

# Are for-profit colleges worthy of shorting?

## Private education has its problems. Is it finally time to sell this industry?

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For-profit institutions are notorious for being unable to place alumni into the work force. While their businesses grow, their reputations sink.

It is time to note the discrepancy: People who attended traditional schools dislike for-profits, but those without traditional options seem to embrace the for-profit route despite knowing the statistics. Let's examine this problematic industry and focus on one of its worst performers in 2011: **Capella Education** ([CPLA](#)).

The for-profit education business model may not be sustainable. Eventually, people are going to realize that for-profit education is not nearly as helpful as it claims, and enrollment could very well decrease significantly. While this prediction hasn't yet played out, now may be the start of significant downtrends in the for-profit education industry.

Capella Education is a small-cap institution that operates franchises known as Capella University. It offers certifications and bachelor's, master's and doctoral degrees to nearly 40,000 students. However, is now a good time to short Capella or the industry itself?

Up about \$3 since its stock market debut, Capella's operations have been slowing over the last three quarters. In the fourth quarter of 2010, revenues peaked at \$115 million; since then, revenues declined to \$111 million in this year's first quarter and \$106 million in the second quarter.

Interestingly, the cost of goods sold increased from \$42 million to \$43 million in the same time period. To counteract the downward pressure, the company has cut operating expenses to \$40 million from \$44 million. Income taxes and other non-operating expenses have been static, and net income is down to \$16 million from \$18 million.

Over the last three quarters, Capella Education's balance sheet has shrunk. Notably, its cash reserves dwindled to \$197 million from \$218 million. Without strategic investments being made, it is possible that the cash is declining simply to support operations while revenues decline as well. Moreover, Capella opened a revolving credit facility in early October 2011, which may be a sign that it needs short-term funding to maintain growth.

The firm's current assets like receivables also decreased during the last few quarters. Property, plant, and equipment were virtually unchanged, and holistically, total assets decreased from \$263 million to \$244 million.

Capella's current liabilities decreased along with assets. Payable accounts decreased, but accrued liabilities increased. Overall, current liabilities decreased from \$41 million to \$37 million. In non-current liabilities, the company increased its deferred tax liability account, which means that

it will eventually have to pay the difference between GAAP taxable amount and the Tax Code taxable amount in the future. Overall, liabilities increased from \$54 million to \$55 million.

In shareholders' equity, Capella's additional paid-in capital decreased from \$115 million to \$66 million, which signifies the losses in stock price. On the other hand, retained earnings increased from \$93 million to \$123 million.

Capella's cash position has been increasingly volatile over the last few quarters. In the fourth quarter of 2010, cash flow from operations was \$88 million. One quarter later, it was \$23 million, and in the second quarter of 2011 it was \$45 million. This variance occurred mainly due to fluctuations in net income, although depreciation and amortization were volatile too.

In the year ended 2010, significant capital expenditures were incurred; since then, capital expenditures were offset by sales of previous investments. Lastly, significant stock repurchase programs increased cash used by financing activities in the last three quarters. Totally, cash has flowed out of the firm in the past three quarters.

When comparing Capella to its direct competitors, Capella is cheaper in terms of price/earnings but more expensive in terms of price/book value and price/sales. Likewise, Capella has a higher operating and net margin.

In terms of growth factors, Capella has had higher revenue growth over three years, but lower EPS growth over the same time period. It also has a higher return on equity. While all these factors seem positive for the company, they take into account a long time of increasing operations. It was only in the last few quarters during which Capella has started to under perform.

Various equity research analysts have also lowered price targets for Capella, including the likes of Piper Jaffray, Wunderlich, Citi, and First Analysis.

Many citizens dislike the concept of for-profit education, and while the industry has been profitable since its inception, the time may be approaching for certain companies to close their doors, especially when they start to lose customers, and ultimately, profits. Traders need to keep an eye on Capella Education; it may break through technical support levels and experience further decline. It is also looking weak from a fundamental perspective.

Capella Education was trading up 1.2% Wednesday to \$29.08, down more than 50% for 2011.

## **Comments:**

Tue 12:31 PM

Can for-profit institutions grow while their reputations sink? Unlikely. More likely is the motivation of short-sellers and their fellow travelers to talk down for-profit institutions--the impact on students, families, communities or the economy be damned. These "analysts" have turned the business of trash talk into personal gold. Are for-profits "notorious" for being unable to place their graduates? Despite a tepid economy, nationally accredited institutions place 70 percent of their graduates. Moreover, graduates of four-year private sector colleges and universities (PSCUs) were employed in higher percentages than graduates of either public or private non-profit universities, according to a recent study by the U.S. Department of Education. Almost four million students are sitting in our classrooms or attending our classes online today,

working on a better future, just like their counterparts in traditional higher education. The only difference? Traditional students do not have short sellers seeking to subvert their efforts at skills attainment and a better life.

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