

To: The McIntire Investment Institute Long Fund
From: Waqas Malik
Subject: Education Management Corporation (EDMC)
Date: November 22, 2002



Price (as of 11/21/02)	\$38.60
Market Cap:	\$1.376B
Volume:	338,640
Shares Out:	35.27M

Profile

Education Management Corporation is a provider of private post-secondary education in United States and Canada. It operates in 42 campus locations in 26 major cities. Corporate Headquarters are located in Pennsylvania. It offers its services through three different divisions: Art Institute and Argosy. EDMC's Art Institutes provide degrees in the areas of creative and applied sciences designed to train a student for entry-level positions in fields such as graphic design, web design, and media production. EDMC's Argosy division offers undergraduate and graduate degrees in the areas of psychology, health sciences, education, business, and law. Lastly, through ITI Information Technology Institute, EDMC offers a graduate business and technology program. About 90% of EDMC's revenue comes from its Art Institutes and the rest from the other two divisions.

Market

The market for post-secondary education is both HS grads and adult learners, both groups whose numbers are getting larger. Many adult learners have to increase their degree level and others simply want to learn more trades.

Brief History

Company was founded in 1962 in Pennsylvania and made its first acquisition in 1970: The Art Institute of Pittsburgh. During the 1970s and 1980s, EDMC grew though starting and acquiring eight additional schools. Completed an initial public offering in October of 1996.

Long Thesis

Management has a proven track record. Each of the top 6 Executive officers has an average of 20 years experience in the education industry. There has been no incident of fraud or corporate irresponsibility.

- Robert B. Knutson – Has been CEO since 1986 and a director since 1969. Has been regarded as a reputable and dedicated leader, which is proven by the amount of time he has spent w/ EDMC. Prior to EDMC, Knutson was with JP Morgan and later Morgan Guaranty Trust Company where he had great success and moved up the ranks before being recruited to EDMC.
- Robert P. Gioella – Has been President and COO since 1999. He has been with the company as president of Art Institute of Philadelphia and VP of Operations.
- John R. McKernan, Jr. – Vice Chairman since 1999, Governor of Maine from 1987 to 1995. As governor, was very influential in Maine's educational policies and programs.

Not as vulnerable to market downturns because of the industry it is in. The Educational services industry has proven in the past to maintain stable or even grow while other industries experience downturns. For example, in the past year compared to Nasdaq, EDMC stock grew around 20%.

Education is a growth industry. Especially in current market conditions, more and more people decide to go back to school, increasing the demand for post-secondary education. Also, according to the US Department of Education, a positive demographic factor of some 20% more students are expected to be enrolled in higher education in the next ten years.

EDMC makes smart acquisitions and builds them into profitable institutions. The basic business model is that EDMC acquires small colleges of no more than a couple of hundred enrollment, or opens new schools. It implements its business strategy to its acquisitions and builds them into profitable returns. Business strategy after acquisition includes: substantially increasing expenditures on classroom technology, increasing rate of new education program development, implementing initiatives to improve student completion rates and graduates' starting salaries.

EDMC is continuing to grow and improve its services. Average student enrollment has grown more than 15 % per year over past 5 years, revenues have grown in excess of 20% and earnings per share have grown at a bit north of 23%.

One service it concentrates on is its career counseling and job placement. Last year approximately 90% of Arts Institutes graduates obtained jobs in their field within six months of graduation.

EDMC's acquisitions have potential to give significant returns in future. Specifically, the acquisition of Argosy, which enlarged the student base by 25%, broadened their curriculum and degree offerings, and was immediately accretive to earnings.

EDMC's Recruitment and Marketing efforts are highly successful as well as innovative. In past fiscal year, referrals from alumni and employers accounted for 34% of new student enrollment at the Art Institutes. This speaks volume to EDMC's commendable reputation as a quality institute and satisfaction of alumni. Also, EDMC has initiated new marketing techniques such as international marketing efforts, college fairs, and online advertising.

Offers very specific oriented programs to students and prides itself on its dedication to student satisfaction. EDMC is known for providing academic programs that directly relate to the needs of the economy. Also, it has practicing professionals as faculty members and a high level of technology in the classroom reflective of the workplace atmosphere. Decent amount of staff resources are designed to advise students regarding academic and financial matters, housing, and career counseling. Many students attracted to EDMC's institutions because of the small class sizes allowing for more one to one interaction w/ professors. Average class size for Art Institutes is 25, and for Argosy graduate program is 15.

Future outlook for EDMC is positive. Over past 5 years average tuition for Art Institute specialized degree has increased about 4% (avg. right now is about \$28,500). This along w/ increased enrollment reflects consumer satisfaction and increased profitability. Concentration as EDMC goes forward is on supporting growth of Art Institutes by expanding to new locations through startup or acquisition, and investing in making Argosy and ITI divisions as profitable as Art Institutes are.

Risks

Tuition increase might hurt more than help EDMC. Tuition has steadily been increasing and it can b/c its institutions are private. Potentially, more people might be dissuaded by this and go back to public education as it is way cheaper. This might be even truer in this economy, where people might be forced to delay expensive schools.

Barrier to Entry is Relatively low. It is relatively easy for potential competitors to enter the Education Industry and thereby cutting down on EDMC's profits and customer base.

Is EDMC overvalued? Valuation always matters. If the market rebounds, it is possible that people will shift their money to finance, tech companies, where there is more fire in the stock.

Too much riding on Management. CEO Robert Knutson and his wife own 11% of the company. Even though there has been no reported corruption, you never know in this post-Enron era.

Competition could be problem. EDMC's competition, which includes better-known and bigger companies like ITT Technical Institutes and Devry, could pose a problem in the long run. Since these companies are better known and have been in the business much longer than EDMC, they could potentially capture EDMC's customers.

Financial Debt could reduce long-term profitability. Financially speaking, EDMC compared to ITT and Devry has more long-term debt. (As of 2001 fiscal year EDMC long-term debt= \$53 million, ITT and Devry long-term debt = \$0)

Value-Added Research

Stephen Lally (professor of psychological consultation at Argosy University)-

- Graduated from UNC Chapel Hill
- “I have been teaching at Argosy for a number of years, and since EDMC has gotten involved I have noticed a significant improvement in programs and services. For example, more technological presence in the classroom, and also more emphasis on student-professor interaction (result of smaller class sizes).”

- “Personally, I am very satisfied with my duties and responsibilities w/ Argosy.”

Scott (Investor Relations Representative from EDMC Corporate Headquarters)

Q: What new measures have you taken that will improve your services?

A: Over past couple of years we have been working hard to integrate new technological services into the classroom such as online courses.

Q: What is EDMC’s strategy for the future?

A: Our concentration going forward is on supporting the growth of the Art Institutes and expanding the Argosy system. We will always continue to invest in our facilities, classroom technology, and employees for the benefits of the students.

Q: What makes you different from your competition such as Devry, or ITT?

A: We think of ourselves as unique in many ways. For example, I would point to diversity of our academic services and programs, and the fact that they appeal to a broad range of students.

P.S. I tried to talk to current students at EDMC’s educational institutions but there were not any student directories that had contact information online. Also when I called them, they refused to disclose the information saying that they did not want to disclose contact information of students.