

# Business Services

## Class Notes

Monthly Insights on the Education Market

### Education Services

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## Research

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# HIGHLIGHTS & STOCK REVIEW

## Ed Indices Last Month

K-12	+2.6%
Higher Education	+11.3%
Education Publishing	+1.4%
Corporate Learning	+13.4%

## Ed Indices During 2006

K-12	-6.2%
Higher Education	-8.0%
Education Publishing	+24.9%
Corporate Learning	+18.7%

## Market Statistics (Jan)

NASDAQ	+2.0%
S&P 500	+1.4%
Dow Jones	+1.3%
Russell 2000	+1.6%

## S&P 500 P/E Ratios

2006E	16.5x
2007E	15.5x

## This Month in Class Notes

*We have made some changes to the format of Class Notes, including adding a table of contents to help with navigation, the addition of a Policy segment that discusses changes at the federal level, and profiling one education company in each edition—this month we highlight Blackboard (BBBB, \$29.20, Outperform)...*

*Laureate and Educate both announce agreements to be taken private by their CEOs and private equity consortiums...*

*Career Education acquires an Italian fashion and design school; meanwhile, back in the U.S., the DOE lifts its growth restrictions on the company...*

*Apollo Group enters the high school market with the acquisition of virtual high school Insight Schools...*

*Earnings reports from DeVry, Corinthian Colleges, ITT Educational Services, New Oriental, Renaissance Learning, McGraw-Hill, and Reader's Digest...*

*We added Capella Education (CPLA) and New Oriental Education & Technology Group (EDU) to the Post-Secondary Index, and moved ProQuest from the K-12 Index to the Publishing Index.*

## Education Stocks Rally to Start the Year

In general, education stocks have experienced a strong start to the year as investors are beginning to speculate on the timing of a turnaround, particularly in higher education stocks. Laureate's announcement that the board signed an agreement to be taken private by its founder/CEO and a private equity consortium caused a number of companies in the post-secondary market to rally. All indices performed at least as well as the S&P in January.

Stocks within our K-12 index increased 3% during the month of January as strength in shares of Leapfrog Enterprises (+13%), Scientific Learning (+11%), and Educate (+10%) were partially offset by a 16% decrease in Renaissance Learning shares and 6% decline in Plato Learning.

Higher education stocks rallied during the month. Laureate increased 24% during the month as the announcement of the buyout offer came on the heels of an 11% year-to-date increase. Newly publicly-traded Capella Education continued its solid gains, increasing 17% during the month. ITT Education Services posted strong 4Q06 results, contributing to the company's 17% gain during the month. As a whole, the post-secondary index increased 11% during the month.

During the month of January, the education publishing index increased a modest 1% following 25% appreciation during 2006. Modest growth of shares of Pearson, ProQuest and Reed Elsevier was partially offset by low-single-digit declines of shares of John Wiley, McGraw-Hill, and Scholastic.

Growth of corporate training stock reaccelerated in January as increases in all six of the stocks in our index drove the index up 13%. Learning Tree International, Saba Software and SumTotal Systems led the growth, each increasing 18%.

## POLICY REVIEW

House Democrats unveiled a joint funding resolution for the 2007 budget which contained an unexpected boost in Pell Grants. The budget will increase the maximum Pell Grant by \$450 to \$4,310, the first increase in five years. Recall that last month, Democrats had been warning that the 2007 education programs would be funded at the same level as 2006 which was true for most programs. The resolution was largely bereft of earmarks funds for higher education as the new majority had promised last month.

House Democrats also pushed through their promised student loan bill in January. The bill will gradually cut student loan interest rates to 3.4% from 6.8% between July 2007 and July 2011. The rate will increase in January 2012 unless the rate is permanently extended. The rate cut plan will cost \$6 billion and will be offset by shrinking subsidies and increasing fees for loan providers. The White House has already publicly opposed the bill, but has not taken a public stance on a veto by President Bush.

The Senate passed an earmark reform bill this month similar to the bill the House had previously passed. The bill would force earmarks to appropriations bills to disclose information on the legislator who requested the earmark along with the purpose and the recipient of the earmark. The Senate bill would also create a searchable online database for the earmark data. Earmarks are typically used to fund research projects in higher education and are viewed as important projects for many legislators. The increased transparency is part of an effort to slow the growth of earmark spending which tripled from 1994 to 2006. However, the increased transparency may not have the intended effect of slowing growth as many members of Congress actively campaign on their ability to bring money to their home districts and states.

As the No Child Left Behind Act (NCLB) celebrated its fifth birthday in January, the push to reform pieces of NCLB continued. Republican Senators Jim DeMint (SC) and John Cornyn (TX) proposed an addition to NCLB that would allow the states to have more flexibility in the use of federal funds. Under the proposal floated by the pair in conjunction with the Heritage Foundation, states would enter a five-year performance agreement with the federal government in exchange for less federal intervention and flexibility in performance tracking and use of funds. Democrats continued their calls for increased funding for schools which the White House may offer in exchange for the expansion of NCLB into secondary education. Senator Christopher Dodd (D, CT) and Representative Vernon Ehlers (R, MI) introduced a bill promoting voluntary national standards for math and science. The bill would pay states up to \$4 million in grants for adopting National Assessment of Educational Progress (NEAP) standards as the state NCLB standard. The push for national standards arose from the contention by certain policy groups that some state standards were set too low in order to make NCLB compliance easier. Senator Edward Kennedy (D, MA) introduced a bill that would fund the analysis of the gap between the NEAP and state standards and help states raise standards without adopting the NEAP ones.

## ELEMENTARY & SECONDARY

### Educate's Board Accepts Buyout Offer

Educate announced it has entered into a definitive agreement to be acquired by a group of investors, including founder/chairman/CEO Christopher Hoehn-Saric, President/COO Peter Cohen, President of Educate Products Chip Paucek, and certain other members of management and affiliates of Sterling Capital Partners and Citigroup Private Equity for \$8/share (\$535 million, including \$162 million in debt). The proposal was first received by the board in late September. The deal is expected to close in 2Q07, subject to shareholder and regulatory approval. Two Apollo Management funds, Apollo Sylvan, LLC and Apollo Sylvan II, LLC, hold 53% of voting stock and have agreed to vote in favor of the deal. The offer price represents 18.0x EV/trailing EBITDA and 27x our 2007 EPS estimate of \$0.30.

### Renaissance Learning Reports 4Q06 Results

Renaissance Learning announced 4Q06 revenue of \$25.9 million (-11%) and EPS of \$0.06 versus \$0.20 in 4Q05. The company added 500 new schools as customers, bringing the total number of schools using Renaissance Learning products to over 71,000. Management anticipates improved financial results in 2007.

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### *OTHER ELEMENTARY & SECONDARY NEWS*

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#### *Personnel Changes*

**Plato Learning Inc. (TUTR)** named Robert Rueckl as CFO, replacing Larry Betterly. Mr. Rueckl most recently served as the company's chief accounting officer. The company also announced that Thomas Hudson will step down from the board of directors in March.

**The Princeton Review (REVU)** announced the resignation of CFO Andrew Bonanni, effective January 26. Former CFO Stephen Melvin will assume the role during the search for a permanent replacement. The company also appointed Gary Solomon as Vice President of Sales and Marketing.

**Siboney Corporation (SBON)** announced the resignation of Treasurer Megan Krasnicki.

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#### *Corporate Developments*

**The Princeton Review (REVU)** launched the third generation of The Assessment Center, a Web-based delivery of online assessment and instructional programs. The product helps teachers and administrators with providing assessments for students in grades 2 to 11 in reading, math and science.

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#### *Miscellaneous*

**Bright Horizons Family Solutions (BFAM)** was named to Fortune magazine's list of "The 100 Best Companies to Work For" for eighth time. The company was no. 92 overall and no. 34 among large companies.

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### **Mayoral Control of Schools Gaining Momentum**

The number of cities with mayoral control of the school system appears likely to increase in the near future as debates about handing over the school reins to the mayor have begun in Albuquerque, Seattle, and Washington, DC. In the last 10 years, mayors have taken control of school systems in Boston, Chicago, Cleveland, New York, and other smaller cities. The trend arises from poor school performance in many urban areas and the voters' insistence on holding mayors responsible despite a lack of control since most cities have an elected school board that hires the school superintendent. The setup arose from the need to insulate the schools from the political fighting and corruption that occurred in many city governments. Analysis of test data shows that school systems under mayoral control made modest improvements in reading and math scores at the elementary and middle school level. A recent report suggests that mayoral control is best used as a turnaround strategy.

Despite the recent momentum, the debates over mayoral takeovers can turn nasty and last much longer than expected. A recent example is the spat for control of the Los Angeles Unified School District in which the school board and Mayor Villaraigosa fought publicly over the mayor's school plan. The California legislature ceded partial control of the Los Angeles school district to the mayor, but a judge overturned the decision as violating the state constitution. In Washington, D.C., newly elected Mayor Fenty is in battle with the school board which is preparing an alternate plan to the mayor's takeover proposal. Even after gaining control, mayors still face obstacles from entrenched foes. Mayor Bloomberg, who has controlled the New York City school system for the last six years, has set up a showdown by embarking on the overhaul of the city school system.

### **Former Advocate Blasts No Child Left Behind**

Michael Petrilli, a former associate assistant deputy secretary at the Department of Education, characterized the No Child Left Behind Act as "fundamentally flawed" and beyond repair. Mr. Petrilli, now with the Fordham Foundation, was an advocate for the law and helped get NCLB passed as a member of the Bush administration. Flaws that Mr. Petrilli noted included the highly qualified teacher requirement, the setting of proficiency levels by the states, turning schools into exam prep factories, and the failure/inability to inform parents of students at failing schools about school choices and free tutoring. Mr. Petrilli advocated letting the federal government redistribute funds and allowing states to make decisions on standards, teacher hiring, and when to intervene at failing schools.

### **State Residency Impacts Probability of College Graduation**

According to a new report from Editorial Projects in Education, the chances of a student earning a degree is greatly dependent on which the state the student resides in. The study examined how students in different states progressed through key educational and development points. The report stated that many states must improve at aiding students with the transition from high school to college since only 11 states have a formal definition of "college readiness" and only six align state tests with college-level work. The highest ranking states on the report's Chance for Success Index were in order Virginia, Connecticut, Minnesota, New Jersey, Maryland, Massachusetts, and New Hampshire while the lowest-scoring states were New Mexico, Arizona, Louisiana, Alabama, Mississippi, Tennessee, and Texas. Students from high ranking states were more likely to have college educated parents and not be part of a low income family. The high ranking states magnified the early benefits for their students by providing above average primary and secondary education with the outcome that students from high ranking states were much more likely to attend college.

### New Website Illuminates Public Data on Schools

The National Council on Teacher Quality launched a new website that allows parents to compare school districts. The database includes teacher union agreements along with state and local policies and regulations. The site covers the 50 largest school districts in the U.S. which educate 8 million students. The council created the database to compile public data in order to help compare teacher working conditions at schools and hopes to add the next 50 largest districts to the database by the end of the year.

### Recent U.S. Census Report: Kids on Track Academically

A U.S. Census report based on data compiled from 10,000 households titled "A Child's Day" indicates that 75% of children between the ages of 12 to 17 in 2003 were in the correct grade level for their age, up from 69% in 1994. The report also showed that 25% of students were gifted, up from 22% in 2000. One of the report's authors, Jane Dye, pointed to an increase in the number of households in which parents enforced restrictions on TV watching. In 2003, approximately 67% of children between the ages of 3 to 5 years old were limited on how much TV they were allowed to watch as well as what shows they were permitted to watch, up from 54% in 1994.

### New Studies Point to AP Benefits

Two new studies sponsored by the College Board show that high school students that take AP courses and exams fare better in college than peers that eschew the courses. One study examined 222,289 students from all backgrounds attending Texas universities and found that students who participated in both AP courses and exams performed better in terms of GPA, credit hours, and on-time graduation rates. The second study of 25,000 University of Texas students showed that students that used the AP credits to place into higher level courses performed better than peers that took the college's introduction courses. The studies refute an earlier study that showed that students that took AP science classes did not perform significantly better than other students when taking the same science classes at college.

### State & Local News

The **California** Board of Education is in a dispute with the U.S Department of Education about the best way to measure student performance as part of the No Child Left Behind Act. In addition, California is trying to delay the deadline to have all students doing math and reading at grade level by 2014. Education Secretary Margaret Spelling indicated that while she has been willing to be flexible on some aspects of the NCLB Act, the 2014 deadline is non-negotiable.

More than half of **Missouri's** 230 school districts are involved in a court case against the state in an effort to prove that the school funding plan approved by legislators in 2005 does not satisfy the state constitution, which requires the state to "establish and maintain free public schools." The school districts are arguing that the \$2.7 billion a year for education is insufficient. The constitution requires that 25% of the state's budget be spent on schools, which the attorney general's office says the state is satisfying.

A coalition of education and labor groups in **Ohio** are proposing an amendment to the state constitution which would give the State Board of Education the power to make decisions about education rather than the lawmakers, whose role would be limited to determining how to pay for the funding that the board recommended. Opponents of the plan argue that the decision would lead to an increase in taxes.

A school district in **Ohio** is running a pilot program that pays students in grade three through six for performance on state exams. Run by an economics professor, Eric Bettinger from nearby Case Western University, the program is in the third and last year of the study which selects random grades from four elementary schools in the district to participate. Funded by a local businessman, the program uses coupons that can be redeemed at local business by children only. The students receive \$15 for every proficient score and \$20 for every accelerated or advanced score on one of the five annual state exams. Dr. Bettinger would like to answer a range of questions including are the effects cumulative, do scores decrease when the incentive is removed, any differences in gender motivation, and relative effectiveness in schools with a higher concentration of students.

**Texas** may be facing a dropout crisis according to a new study as at least half of all high students in urban districts are dropping out of school. Texas schools lose one student every four minutes and over 2.5 million students have dropped in 20 years as each graduating class loses at least 120,000 students. The report's authors who are from Intercultural Development Research Association, argue that the state is not doing enough to fix the problem which cost Texas \$730 billion in lost revenue and costs over the last 20 years.

#### K-12 SHORT INTEREST

Company	Ticker	Short Interest	% Chg M/M	Avg Vol	Days to Cover	Last Month
<b>K-12 Education</b>						
Bright Horizons Family Solutions, Inc.	BFAM	1,267,625	2%	180,179	7.0	6.8
Educate, Inc.	EEEE	979,700	-5%	88,969	11.0	13.8
Leapfrog Enterprises, Inc.	LF	2,663,409	-13%	279,459	9.5	6.2
Plato Learning, Inc.	TUTR	65,700	-20%	67,765	1.0	0.8
Princeton Review, Inc.	REVU	131,935	6%	36,516	3.6	2.1
ProQuest Company	PQE	2,159,967	-32%	847,412	2.5	18.4
Renaissance Learning, Inc.	RLRN	1,521,274	-9%	36,384	41.8	51.5
School Specialty, Inc.	SCHS	2,372,486	-1%	147,277	16.1	5.4

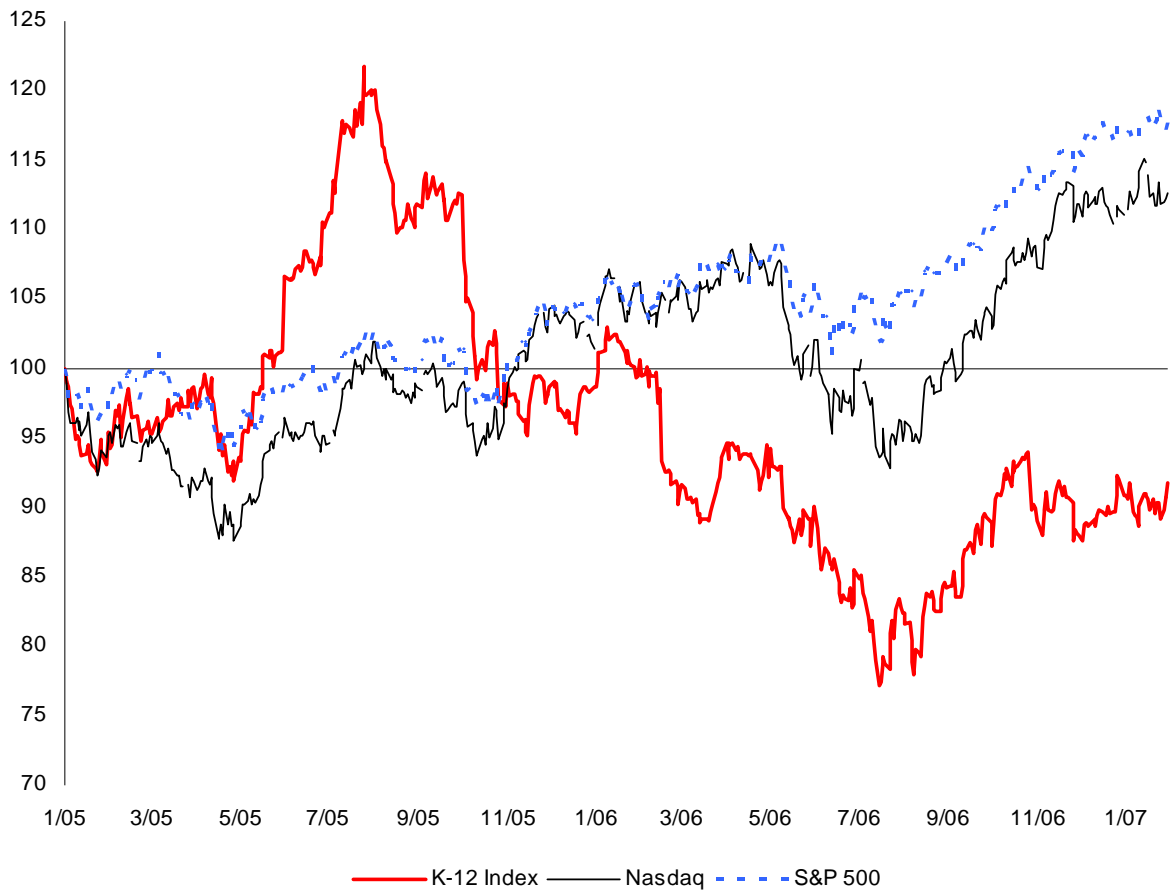
Source: NASDAQ

Above are short interest data for select publicly traded K-12 companies. The table includes the number of short interest shares as of January 15, the percent change versus the previous month, average daily volume, days-to-cover ratio (short interest divided by average volume) and the previous month's days-to-cover ratio.

Overall, the number of short interest shares declined in January versus December. ProQuest decreased the most to 2.2 million shares, down 32% from 3.2 million shares the prior month, and marking the fewest shares short since November 2005. The decline in short shares followed a 27% decrease in share price on December 15. Average volume spiked to 847,412 from 172,250 the prior month. As a result, days to cover decreased significantly to 2.5 days from 18.4 days in December.

Other sizable declines in the number of short interest shares include Plato Learning with a 20% decrease, Leapfrog (13% decrease), and Renaissance Learning (-9%). Despite the decrease in number of short interest shares, Renaissance Learning maintains the highest days-to-cover ratio in the K-12 space at 41.8 days, followed by School Specialty (16.1 days) and Educate (11.0 days). Plato Learning has the shortest days-to-cover ratio with one day, followed by ProQuest (2.5 days) and Princeton Review (3.6 days).

**K-12 INDEX VS S&P 500 AND NASDAQ**



Source: FactSet

## POST-SECONDARY

### Laureate's Board Accepts Buyout Offer

Laureate announced that it has entered into a definitive agreement to be acquired by its founder/chairman/CEO and an investor consortium for \$60.50/share, or \$3.8 billion including the assumption of debt. The offer price is an 11% premium to the closing price on January 26 of \$54.41, and equates to 30x our 2006 EPS estimate of \$2.00, 24x our 2007 EPS estimate of \$2.50, and 16.4x EV/trailing EBITDA. Over the last three years, Laureate has traded between 18x-28x forward earnings, with an average of approximately 24x.

Founder and CEO Doug Becker first approached the Board with a proposal in September 2006. Becker reportedly presented three other offers to the board before this offer was accepted. The investor group is led by Becker, Kohlberg Kravis Roberts & Co., Citigroup Private Equity, S.A.C. Capital Management, and several others. The agreement includes a "go shop" provision, which allows the special committee to solicit, receive, and evaluate other offers over the next 45 days. Given we do not foresee the emergence of another buyer, we lowered our rating to Neutral.

### DeVry's Turnaround Continues; F2Q08 Results

DeVry reported F2Q07 (December) revenue increased 13% versus the prior year to \$237 million, above our estimate and the Street estimate of \$233 million, with all three business segments contributing to growth. DeVry University revenue increased 9% to \$186.7 million due to improved enrollment growth at both the undergraduate and graduate level. Strong enrollment at Ross and Chamberlain drove Medical and Healthcare revenues to increase 27% to \$36 million. Professional and training revenues grew 49% to \$14.9 million due to strong performance by Becker CPA Review and Stalla Review for CFA and growing CD-ROM sales.

The gross margin improved 210bps to 49.2% and beat our 48.1% estimate. Student services and administration expense grew to \$93 million (+14%) and increased as a percentage of revenue 20bps to 39.2%, exceeding our estimate of 38.3%. The higher cost was attributed to increased spend associated with marketing, recruiting, and systems enhancements. Operating margin improved 190bps versus the prior year, and was 20bps above our estimate. EPS came in at \$0.23 versus \$0.15 the prior year, in line with consensus and \$0.01 above our estimate of \$0.22.

Our Neutral rating on the stock is based on the following. First, we believe the turnaround is reflected in the stock price. At \$28.16, the stock is trading 30x our C2007 EPS estimate of \$1.01 and 23x our C2008 EPS estimate of \$1.25. Second, the big box campuses remain underutilized as traditional student enrollment lags. Efforts to improve capacity will likely take 12-18 months or more. Third, we expect the company's incremental investing in sales and marketing to keep margins compressed. While DeVry's operating margin did improve to 8.9% in C2006 from 6.7% in C2005, it is still well below most of its competitors. Trailing-twelve-months operating margin was 31% at Strayer (as of September), 28% at Apollo (August), 24% at ITT (December), and 14% at Career Education (September).

### Corinthian Reports F2Q08 Earnings

Corinthian Colleges reported F2Q07 (December) revenue of \$245 million, flat versus the prior year, but slightly above our and the consensus estimate of \$244 million. As of December 31, Corinthian had total student enrollment of 65,431 students, a 1% decrease from 66,139 the prior year. Ground campus enrollment declined 5% to

58,614 while online enrollment increased 53% to 6,817. Online course registration, including hybrid and online-only courses, grew 28% to 26,164. Total starts were up 1% to 21,554 from 21,376 due to strong starts in healthcare and online.

Gross margin decreased 250bps to 42.2% and was below our 43.7% estimate, mainly due to increased bad debt and higher occupancy costs from new WyoTech capacity. Bad debt expense increased to 6.2% versus 5.4% the prior year. The increase was due to inattention by campus leadership. Marketing and advertising expense totaled \$66.6 million (+0%), and as a percentage of revenue was flat from the same period the prior year. General and administrative (G&A) expense increased \$5.5 million to 12.6% (+220bps), above our estimate of 11.5%. Legal expenses related to the company's historical review of stock options (approximately \$3.5 million) and a \$4 million increase in litigation reserves were the reasons for higher G&A expense. Operating margin declined 470bps to 2.4%, and trailed our 5.2% estimate by 280bps.

Corinthian reported F2Q07 GAAP EPS of \$0.03 vs. \$0.12 in F2Q06, but included several unusual/one-time items (\$0.02 for legal expenses related to stock option investigation, \$0.02 for facility closures/severance, \$0.03 for increased litigation reserves). Management's guidance of \$0.09-\$0.11 excluded these items, as did our \$0.09 estimate and the consensus \$0.10 estimate. We are excluding the closure and severance charges, but including the other items in our model. Therefore, our reported F2Q07 EPS estimate is \$0.05.

The company lowered its F2007 EPS guidance to \$0.35-\$0.39 from \$0.47-\$0.52, which includes the \$0.02 severance charges, the impact of legal expenses related to the stock option investigation realized in F1H07, an increase litigation reserves \$0.03, and the impact from lower WyoTech enrollment (\$0.04).

Management introduced a new initiative, Inspire, which focuses on the student life cycle from the beginning of school to career placement. As part of Inspire, the company will standardize new student orientation at all campuses, provide instructors with the training needed to create an interactive learning environment, and integrate career services throughout the student's school cycle. In addition, the brand consolidation campaign continued. The company has consolidated the number of brands down to the "low teens" with more brand changes over the next few months, mostly in diploma schools such as Bryman, Olympia College, and Georgia Medical Institute.

### ITT Reports Solid 4Q06 Earnings

ITT Educational Services reported 4Q06 revenue increased 13% to \$206.2 million, ahead of the consensus estimate of \$203.7 million. Total student enrollment increased 9% to 46,896 versus the prior year, while new student enrollment increased 16% to 10,208. Cost of educational services as a percentage of revenue decreased to 43.4% from 46.6% due to improved operating efficiencies and leverage. The company increased advertising during the quarter, resulting in an increase in student services and administrative expenses as a percentage of revenue (25.8% versus 23.2%). Bad debt expense increased to 1.6% versus 1% the prior year. As a result, operating margins increased 60 basis points to 30.8%. During the quarter, ITT repurchased roughly 566,500 shares. EPS came in at \$0.97 versus \$0.81 in 4Q05, above the consensus estimate of \$0.94. Management guided 2007 EPS to be in the range of \$3.17-\$3.21 versus \$2.72 in 2006, implying growth of 17%-18%.

### New Oriental Reports 4Q06 Earnings

New Oriental reported F2Q07 (November) revenue of \$21.6 million, up 33% versus the prior year, and above the consensus estimate of \$19.9 million. Revenue growth

was driven largely by enrollment growth as total student enrollment in language training and test preparation courses increased by 20% y/y to 217,500 from 180,800 in F2Q06. Operating margin improved to 0.2%, compared to -8.0% the previous year due to improved operating leverage as revenue growth exceeded operating expense growth. EPS for the quarter was \$0.03 versus the consensus estimate of \$0.00. The company opened two schools in the quarter, bringing total number of schools to 34 and learning centers to 87. Net cash improved to \$148 million largely due to the IPO on the NYSE during the quarter. Management provided F3Q07 revenue guidance of \$25.8 million to \$27.1 million, implying growth of 20% to 26%.

### **DOE Lifts Career Ed's Growth Restriction; Italian Fashion Acquisition**

Career Education received notice from the Department of Education (DOE) that it has lifted the restrictions imposed in June 2005 which prevented the company from making domestic acquisitions of schools and restricted the company's ability to open additional campuses in the U.S. The restrictions were originally imposed as the DOE reviewed financial statements and annual compliance audit opinions for 2000-2003 and evaluated Title IV program reviews at several campuses. The company paid \$500,000 to the DOE in April 2006 to settle financial aid violations at two campuses.

Only a few days after the announcement that the DOE lifted its restrictions, Career Education announced it has acquired Istituto Marangoni, a European fashion and design school with 1,500 students based in Milan, London, and Paris. The company already had a presence in Europe with 10 INSEEC schools in France and AIU in London. Terms of the deal were not disclosed. We do not expect the acquisition to significantly impact results.

### **Katharine Gibbs-New York in Trouble with NY Ed Dept**

The New York State Education Department released a letter sent to the Katharine Gibbs School-New York. The letter outlined a series of problems at the two-year college that could affect the school's state registration and is the final report arising from a peer-review of the school in April 2006. In the report, the review team indicated that the school was not in compliance with state regulations and made 80 recommendations to correct problems in a number of areas including funding, faculty, library, admissions, and support services.

In Gibbs' August 2006 response, the letter indicated that the school addressed many of recommendations, but failed to demonstrate to the NY Department of Education that the school would be in compliance with regulations in three areas: faculty, admissions, and support services. Some of the specific concerns in regard to faculty were weak credentials, faculty teaching outside of areas of training and expertise, insufficient full-time faculty, and heavy teaching loads. Problems in the admission process included pressures to enroll, high staff turnover, lack of training for representatives in assessing applicant chances for success, and not enough remedial classes to prepare students for college-level work. The department termed the school's response to the career services recommendations as "incomplete."

The department has given Gibbs 60 days to report back on plans for improvement and will conduct another review during the school's April quarter. If the April review does not report substantial compliance by Gibbs-New York, the department will terminate the registration of all degree programs at the school. This would cause Gibbs-New York to lose access to federal funding due to non-compliance with Title IV funding regulations that require state registration. In addition, the NY Education Department is mandating that the school, which currently has close to 2,000 students, limit new enrollment in order to focus attention on the needed changes.

### **Apollo Acquires Online High School**

Apollo Group announced that it acquired an online provider of high school education, Insight Schools, back in October 2006. Insight Schools is based in Portland, Oregon, and launched its first school in the state of Washington in September. Insight Schools of Washington is a public (therefore tuition-free to Washington residents) alternative high school, with over 600 students. The management team, led by founder Keith Oelrich, will remain with the company. While Insight Schools may provide Apollo Group with another avenue for growth, we are concerned that Apollo is shifting further away from his core competency of offering post-secondary education to working adults.

### **University of Phoenix Goes in Front of the Supreme Court**

Apollo Group's University of Phoenix went before the United States Supreme Court to request the court review a decision made by the Ninth Circuit Court of Appeals which, according to UOP, "dramatically expands the scope of the False Claims Act." In September 2006, the U.S. Court of Appeals for the Ninth Circuit ruled unanimously to reinstate a fraud lawsuit against Apollo filed under the federal False Claims Act. The qui tam lawsuit claims that Apollo falsely obtained \$1.5 billion in federal funds during the six years before the original filing date in 2003 by paying admission counselors at the UOP bonuses based on the number of students enrolled. A federal district court had previously dismissed the lawsuit by two former enrollment counselors at the UOP for not offering a legitimate theory for fraud.

### **eCollege Details 2007 Financial Plans**

eCollege hosted a conference call to detail its guidance for 2007 and financial plan for 2008 and 2009. Recall, late last year, eCollege announced it was seeking strategic alternatives for the Datamark division. As such, that segment has been classified under discontinued operations. The company expects eLearning revenue of \$62.5 million to \$64.5 million, an increase of 20%-23% and operating income of \$14.5 million to \$15.5 million, up 27%-35%, implying margins of 23%-24%. EPS from continuing operations is expected to increase 17%-26% to \$0.36-\$0.39, assuming 23.4 million shares and a 42% tax rate. Management cited anticipated enrollment growth of 31% as the primary driver of revenue growth and indicated the pipeline is the strongest it has seen since 2005. eCollege also expects \$2.4 million in revenue from its new Content Management System, Program Intelligence Manager, and ePortfolio product lines, up from \$794,000 in 2006.

For 1Q07, the company is guiding eLearning revenue of \$14.7-\$14.9 million (an increase of 22%-24%), operating income of \$2.5-\$2.7 million (17%-18% margins), and EPS of \$0.06-\$0.07. Beyond 2007, eCollege anticipates 20% revenue growth and operating margins in the low 30% range for 2008 and 2009. Management provided some detail on the Datamark business as well, including plans to continue to invest in the business.

### **Blackboard Releases New Assessment Product**

Blackboard announced the launch of its new assessment product, called the Blackboard Outcomes System. The highly anticipated release was on schedule. The product was designed to help higher education institutions improve accountability and assessment, a recent area of emphasis, particularly by U.S. Secretary of Education Margaret Spellings, who has proposed changing accreditation requirements. Blackboard consulted a number of higher education institutions during the development process. The product is meant to help improve visibility, meet accreditation standards, and improve assessment capabilities. Blackboard Outcomes System provides Blackboard with another opportunity to cross sell products to existing clients as well as target new clients. Management has previously

indicated that it does not expect the new product to impact revenue until the end of 2007 or early 2008.

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### ***OTHER POST-SECONDARY NEWS***

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#### ***Financial and M&A Activity***

**New Oriental Education & Technology Group Inc. (EDU)** filed a registration statement with the SEC for a secondary offering of 7 million American depositary shares. The company plans to sell 550,242 ADS, and stockholders plan to sell the additional 6.45 million ADS.

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#### ***Personnel Changes***

**Apollo Group, Inc. (APOL)** announced the appointment of James Reis to the board of directors and the board audit committee. Mr. Reis currently holds the position of executive vice president of GAINSCO, Inc.

**Education Realty Trust, Inc. (EDR)** promoted Thomas Trubiana to Senior Vice President and Chief Investment Officer from Senior Vice President of Development. The company also appointed Craig Cardwell as President of Allen & O'Hara Education Services, a division of the company.

**The First Marblehead Corporation (FMD)** named Greg Johnson as executive vice president and chief marketing officer. Mr. Johnson joined the company from Arnold Worldwide where he was the director of Arnold One.

**ITT Educational Services, Inc. (ESI)** announced that Rene Champagne, Chairman and CEO, will step down from the CEO position on April 1. The board of directors elected Kevin Modany to succeed Mr. Champagne as CEO. Mr. Modany is currently President and COO of ITT.

**Lincoln Educational Services Corporation (LINC)** announced the promotion of Shaun McAlmont to President and COO from his position as executive vice president and President of Online. The former President and COO, Lawrence Brown, will assume the new role of Vice Chairman. Scott Shaw was promoted to senior vice president and will assume responsibility for Human Resources and Legal in addition to Strategic Planning and Business Development.

**Universal Technical Institute Inc. (UTI)** announced the appointment of Rick Crain as senior vice president of marketing. Mr. Crain worked as a private consultant prior to joining UTI.

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#### ***Corporate Developments***

**Blackboard Inc. (BBBB)** entered into a partnership with Thinkronize, Inc. to provide Blackboard's K-12 users with direct access to Thinkronize's netTrekker d.i., an educational search engine. The companies introduced a new beta version of the netTrekker Blackboard Building Block for the Blackboard LMS and the Blackboard K-12 Starter Edition.

Chamberlain College of Nursing (owned by **DeVry Inc.**) received approval from the Ohio Board of Regents to open a new campus in Columbus which will begin offering classes in March. The new school will be co-located with the DeVry University and will offer associate and bachelor nursing degree programs.

**Education Realty Trust, Inc. (EDR)** won two management contracts covering six collegiate communities in Michigan and North Carolina. The communities have 3,956 beds and boost the total number of owned and managed beds by the company to 40,742.

**The First Marblehead Corporation (FMD)** entered into a multi-year agreement with E-LOAN to provide facilitation, securitization and program management services relating to the direct-to-consumer private student loan products to be marketed by E-LOAN.

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### **Princeton Freezes Tuition but Increases Cost of Room & Board**

Princeton University announced that it plans to hold tuition constant at \$33,000 per year in 2007-08. The move marks the first time since 1967-68 that tuition did not increase at the school, and comes on the heels of a 4.9% increase in 2006-07 and 5% increase in 2007-08. The College Board estimates that tuition and fees increased 5.9% at four-year private institutions and 6.3% at four-year public institutions during 2006-07. Princeton attributed its ability to hold tuition constant to better returns on investments and increased gifts from alumni. However, Princeton intends to increase the cost for undergrads living on campus with a full meal plan by 19% to \$10,980 from \$9,200, resulting in a 4.2% increase in total costs. Princeton indicated that the increase in room and board costs were to pay for renovations in the university's dining facilities and dormitories.

### **University of Illinois Shifts to Non-Profit Online Plan**

The University of Illinois shelved plans for a for-profit online campus after faculty senates at the university's three campuses voted in opposition to the plan. The university administration accepted an alternative proposal from a group of professors that tied each online program to an existing academic department and was non-profit. The original plan called for a focus on high-demand areas decided on by administrators with teaching done largely by adjunct faculty. Under the new plan, an academic department will create the programs and courses will have a regular faculty member assigned to design and plan it.

### **Unaccredited Universities Losing Hiding Places**

Alabama and Mississippi, two havens for unaccredited universities, may soon close their doors to the schools. Mississippi passed a law last year allowing district attorneys to take unaccredited and unlicensed schools based in the state to court. In the last year, seven of the 11 institutions operating without state approval have closed shop and the state is currently suing another school with two more suits pending. Regulators in Alabama are currently drafting legislation to close loopholes that schools have exploited. The moves follow similar steps taken in Montana and Wyoming, leaving unaccredited institutions with few options in the U.S. (Hawaii). However, California may again become an option for unaccredited schools as Governor Schwarzenegger vetoed a bill to extend the life of the Bureau of Private Postsecondary and Vocational Education.

### **Endowment Returns Increase in F2006**

The Commonfund Institute published its annual Commonfund Benchmarks Study of Educational Endowments. The study, which represents the results of 741 private college and university endowments, independent school endowments, public system funds, and state institution-related foundations, indicated that the average return of all endowments increased 10.6% in F2006 (June for 80% of the participants), versus an average return of 9.7% in F2005. The schools with the top 10% of returns reported returns greater than 16.8%. On average, private institutions reported the highest returns (11.2%), followed by public institutions (10.1%), and independent schools (9.6%). Commonfund Institute's Executive Director John Griswold attributed the greater returns to a shift in allocations more towards private equity real estate and energy, and away from hedge funds.

### **Report Says Colleges Need to Better Prepare Students for Workforce**

The National Leadership Council for Liberal Education & America's Promise (LEAP), an initiative started in 2005 by the Association of American Colleges and Universities

(AAC&U) published a report entitled *“College Learning for the New Global Century.”* The report is a result of a month-long survey of recent college graduates and various employers in an effort to determine what skills are necessary in the 21<sup>st</sup> century to prepare college students for the workforce. The report urges all universities, colleges, and community colleges, regardless of size, to shift more towards a liberal arts education and focus on what the report calls “the essential learning outcomes,” consisting of knowledge of human cultures and the physical and natural world (study of math, sciences, social science, history, humanities, languages, and the arts), intellectual and practical skills (i.e. critical and creative thinking, written and oral communication), personal and social responsibility, and integrative learning. By focusing on such topics, the report postures that college graduates will more likely master the top three qualifications that executives look for in a job candidate: teamwork skills, critical thinking and analytical skills, and oral/written communication.

### The DOE Settles with Nelnet

In the November 2006 edition of Class Notes, we reported that an audit released by the Office of Inspector General for the Department of Education claimed that the National Education Loan Network (Nelnet) overcharged the federal government by \$278 million for loan subsidy payments. The Office of Inspector General believed that Nelnet was improperly using a loophole that was closed in February 2006 by Congress. Nelnet and other education loan providers used the loophole to receive subsidy payments in excess of market-based rates. The Department of Education reached a settlement with Nelnet such that Nelnet would not receive any allowance payments for loans after July 1, 2006, but would retain the payments received prior to that date. Critics complained that Nelnet should not have been allowed to keep any of the subsidies.

### State & Local News

Governor Schwarzenegger of **California** vetoed a bill to extend the life of the Bureau of Private Postsecondary and Vocational Education, citing “fundamental problems” with the bureau. The bureau will be closed as of July 1. The Department of Education will allow students at for-profit schools to apply for Title IV funding despite the impending shutdown of the bureau as long the institutions comply with the state laws. Federal funding could have denied to Californian for-profits students since state authorization is a required component for Title IV eligibility.

**POST-SECONDARY SHORT INTEREST**

Company	Ticker	Short Interest	% Chg M/M	Avg Vol	Days to Cover	Last Month
<b>Post-secondary Education</b>						
Apollo Group, Inc.	APOL	7,209,164	-15%	1,445,382	5.0	2.7
Blackboard, Inc.	BBBB	3,276,386	5%	217,904	15.0	16.3
Capella Education Co.	CPLA	102,120	174%	36,687	7.0	0.4
Career Education Corp.	CECO	6,055,756	-7%	1,173,326	5.2	5.7
Corinthian Colleges, Inc.	COCO	8,697,795	-7%	693,108	12.5	8.6
DeVry, Inc.	DV	2,581,893	-24%	293,588	8.8	8.3
eCollege.com	ECLG	3,773,449	-3%	109,324	34.5	36.9
ITT Educational Services, Inc.	ESI	1,604,813	-3%	349,694	4.6	3.9
Laureate Education, Inc.	LAUR	2,027,923	-15%	357,520	5.7	8.7
Lincoln Educational Services Corp.	LINC	129,622	-12%	48,298	2.7	6.6
Strayer Education, Inc.	STRA	1,308,979	-3%	74,890	17.5	7.5
Universal Technical Institute, Inc.	UTI	2,136,165	-2%	214,006	10.0	7.7

Source: NASDAQ

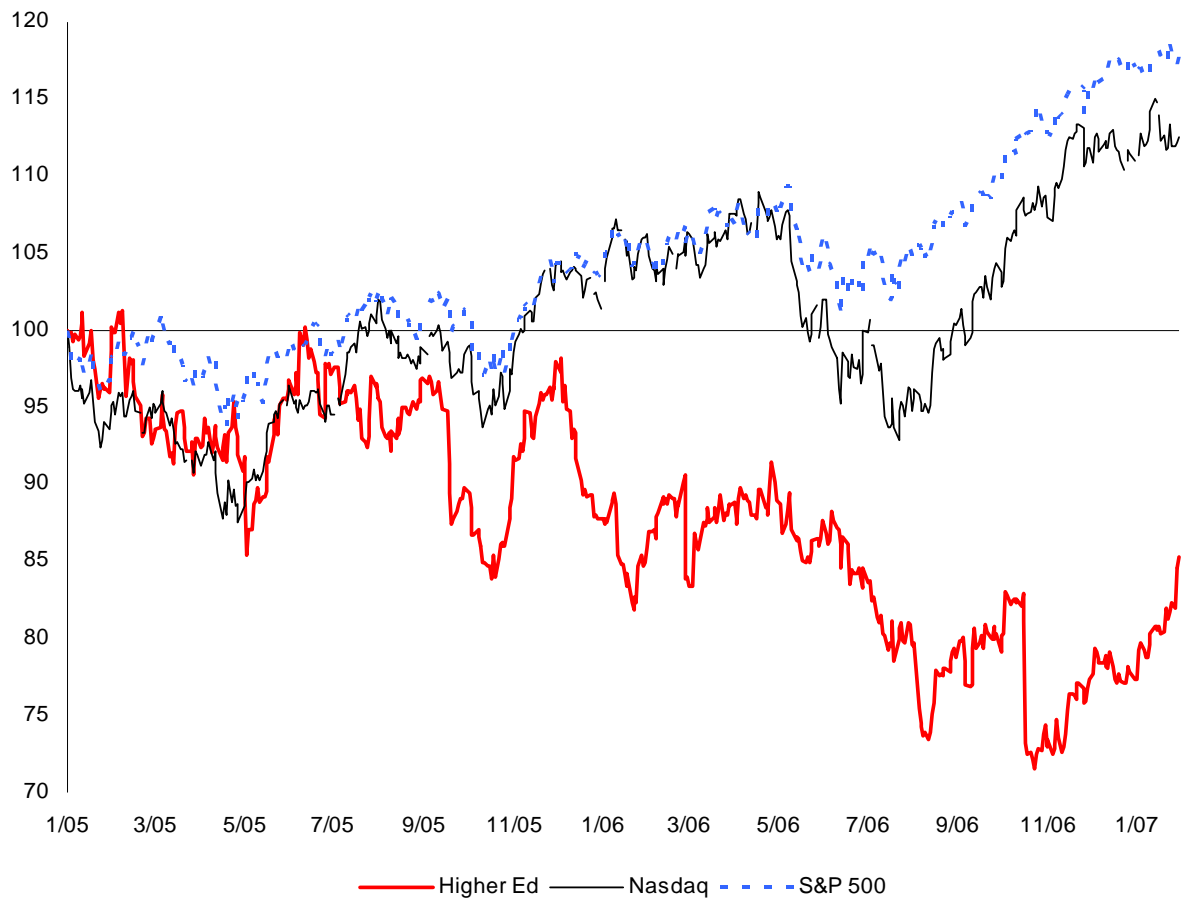
Above are short interest data for select publicly traded post-secondary education companies. The table includes the number of short interest shares as of January 15, the percent change versus the previous month, average daily volume, days-to-cover ratio (short interest divided by average volume) and the previous month's ratio.

Short interest shares declined at most post-secondary companies as the stocks have rallied since the beginning of the year. DeVry decreased the most to 2.6 million shares, down 24% from 3.4 million shares in December. The number of short interest shares peaked in March 2006 at 10.8 million and have been decreasing ever since. However, lower volume during the month caused the days-to-cover ratio to increase to 8.8 days from 8.3 days. In March 2006, the days-to-cover ratio was 22.3 days. Other sizable declines in the number of short interest shares include Apollo Group with a 15% decrease, Laureate (15% decrease), and Lincoln Educational Services (12% decrease).

Only Capella and Blackboard experienced increases in the number of short shares during the month. Capella's short interest shares more than doubled to 102,120 as the newly public company becomes better known and its stock price continues to rise. The number of Blackboard short interest shares have been increasing fairly steadily since January 2006 as the company's patent dispute with Desire2Learn and fears that growth will decelerate weigh on the stock.

For the most part, days-to-cover ratios increased in January, as average volume was lower for most companies. Within the post-secondary sector, eCollege continues to have the highest days-to-cover ratio at 34.5 days, followed by Strayer (17.5 days), and Blackboard (15.0 days). Companies boasting the lowest days-to-cover ratio are Lincoln Educational Services (2.7 days), ITT Educational Services (4.6 days), and Apollo Group (5.0 days).

POST-SECONDARY INDEX VS S&P 500 AND NASDAQ



Source: FactSet

# INTERNATIONAL

## **Trend of Overcrowded Canadian Universities Expected to Reverse**

According to an article from the Canadian Press, universities in Canada are currently overcrowded with students with not enough professors. The trend is due to a spike in enrollment by the children of the baby boom generation, often referred to as the echo boom generation. Statistics Canada reported in November that college enrollment exceeded one million for the first time in 2004-05 and applicants for admission to Ontario's universities increased 5.2% in 2007 on top of 11.7% growth in 2006. The article suggests that the overcrowding could be over in as little as five years as the echo boom generation exits school.

## **India Calls for More Universities**

The National Knowledge Commission (NKC) released a report recommending that India increase the number of universities to 1,500 by 2015 from the current level of roughly 350 schools. Separately, NKC has suggested the establishment of 50 national universities to provide the highest standard of education. In an effort to do away with the existing system of over-regulation, the Commission has further suggested the creation of an Independent Regulatory Authority for Higher Education which would be in charge of entry, accreditation, disbursement of public funds, affirmative action, and license.

## **Saudi Arabia Concerned Over Diploma Mills**

A number of academics in Saudi Arabia are concerned about an increase in diploma mills in the country. Offices are claiming to be educational institutions and selling non-accredited degrees for roughly \$5,300. The concern is that unqualified doctors or engineers entering the workforce could damage the reputation of the occupation and the Saudis in the profession with real degrees.

## EDUCATION PUBLISHING

### McGraw-Hill Reports 4Q06 Earnings

McGraw-Hill Companies reported 4Q06 revenue of \$1.6 billion, up 3% y/y, and inline with the consensus estimate. Revenue growth was driven by Financial Services Group (+22%) and the Higher Education, Professional and International Group (+5%), offset by weakness in School Education Group (-30%). The School Education Group revenue decline was due to a lack of new products and weakness in NCLB market while Higher Education, Professional and International Group revenue growth arose from increasing sales in the science, engineering and math imprint and the business and economics imprint. EPS improved to \$0.59, a \$0.02 increase over the previous year and slightly better than the consensus of \$0.58. Management expects the education market to rebound in 2007 and the company to have double-digit earnings growth.

### Reader's Digest Reports F2Q07 Earnings

Reader's Digest Association reported F2Q07 (December) revenue of \$802 million, up 5% from \$765 million the prior year. The revenue growth was driven by improved sales at RD North America (+11%) and Reader's Digest International (+10), partly offset by lower sales at Consumer Business Services (-9%). Currency fluctuations positively contributed \$25 million of the revenue improvement. EPS improved to \$0.65 from \$0.22 in F2Q06 excluding a \$1.94 goodwill charge associated with Books Are Fun. Free cash flow improved by \$13 million to \$133 million due to a reduction in net debt. The previously announced buyout agreement with Ripplewood Holdings is expected to close by the end of February 2007.

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### OTHER EDUCATION PUBLISHING NEWS

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#### **Financial and M&A Activity**

The Board of Directors of **The McGraw-Hill Companies (MHP)** approved a 12.9% increase in the quarterly dividend and authorized a new stock repurchase program for up to 45 million shares.

#### **Personnel Changes**

Pearson School Companies (**Pearson plc (PSO)**) announced that Michael Golden will join the company on March 1 as vice president, administration and planning. Mr. Golden formerly served as former deputy secretary in the Office of Information and Educational Technology, Pennsylvania Department of Education.

**ProQuest Company (PQE)** announced that Alan Aldworth resigned his positions as Chairman, President and CEO. CFO Richard Surratt assumed the roles of President and CEO. David Asai, previously the company's Controller, is the new CFO. William Oberndorf, was appointed as the new Chairman of Board of Directors.

**Scholastic Corp. (SCHL)** named Maureen O'Connell CFO, chief administrative officer and executive vice president, replacing the former CFO, Mary Winston. Ms. O'Connell was most recently CFO of Affinion Group Inc.

#### **Corporate Developments**

**ProQuest Company (PQE)** announced the launch of VmathLive the new online math resource in which students compete against each other in the US and abroad as practice for high-stakes math tests. VmathLive is part of Voyager Expanded Learning's Voyager's math intervention system, Vmath.

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**EDUCATION PUBLISHING SHORT INTEREST**

Company	Ticker	Short Interest	% Chg M/M	Avg Vol	Days to Cover	Last Month
<b>Educational Publishers</b>						
John Wiley & Sons, Inc.	JWA	294,229	3%	129,418	2.3	0.7
McGraw-Hill Companies, Inc.	MHP	2,329,164	-14%	1,155,359	2.0	2.0
Pearson, plc.	PSO	101,420	-16%	73,500	1.4	1.4
Reader's Digest Association Inc.	RDA	4,879,357	-16%	1,572,200	3.1	2.4
Scholastic Corp.	SCHL	2,694,254	-16%	520,194	5.2	10.9

Source: NASDAQ

Above are short interest data for select publicly traded education publishing companies. The table includes the number of short interest shares as of January 15, the percent change versus the previous month, average daily volume, days-to-cover ratio (short interest divided by average volume) and the previous month's ratio.

With the exception of John Wiley & Sons, all of the companies in our education publishing index experienced a decrease in the number of short interest shares, led by Scholastic which decreased 16% to 2.7 million shares from 3.2 million, Reader's Digest Association, which decreased 16% to 4.9 million from 5.8 million, and Pearson, which also declined 16% to 101,420 shares from 120,445 shares. Scholastic experienced the largest decline in days-to-cover ratio given the decrease in short interest shares as well as higher average volume for the month. However, at 5.2 days, it still remains the highest ratio in the education publishing group, followed by Reader's Digest at 3.1 days. Given John Wiley's increase to 2.3 days, Pearson takes over as the company with the lowest days-to-cover ratio of 1.4 days.

**PUBLISHING INDEX VS S&P 500 AND NASDAQ**



Source: FactSet

## CORPORATE TRAINING

### Saba Reports F2Q07 Results

Saba posted F2Q07 (November) revenue of \$27.8 million (+67% y/y), beating the consensus of \$25.1 million. EPS improved to \$0.07 versus \$0.04 in F2Q06, \$0.01 better than the Street estimate. The company signed a number of deals in the quarter including agreements with AT&T, Deutsche Telekom, Novartis, and Royal Mail. Management expects F3Q07 revenue of \$27.0 million to \$28.0 million and EPS of \$0.07 to \$0.10 versus consensus expectations of \$26 million and \$0.10.

### SumTotal Previews 4Q06 Results and 2007

SumTotal announced that the company expects 4Q06 revenue of \$30.0 million to \$30.2 million, ahead of the consensus estimate of \$29.4 million and adjusted EPS of \$0.07 to \$0.08, inline with the Street expectation of \$0.07. Deferred revenue is estimated to improve to between \$30.4 and \$30.6 million compared to \$26.7 million in 4Q06. Management provided 2007 guidance of revenue between \$130 and \$135 million and EPS of \$0.45 to \$0.48, both better than the consensus of \$128 million and \$0.41.

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### *OTHER CORPORATE TRAINING NEWS*

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#### ***Financial and M&A Activity***

**GP Strategies Corporation (GPX)** announced that it had completed the previously announced acquisition of Sandy Corporation, a custom product sales training provider, from Automatic Data Processing. The purchase price at closing was \$11.7 million. In addition, GP may be required to pay ADP up to an additional \$8.0 million depending on certain revenue targets.

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#### ***Personnel Changes***

**Learning Tree International, Inc. (LTRE)** announced the retirement of Mary Adams, Chief Administrative Officer effective February 15. Ms. Adams had been with the company for 31 years.

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#### ***Corporate Developments***

**Plateau Systems** announced that Reuters will deploy Plateau's fully hosted LMS solution to support and streamline elearning and other learning initiatives across its entire workforce, which encompasses 16,800 employees in 89 countries

**SumTotal Systems (SUMT)** announced that TotalLMS7.5 was judged to conform to the Sharable Content Object Reference Model (SCORM), an e-learning standards initiative sponsored by the U.S. Department of Defense. SCORM is a set of specifications that enable interoperability of Web-based learning content.

**SumTotal Systems (SUMT)** released SumTotal Enterprise Suite 7.5 which helps clients to train across the extended enterprise of customers, partners, and supply chain and distribution channels.

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**CORPORATE TRAINING SHORT INTEREST**

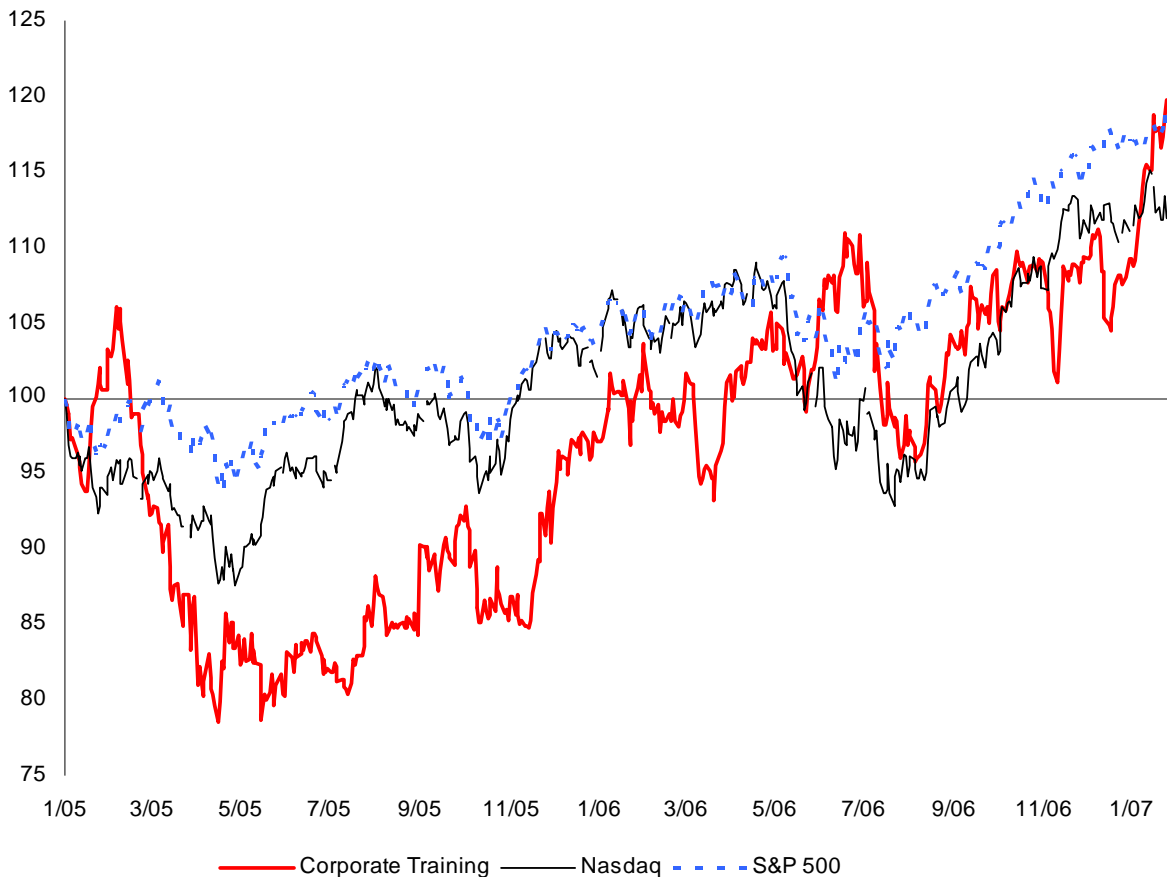
Company	Ticker	Short Interest	% Chg M/M	Avg Vol	Days to Cover	Last Month
<b>Corporate Training</b>						
Learning Tree International, Inc.	LTRE	777,229	-30%	105,745	7.4	27.1
SkillSoft, plc.	SKIL	836,766	28%	487,035	1.7	0.9
SumTotal Systems, Inc.	SUMT	394,206	-9%	110,863	3.6	5.4

Source: NASDAQ

Above are short interest data for select publicly traded corporate training companies. The table includes the number of short interest shares as of January 15, the percent change versus the previous month, average daily volume, days-to-cover ratio (short interest divided by average volume) and the previous month's days-to-cover ratio.

Learning Tree International short interest shares decreased 30% during the month to 777,229 from 1.1 million, following the company's pre-announcement of F4Q06 (September) earnings are expected to be better than previously expected. As a result, the days-to-cover ratio decreased to 7.4 days from 27.1 days the prior month, the lowest level in two years. SkillSoft short interest shares increase 28% to 836,766 and days-to-cover inched up to 1.7 days as the stock has steadily increased on no incremental news. Short interest shares of SumTotal declined 9% to 110,863 and days-to-cover decreased to 3.6 days following the company positive 4Q06 pre-announcement.

**CORPORATE TRAINING INDEX VS S&P 500 AND NASDAQ**



Source: FactSet

# Blackboard, Inc. (BBBB - NASDAQ)

Founded in 1997 and headquartered in Washington D.C., Blackboard is the one of the largest providers of enterprise software applications and related services to the education market including the U.S. post-secondary, international postsecondary, U.S. K-12 and other (e.g., government, education publishers) markets. The company has over 3,500 clients in over 70 countries. The company offers five software applications in two suites, the Blackboard Academic Suite and the Blackboard Commerce Suite. In January 2007, Blackboard announced the launch of its new assessment product, called the Blackboard Outcomes System. Blackboard's annual subscription model (70% of revenue) results in a high level of predictability and visibility. The company also operates a Professional Services segment.

## INVESTMENT SUMMARY

**Solid Growth Opportunity.** We expect Blackboard to achieve revenue growth in excess of 20% and EPS growth greater than 25% over the next several years. We expect growth to come from cross-selling and up-selling opportunities in the U.S. higher education market and further penetration of the K-12 and international markets.

**Market Leader.** Blackboard is a leading provider of enterprise software applications to the education industry. Blackboard's products are used by 30% of the total number of U.S. higher education institutions, 10% of international higher education institutions and 2.5% of U.S. K-12 institutions. The next largest competitor has less than 1% share of the three markets combined.

**WebCT Integration on Track.** Since the acquisition, Blackboard has combined the two sales forces, which are now selling both WebCT and Blackboard products. The company is seeing some early synergies and cost effectiveness. When Blackboard closed the acquisition of WebCT, management guided it to be modestly accretive to non-GAAP cash EPS in 2006 and significantly accretive to non-GAAP cash EPS in 2007. Since March, Blackboard has raised its 2006 revenue and EPS guidance four times.

**Attractive Financial Model.** Blackboard's annual subscription model results in a high level of predictability and visibility. Approximately 70% of revenue is classified as recurring ratable, meaning customers pay for the license upfront and then the company recognizes the revenue on monthly basis over the length of the contract. Given the company boasts renewal rates in excess of 90%, management has 80% visibility into the immediate quarter and 70% visibility into the forward twelve months revenue. Blackboard also enjoys solid cash flow.

**Valuation and Risks.** Our \$36 price target is based on 17x our 2007 cash flow from operations estimate of \$2.12/share. Since mid-2005, Blackboard has traded 15x-30x trailing cash flow. Risks include challenges of selling into the education market, the U.S. higher education market is highly penetrated, competition, availability and integration of acquisitions, and potential backlash from the company's patent dispute.

## STATISTICAL PROFILE

Price (1/31/07): \$29.20 Dividend: \$0.00  
 52-Wk. Range: \$33 – 23 Yield: 0.0%  
**Rating: Outperform**  
**Suitability Rating: Higher Risk**

FY: December	2005A	2006E	2007E
EPS	\$0.95	(\$0.41)	\$0.40
P/E Ratio	30.7	N/M	73.0
Cash Flow/Share	\$1.49	\$0.74	\$2.12
P/CF Ratio	19.6	39.5	13.8

Projected 3-Year EPS Growth Rate:	25%
Book Value (9/30/06):	\$4.75
Market Capitalization (millions):	\$815
Debt/Total Capitalization (9/30/06):	24%
Return on Equity (9/30/06):	N/M
Return on Invested Capital (9/30/06):	4%
Institutional Ownership:	84%
Insider Ownership:	11%
Shares Outstanding (millions):	27.9
Average Daily Trading Volume:	249,669
Headquarters:	Washington, D.C.
IPO/Founded:	2004/1997
Chairman/Founder:	Matthew Pittinsky
CEO/Founder:	Michael Chasen
CFO:	Michael Beach
IR:	Michael Stanton

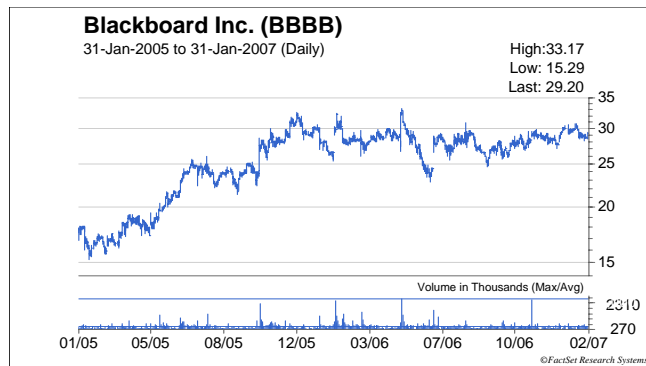


Chart Courtesy of FactSet Research Systems

## Education Universe – Comparable Company Analysis

\$ millions, except per share amounts

Company	Ticker	FY End	Rating	Price Target	Price 01/31/07	52-week range		Performance			Avg. Daily Volume (000s)	Market Cap.	Debt/Cap	ROE (ttm)	Book Value Per Share	Dividend Yield	
						High	Low	1 Mo.	3 Mo.	2006							
<b>K-12 Education</b>																	
Bright Horizons Family Solutions, Inc.	BFAM	December	Neutral	\$40	\$39.17	\$44.98	\$31.80	+1%	+2%	+4%	173	\$1,025	2%	18.8	7.90	0%	
Educate, Inc.	EEEE	December	Neutral	\$8	\$7.81	\$13.10	\$5.06	+10%	+2%	-40%	128	\$336	33%	1.2	4.99	0%	
Leapfrog Enterprises, Inc.	LF	February	NR	–	\$10.72	\$12.72	\$6.71	+13%	+11%	-19%	467	\$671	0%	-20.4	6.76	0%	
Nobel Learning Communities, Inc.	NLCI	June	NR	–	\$11.70	\$11.99	\$8.99	+2%	+14%	+21%	3	\$95	12%	11.2	5.72	0%	
Plato Learning, Inc.	TUTR	October	NR	–	\$5.08	\$10.23	\$4.87	-6%	-13%	-32%	91	\$121	0%	-18.0	5.29	0%	
Princeton Review, Inc.	REVV	December	NR	–	\$5.14	\$6.49	\$4.72	-3%	-1%	+3%	59	\$142	9%	-16.6	1.77	0%	
Renaissance Learning, Inc.	RLRN	December	NR	–	\$14.87	\$18.80	\$10.23	-16%	+0%	-6%	35	\$434	0%	12.5	2.91	1.40%	
School Specialty, Inc.	SCHS	April	Neutral	\$38	\$38.95	\$39.60	\$30.12	+4%	-1%	+3%	263	\$857	33%	4.7	25.84	0%	
Scientific Learning, Inc.	SCIL	December	NR	–	\$6.10	\$6.30	\$3.82	+11%	+26%	-3%	7	\$103	0%	NM	-0.04	0%	
<b>K-12 Index (Market Cap Weighted)</b>								<b>+3%</b>	<b>+3%</b>	<b>-6%</b>							
<b>Post-Secondary Education</b>																	
Apollo Group, Inc.	APOL	August	Neutral	\$37	\$43.40	\$59.79	\$33.33	+11%	+17%	-36%	2,661	\$7,510	0%	63.0	3.93	0%	
Blackboard, Inc.	BBBB	December	Outperform	\$36	\$29.20	\$33.17	\$22.78	-3%	+5%	+4%	250	\$819	5%	-2.1	4.75	0%	
Capella Education Co.	CPLA	December	NR	–	\$28.42	\$29.50	\$23.29	+17%	NA	-3%	137	\$437	0%	NA	2.41	0%	
Career Education Corp.	CECO	December	Neutral	\$27	\$28.67	\$42.59	\$17.60	+16%	+29%	-27%	1,499	\$2,715	1%	19.4	10.00	0%	
Corinthian Colleges, Inc.	COCO	June	Neutral	\$13	\$13.06	\$15.36	\$10.50	-4%	+7%	+16%	882	\$1,128	4%	8.0	4.63	0%	
DeVry, Inc.	DV	June	Neutral	\$30	\$28.16	\$29.90	\$19.75	+1%	+16%	+40%	411	\$1,994	2%	9.3	8.48	0.36%	
eCollege.com	ECLV	December	NR	–	\$16.53	\$25.73	\$10.96	+6%	-4%	-13%	158	\$368	5%	6.5	4.52	0%	
ITT Educational Services, Inc.	ESI	December	NR	–	\$77.60	\$77.12	\$57.48	+17%	+13%	+12%	408	\$3,185	4%	57.7	3.09	0%	
Laureate Education, Inc.	LAUR	December	Neutral	\$60	\$60.34	\$62.15	\$40.52	+24%	+14%	-7%	403	\$3,102	12%	9.3	20.00	0%	
Lincoln Educational Services Corp.	LINC	December	Neutral	\$14	\$12.12	\$18.45	\$11.35	-10%	-27%	-5%	40	\$308	8%	13.7	5.52	0%	
New Oriental Educ. & Tech. Group	EDU	May	NR	–	\$35.73	\$39.62	\$20.60	+7%	+48%	+32%	305	\$893	3%	NA	6.08	0%	
Strayer Education, Inc.	STRA	December	Neutral	\$116	\$113.77	\$118.88	\$87.56	+7%	+1%	+13%	134	\$1,634	0%	31.0	11.45	1.10%	
Universal Technical Institute, Inc.	UTI	September	NR	–	\$23.65	\$37.71	\$17.00	+6%	+18%	-28%	245	\$632	0%	27.6	4.05	0%	
<b>Post-Secondary Index (Market Cap Weighted)</b>								<b>+11%</b>	<b>+15%</b>	<b>-8%</b>							
<b>Educational Publishers</b>																	
John Wiley & Sons, Inc.	JWA	April	NR	–	37.16	\$41.80	\$31.60	-3%	+5%	-1%	226	\$2,126	9%	25.1	7.52	1.13%	
McGraw-Hill Companies, Inc.	MHP	December	NR	–	67.08	\$69.98	\$47.80	-1%	+5%	+32%	1,394	\$23,760	NA	30.6	6.14	1.25%	
Pearson, plc.	PSO	December	NR	–	15.77	\$16.64	\$12.29	+4%	+7%	+27%	111	\$12,591	25%	8.5	7.62	3.60%	
ProQuest Company	PQE	December	NR	–	11.10	\$29.79	\$8.96	+6%	-13%	-63%	387	\$332	63%	19.0	10.61	0%	
Reed Elsevier, plc.	RUK	December	NR	–	45.84	\$48.40	\$35.78	+4%	+1%	+17%	22	\$14,252	0%	29.6	5.66	2.67%	
Scholastic Corp.	SCHL	May	NR	–	35.35	\$36.83	\$24.99	-1%	+13%	+26%	352	\$1,503	27%	4.9	23.67	0%	
<b>Education Publishers Index (Market Cap Weighted)</b>								<b>+1%</b>	<b>+4%</b>	<b>+25%</b>							
<b>Corporate Training</b>																	
GP Strategies Corp.	GPX	December	NR	–	\$8.54	\$8.60	\$6.60	+3%	+6%	+2%	35	\$135	8%	11.3	4.91	0%	
Healthstream, Inc.	HSTM	December	NR	–	\$4.40	\$5.14	\$2.50	+11%	+30%	+70%	29	\$96	0%	9.9	1.27	0%	
Learning Tree International, Inc.	LTRE	September	NR	–	\$10.53	\$12.66	\$7.19	+18%	+21%	-31%	57	\$174	0%	1.5	3.68	0%	
Saba Software, Inc.	SABA	May	NR	–	\$7.37	\$7.36	\$4.86	+18%	+24%	+53%	131	\$210	3%	-26.1	1.76	0%	
SkillSoft, plc.	SKIL	January	NR	–	\$6.95	\$6.98	\$4.60	+12%	+10%	+13%	620	\$709	0%	17.9	1.15	0%	
SumTotal Systems, Inc.	SUMT	December	NR	–	\$7.13	\$7.77	\$4.20	+18%	+12%	+34%	126	\$184	7%	-21.2	2.91	0%	
<b>Corporate Training Index (Market Cap Weighted)</b>								<b>+13%</b>	<b>+14%</b>	<b>+19%</b>							
<b>S&amp;P500</b>					<b>SPX</b>	<b>1,438.24</b>	<b>1,441</b>	<b>– 1,219</b>	<b>+1%</b>	<b>+4%</b>	<b>+14%</b>						

Sources: SEC documents, FirstCall, FactSet, Robert W. Baird Estimates for APOL, BBBB, BFAM, CECO, COCO, DV, EEEE, LAUR, LINC, SCHS, and STRA

## Education Universe – Comparable Company Analysis

\$ millions, except per share amounts

Company	Ticker	Revenue				EPS			Price/Earnings			EV/ EBITDA (TTM)	FCF TTM	FCF (TTM) Yield	Price/ Sales	Price/ Book			
		F2006E	% Change	F2007E	% Change	C2005A	C2006E	C2007E	C2005A	C2006E	C2007E								
<b>K-12 Education</b>																			
Bright Horizons Family Solutions, Inc.	BFAM	698.4	12%	784.7	12%	1.29	1.51	1.80	30.3x	26.0x	21.7x	12.0	22.2	2.2%	1.5	4.96			
Educate, Inc.	EEEE	357.2	8%	393.8	10%	0.52	0.03	0.30	15.0x	NM	26.4x	17.7	(1.7)	-0.5%	1.0	1.57			
Leapfrog Enterprises, Inc.	LF	513.5	-21%	519.6	1%	0.28	(1.97)	(0.41)	38.3x	NM	NM	NA	48.4	7.2%	1.2	1.59			
Nobel Learning Communities, Inc.	NLCI	NA	NA	NA	NA	0.37	NA	NA	31.6x	NA	NA	6.7	4.4	4.7%	0.6	2.05			
Plato Learning, Inc.	TUTR	90.7	-26%	82.1	-10%	(0.39)	(0.51)	(0.38)	NM	NM	NM	23.7	3.8	3.2%	1.3	0.96			
Princeton Review, Inc.	REVV	142.4	9%	156.9	10%	(0.16)	(0.15)	0.10	NM	NM	51.4x	48.9	(3.9)	-2.7%	1.0	2.90			
Renaissance Learning, Inc.	RLRN	111.5	-4%	118.1	6%	0.80	0.41	0.60	18.6x	36.3x	24.8x	14.2	14.8	3.4%	3.9	5.11			
School Specialty, Inc.	SCHS	1,015.7	1%	1,089.8	7%	1.48	1.27	2.23	26.3x	30.7x	17.5x	11.7	51.2	6.0%	0.8	1.51			
Scientific Learning, Inc.	SCIL	39.9	-1%	50.9	28%	0.31	(0.02)	0.16	19.7x	NM	38.1x	NA	(1.3)	-1.2%	2.7	NM			
<b>K-12 Average</b>									<b>25.7x</b>	<b>31.0x</b>	<b>30.0x</b>	<b>19.3</b>		<b>2.5%</b>	<b>1.6</b>	<b>2.58</b>			
<b>Post-Secondary Education</b>																			
Apollo Group, Inc.	APOL	2,476.3	10%	2,586.3	4%	2.60	2.42	2.49	16.7x	17.9x	17.4x	9.1	435.4	5.8%	3.0	11.06			
Blackboard, Inc.	BBBB	182.0	34%	233.6	28%	0.95	(0.41)	0.40	30.7x	NM	72.3x	56.8	17.6	2.1%	4.9	6.15			
Capella Education Co.	CPLA	179.5	20%	209.9	17%	NA	1.02	0.99	NA	27.9x	28.9x	NA	NA	NA	2.6	11.80			
Career Education Corp.	CECO	1,968.4	-3%	1,873.9	-5%	2.32	1.54	1.40	12.4x	18.6x	20.4x	6.3	217.4	8.0%	1.4	2.87			
Corinthian Colleges, Inc.	COCO	966.6	0%	976.2	1%	0.57	0.41	0.52	22.9x	32.0x	25.1x	12.8	(1.7)	-0.2%	1.2	2.82			
DeVry, Inc.	DV	843.3	8%	947.1	12%	0.46	0.74	0.93	61.7x	38.2x	30.4x	14.9	97.3	4.9%	2.2	3.32			
eCollege.com	ECLG	52.3	-49%	63.4	21%	0.50	0.38	0.48	33.1x	43.7x	34.3x	15.5	13.0	3.5%	3.2	3.65			
ITT Educational Services, Inc.	ESI	853.1	24%	957.2	12%	2.36	2.72	3.21	32.9x	28.5x	24.2x	14.8	136.5	4.3%	4.2	25.15			
Laureate Education, Inc.	LAUR	1,130.7	29%	1,341.0	19%	1.66	2.00	2.50	36.4x	30.1x	24.1x	16.8	9.9	0.3%	2.9	3.02			
Lincoln Educational Services Corp.	LINC	323.0	8%	348.0	8%	0.76	0.62	0.75	15.9x	19.6x	16.2x	6.9	2.5	0.8%	1.0	2.19			
New Oriental Educ. & Tech. Group	EDU	124.9	30%	151.2	21%	NA	NA	0.79	NA	NA	45.4x	NA	NA	NA	9.3	5.88			
Strayer Education, Inc.	STRA	263.7	20%	310.1	18%	3.26	3.58	4.20	34.9x	31.8x	27.1x	17.7	48.2	2.9%	6.5	9.94			
Universal Technical Institute, Inc.	UTI	347.1	12%	360.5	4%	1.19	0.90	0.72	19.9x	26.1x	32.9x	10.2	(0.7)	-0.1%	1.8	5.84			
<b>Post-Secondary Average</b>									<b>28.9x</b>	<b>28.6x</b>	<b>30.7x</b>	<b>16.5</b>		<b>3.0%</b>	<b>3.4</b>	<b>7.21</b>			
<b>Educational Publishers</b>																			
John Wiley & Sons, Inc.	JWA	1,199.0	15%	1,656.3	38%	1.56	1.64	1.55	23.8x	22.7x	24.0x	9.8	177.2	8.3%	1.9	4.94			
McGraw-Hill Companies, Inc.	MHP	6,255.1	4%	6,769.1	8%	2.27	2.52	2.89	29.6x	26.6x	23.2x	12.6	1,251.2	5.3%	3.8	10.93			
Pearson, plc.	PSO	8,266.5	17%	8,111.5	-2%	0.59	0.76	0.82	26.7x	20.8x	19.2x	8.6	781.2	6.2%	1.7	2.07			
ProQuest Company	PQE	115.0	NA	130.0	13%	(1.88)	(2.19)	0.26	NM	NM	42.7x	4.5	22.5	6.8%	0.6	1.05			
Reed Elsevier, plc.	RUK	10,279.0	9%	NA	NA	2.17	2.63	2.84	21.1x	17.5x	16.1x	NA	NA	NA	1.5	8.10			
Scholastic Corp.	SCHL	2,182.5	-4%	2,386.5	9%	1.65	1.71	2.17	21.4x	20.6x	16.3x	6.6	(0.4)	0.0%	0.7	1.49			
<b>Education Publishers Average</b>									<b>1.35</b>	<b>1.44</b>	<b>1.93</b>	<b>24.5x</b>	<b>21.6x</b>	<b>25.8x</b>	<b>8.4</b>		<b>5.3%</b>	<b>1.7</b>	<b>4.76</b>
<b>Corporate Training</b>																			
GP Strategies Corp.	GPX	178.6	2%	222.4	25%	0.29	0.41	0.61	29.4x	20.7x	14.0x	9.1	16.6	12.3%	0.8	1.74			
Healthstream, Inc.	HSTM	31.6	15%	35.1	11%	0.09	NA	NA	48.9x	NA	NA	15.5	4.5	4.7%	3.1	3.47			
Learning Tree International, Inc.	LTRE	162.4	7%	NA	NA	0.07	0.12	NA	145.2x	86.0x	NA	11.3	(2.1)	-1.2%	1.1	2.86			
Saba Software, Inc.	SABA	105.7	49%	120.5	14%	(0.07)	0.21	0.42	NM	35.2x	17.5x	NA	(5.1)	-2.4%	2.3	4.19			
SkillSoft, plc.	SKIL	224.4	4%	240.4	7%	0.17	0.21	0.27	41.9x	33.6x	26.2x	13.1	31.7	4.5%	3.2	6.03			
SumTotal Systems, Inc.	SUMT	110.4	47%	132.0	20%	(0.07)	0.24	0.44	NM	29.5x	16.2x	196.4	0.0	0.0%	1.8	2.45			
<b>Corporate Training Average</b>									<b>78.7x</b>	<b>46.1x</b>	<b>18.9x</b>	<b>49.1</b>		<b>3.0%</b>	<b>2.1</b>	<b>3.46</b>			
<b>S&amp;P500</b>					<b>SPX</b>	<b>76.28</b>	<b>87.42</b>	<b>92.60</b>	<b>18.9x</b>	<b>16.5x</b>	<b>15.5x</b>								

Sources: SEC documents, FirstCall, FactSet, Robert W. Baird Estimates for APOL, BBBB, BFAM, CECO, COCO, DV, EEEE, LAUR, LINC, SCHS, and STRA

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