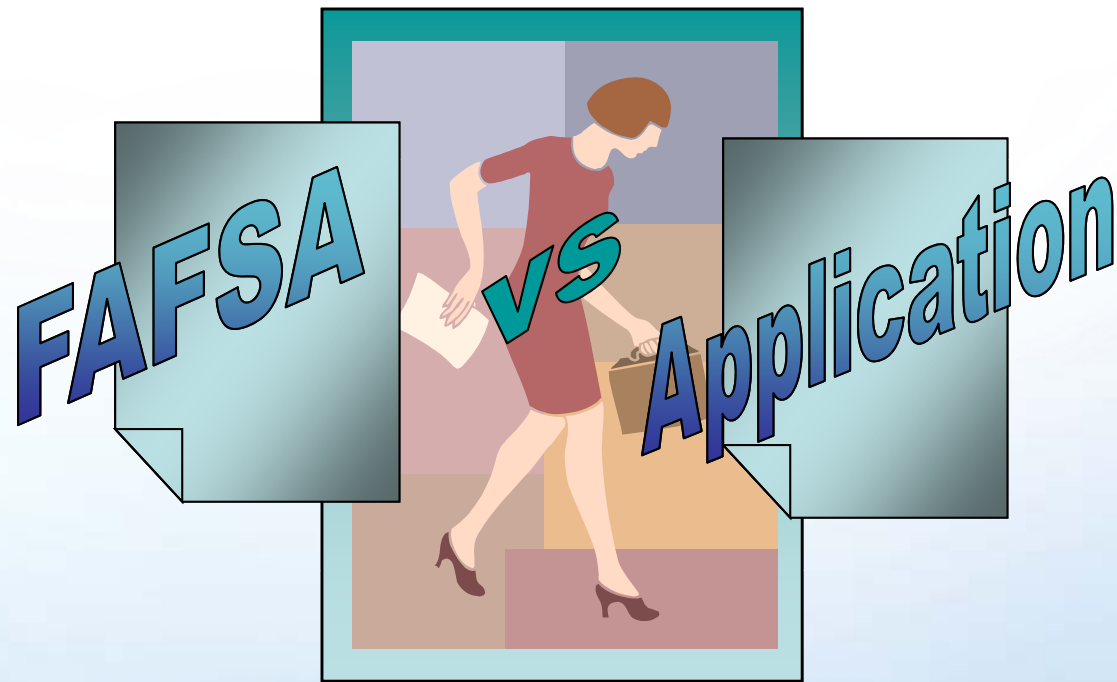
- Documentation
- Appropriate Factors
- Percentage of Student Population



6. Frequent Inconsistencies in Needs/EFC Information



- Comparing FAFSAs to enrollment applications, SARs and ISIRs.



7. Program and Location Eligibility

- Timely licensing and accrediting approvals prior to Title IV disbursement.
- Prior campus closures, closeout liabilities
- Closed commonly owned schools



8. Distance Learning Programs/Courses

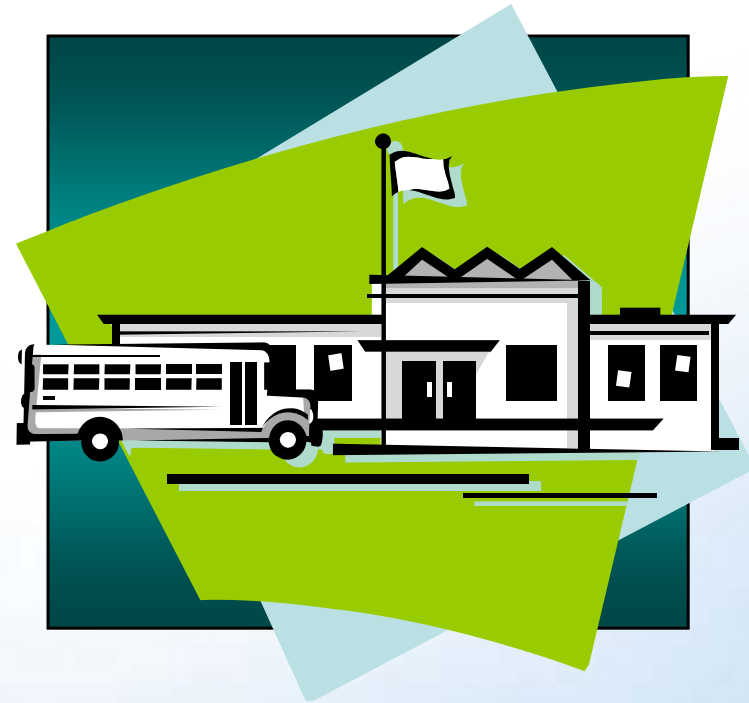


- Online programs:
 - proper accrediting approval
 - proper delivery system
 - substantial interaction
 - student integrity
 - accrediting growth oversight



9. Default Rate Trends

- Upward trend?
- **Projected 3 Yr Rates**
- Strategic response
- Adequate default management staff & plan



D. Financial Audit

1. Accounting Procedures

- Financial statement review
- Revenue recognition methods
- Write off of accounts receivable
- Forecasts, budgets, projections
- Contingent liabilities



2. Financial Responsibility Scores: Close to or in “Zone”

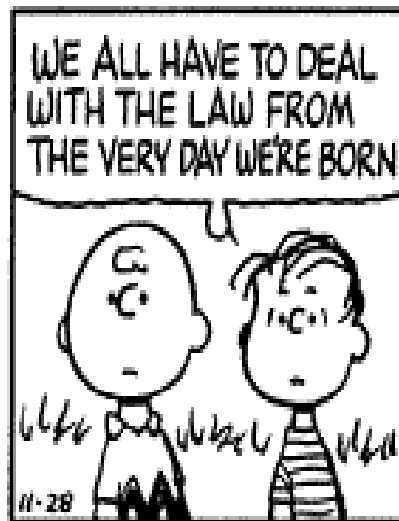
- Long-Term Debt
- Accounting for Tuition A/R
- Letter of Credit.
- Cash Monitoring.



3. Litigation & Reviews



- A. Employee litigation
- B. Student complaints/litigation
- C. Regulatory: Program Reviews, Investigations, Litigation

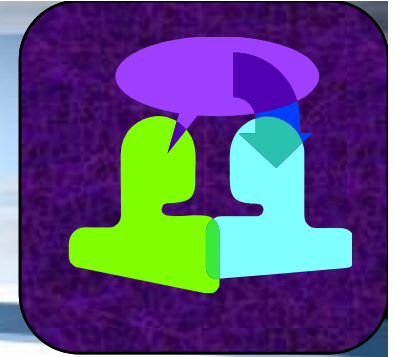


V. Make or Break

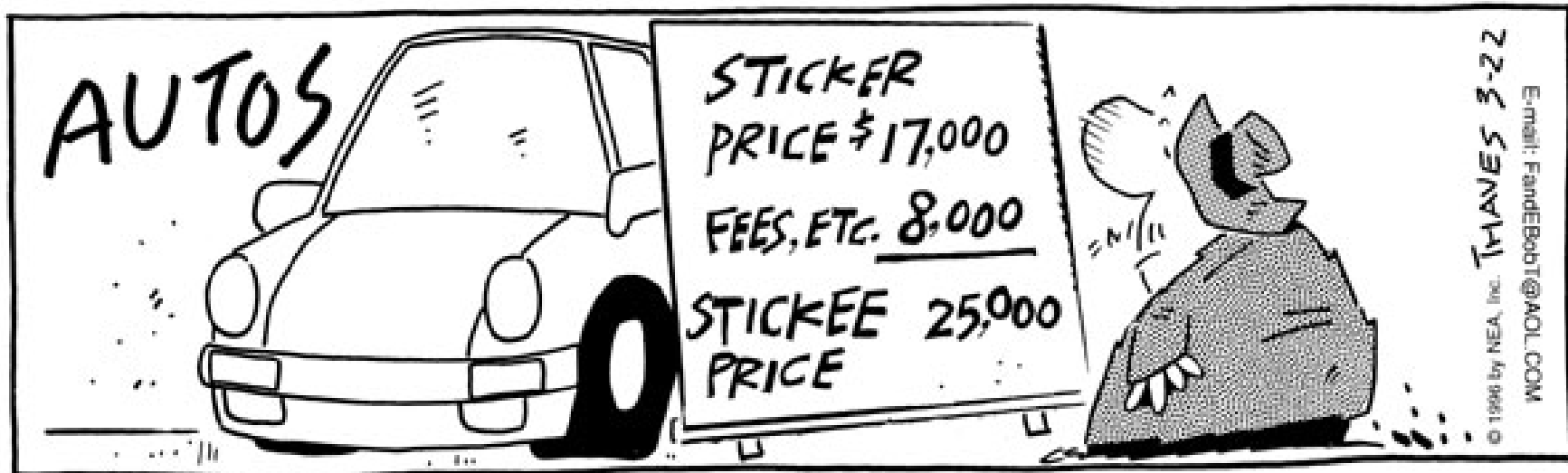


Major Deal Issues

Major Deal Issues



- A. Purchase Price Adjustment:** deferred tuition vs. tuition receivables – working capital
- B. Payment Structure:** escrow or promissory note – security for seller, subordination, risk



Major Deal Issues



C. Representations & Warranties

1. Time period: 3-5 years
2. “Material” or “knowledge” qualifiers?
3. Receivables - reserve adequacy?
4. Others – monthly F/S, student metrics



Major Deal Issues



D. Indemnification: risk allocation

1. Caps – relationship to purchase price
2. Claim Period limit
3. Buyer's security – note or escrow
4. Bucket or floor on claims

E. Non-Compete: duration and geographic scope

F. Consulting Agreement: time period, payment



Major Deal Issues



G. Employment Issues: risk allocation

1. Key employee contracts – termination, buyout penalties
2. Accrued benefits (PTO)
3. Benefit plans – disposition, COBRA

H. Campus Leases: Seller Owner? Terms

*Landlord consent: new demands?

H. Outsourcing Contracts – continued or terminated: financial aid, data, recruiting, default management



Conclusion

- **A GOOD DEAL** takes Preparation, Patience and Persistence – on both sides, and ...
- A good fit, good timing and reasonable expectations – on both sides



Copyright © 2000 Thaves, Distributed by Newspaper Enterprise Association, Inc.
Redistribution in whole or in part prohibited

Change in Ownership: **Are You Ready to Deal?**

Planning a sale or buy...

Contact Us

Ron Holt, Esq.

Megan Banks, Esq.

Mitch Kempker, Esq.

Dunn & Davison, LLC.

1100 Walnut, Suite 2300

Kansas City, MO 64106

Phone: 816-292-7600

Cell: (816) 509-5194

Fax (816) 292-7601

rholt@dunndavison.com