Siena Market Line
1st week of March 2015

Grand Canyon Education, Inc.

NasdaqGS: LOPE

Analyst: Benjamin Lunaud
Sector: Education Services

BUY

Price Target: $56.2

Key Statistics as of 3/05/2015

Market Price:	$44.79
Industry:	Education Services
Market Cap:	$ 2,103.9 M
52-Week Range:	$36.95-51.99
Beta:	0.93

Thesis Points:

- Demand should increase more than expected
- Revenue per student should increase more than expected
- New investments should lead to more revenues
- Conversion to nonprofit organization

Company Description:

Grand Canyon Education, Inc., together with its subsidiaries, provides postsecondary education services in the United States and Canada. It offers approximately 160 graduate and undergraduate degree programs in the fields of education, healthcare, business, teaching, nursing, professional, and liberal arts. The company offers its programs across eight colleges both online and on ground through campus in Phoenix, Arizona; leased facilities; and facilities owned by third party employers. As of December 31, 2014, it had 67,806 students enrolled in its programs. The company was founded in 1949 and is based in Phoenix, Arizona.

Thesis

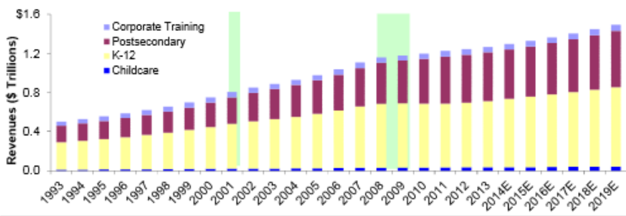
LOPE is undervalued and revenue expectations from management and analysts are underestimated. A new department has been created (IT and engineering) and demand should increase faster than expected. This should lead to an increased number of students in the university. Also, ground students are increasing faster than online students and the percentage of students living on campus is increasing, meaning that revenue per student will increase as well. A possible increase in tuition if necessary is still possible and will generate again more revenue. Therefore, value would be created as LOPE is able to control its costs. Additionally, LOPE is looking for a conversion to a nonprofit organization and should be ready to buy back its shares at a premium.

Management

Brent Richardson (Executive Chairman of the Board), has been serving as LOPE's Executive Chairman since July 1, 2008. From 2000 to 2004, Mr. Richardson served as Chief Executive Officer of Masters Online, LLC, a company that provided online educational programs and marketing services to several regionally and nationally accredited universities.
Brian Mueller (CEO, President and Director) and Dr. W. Stan Meyer (COO) have been serving as the President of the Grand Canyon University Foundation, a foundation formed to benefit public charities.
LOPE management has had previous experiences in the online business education allowing LOPE to benefit from this experience. More importantly, they are involved in a foundation formed to benefit public charities. It makes the university eligible to become a nonprofit organization, which is one of the main goals of Grand Canyon University (GCU).

Industry Overview

Exhibit 3. U.S. Education Industry Revenues (1993–2019E)



Education is representing a $1 trillion industry or 10% of America's GNP and second in size only to the health care industry. Growth expectations are still bullish in this sector on the long term prospect. Growth in the for-profit education sector has slowed, but is expected to grow by 3.8 percent annually for the next five years, to reach $145 billion in 2019 (see graph). Concerning online education, growth is expecting to be even faster for companies using technology as part of their services delivery and should outperform other traditional models. Online delivery model has become more accepted and the programs' quality is not a problem anymore. Indeed, online classes allow real-time updates and ability for customization. Even if traditional learning classroom will probably be never replaced, the combination of both online courses and traditional education is a real asset for universities.
On the other hand, the industry is threatened by government interventions. Obama has proposed regulations asking for-profit sector to provide tuition assistance to students based on their performances such as graduation rates, student income and debt after graduation. Also, Obama administration proposed a program that would allow students to have two years of free community colleges, meaning a decrease in demand for other universities.
By providing a traditional college experience, LOPE is not really threatened by this last regulation. Also, LOPE is providing an education of quality allowing students to succeed after graduation. This should reduce the risk of the first regulation.

More importantly, LOPE is trying to become a non-profit organization. If they succeed, they will not be affected by such regulations.

Porter Five Forces

Threat of new entrants is actually low in this industry. There is already too many competitors with a total of 4,599 Title IV-eligible in the US (degree-granting institutions: 2,870 4-year institutions and 1,729 2-year institutions). Also, costs are consequent and require a lot of infrastructures, staffs and teachers. It necessitates expenses in advertising and marketing as well, meaning a lot of SG&A expenditures. LOPE would have to be more competitive with existent competitors but is not really threatened by new entrants. LOPE will still be profitable as it was already able to increase its margins with the existing competition.
Substitutes are probably low as education and diplomas are a requirement to adapt to our current society. There are people looking for an in-home education but it does not really threaten the demand for LOPE. One other substitute for traditional education could be online classes but LOPE is already providing this alternative. Therefore, Grand Canyon University is not threatened

by a decrease in demand.

Suppliers Bargaining Power is low since a lot of universities are providing the same services. With an important source of supplier in this industry, universities are not able to raise considerably their prices. On the other hand, LOPE has not increased its tuition prices over the last 6 years and housing prices over the last 2 years and announced in the last earning call that they will be able to raise their prices and still be competitive as a low cost provider. This is a potential for more revenues per student for LOPE.

Buyer bargaining power is high even if demand for university education is substantial. Universities are asking for high quality students and they have to propose scholarships, reducing considerably their revenues. LOPE managers said at the earning calls that scholarships will increase by 1% as a percentage of revenue but this is not a factor that will reduce considerably their revenues.

Rivalry is important in the education industry and will increase with the apparition of new low cost providers. Also, technology allows universities to reduce considerably their costs and will increase the possibility to see new entrants in the future. It is also likely that current institutions will become more competitive. In addition, geographical location is becoming less a constraint for students, increasing again rivalry amongst universities.

Grand Canyon University main competitors in Arizona are: Arizona State University, Northern Arizona University and University of Arizona. LOPE has some competitive advantages allowing the university to increase its profitability and increase its margins. First, LOPE is a low cost provider. The price of one course starts at only $350 and the average tuition in Arizona is $13,000 compared to $7,000 for Grand Canyon University. Also, a room on campus cost $6,500 compared to an average of $11,000 within the US. Also, by providing most of its courses online, materials are providing electronically and it reduces costs for students as they do not have to buy $200-$300 books. Another competitive advantage is the quality of the education provided by GCU. 75% of pre-med students receive admission to medical school compared to an average of 42% in other universities. There is 90%-97% nursery pass rate on the NCLEX compared to a national average of 82%. There is 100% placement rate with the traditional nursing graduates, 100% placement rate within the traditional teaching graduates and a 90% placement rate with the traditional business graduates. GCU expects the same rate for its new college of science with sectors technology and engineering. Finally, GCU has an innovative business method as it provides online courses and it is ranked in the top 30 online schools in the US, allowing it to compete with a majority of traditional schools. It also provides lower costs for online classes than its peers.

These competitive advantages allow LOPE to increase demand for its classes, therefore increasing its number of

	December 31, 2014(1)		December 31, 2013(1)	
	# of Students	% of Total	# of Students	% of Total
Graduate degree (2)	26,319	38.8%	22,476	37.7%
Undergraduate degree	41,487	61.2%	37,182	62.3%
Total	67,806	100.0%	59,658	100.0%

	December 31, 2014(1)		December 31, 2013(1)	
	# of Students	% of Total	# of Students	% of Total
Online(3)	55,060	81.2%	49,580	83.1%
Ground (4)	12,746	18.8%	10,078	16.9%
Total	67,806	100.0%	59,658	100.0%

students. Online enrolment grew by 11.1% from 49,580 students in 2013 to 55,060 in 2014 (Chart above). The number of ground students increased faster by 26% between 2013 and 2014 to 12,746 students. By increasing the number of students LOPE was able to increase its revenue even faster.

Past performances

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	Current/LTM	FY 2015 Est	FY 2016 Est
	2008-12-31	2009-12-31	2010-12-31	2011-12-31	2012-12-31	2013-12-31	2014-12-31	2014-12-31	2015-12-31	2016-12-31
Revenue, Adj	161.3	261.9	385.6	426.7	511.3	598.3	691.1	691.1	773.1	851.5
Growth %, YoY	--	62.4	47.2	10.7	19.8	17.0	15.5	15.5	11.9	10.1
Gross Profit, Adj	106.9	174.3	206.8	231.9	290.9	343.9	402.3	402.3	449.8	494.9
Margin %	66.2	66.6	53.6	54.4	56.9	57.5	58.2	58.2	58.2	58.1
EBITDA, Adj	17.9	61.0	79.8	100.0	136.0	168.7	214.6	214.6	246.7	275.1
Margin %	11.1	23.3	20.7	23.4	26.6	28.2	31.1	31.1	31.9	32.3
Net Income, Adj	5.7	31.5	41.4	51.1	69.4	88.7	114.6	114.6	126.1	141.0
Margin %	3.6	12.0	10.7	12.0	13.6	14.8	16.6	16.6	16.3	16.6
EPS, Adj	0.17	0.69	0.89	1.13	1.53	1.92	2.44	2.44	2.65	2.92
Growth %, YoY	--	306.9	29.1	26.7	35.2	25.5	26.9	26.3	8.7	10.4
Cash from Operations	10.2	61.2	84.1	88.0	144.2	118.4	167.0	167.0	130.5	180.1
Capital Expenditures	-8.4	-24.8	-62.6	-80.5	-97.7	-78.9	-168.6	-168.6	-191.2	-110.1
Free Cash Flow	1.9	36.4	21.5	7.4	46.5	39.5	-1.7	-1.6	-60.7	70.0

Revenues increased by 15.5% between 2013 and 2014 to $691.1 million. EBITDA margin increased over the last 5 years to reach 31.1% in 2014. LOPE has been able to control its costs and to increase its revenue faster allowing the university to increase the value of the company. More importantly, LOPE has been able to increase its margins with frozen tuition and housing prices. Cash from operations increased over the last 5 years and increased by 41% in 2014 from $118.4 million to $167 million. EPS grew by 23.74% from 2013 to 2014. LOPE has been able to beat analysts' estimates for 17 consecutive quarters and will be able to continue to do so.

Financials: LOPE vs Industry

LOPE is also doing better than its industry average over the past years. Revenue and EBITDA growth were negative for the industry compared to an increase of 15.5% and 24.4% respectively for LOPE. Net income growth was 25.65% in 2014 for LOPE compared to 3.60% for the average industry. ROE is 27.15% for LOPE compared to 7.36% for its industry. ROA is 16.24% for LOPE and is higher than the competition with a ROA of 16.25%. According to Bloomberg, ROIC was 24.40% for LOPE better than the industry with a ROIC of 14.85%. Concerning the debt, LOPE has a negative net debt of $79 million and a TIE of 96.46x, more than 4 times higher than its competitors. Overall, LOPE did better than its industry average over the last few years in term of debt management, liquidity and profitability.

Value drivers

LOPE should continue to outperform its industry over the next few years. Revenue growth should be higher than LOPE's estimates and analysts' estimates.

First, demand is increasing every year and is supposed to be higher than LOPE expectations. From 2013 to 2014, the number of students increased by 14%. LOPE is forecasting 75,600 students in 2015 or an increase of only 11.49%. LOPE is proposing attractive programs at low costs and has a growing brand name. LOPE just created for 2015 a new science department with two new sectors being computer engineering and information technology. Looking at other department performances, demand for these two new areas should be high and LOPE expects the same degree of placement rate than in the other areas. This should bring even more students to the university. Also, by announcing that they will be a nonprofit organization, LOPE will not have to pay taxes and will be able to propose even lower costs for students. The demand should increase and the number of students should increase even faster than 11.49%. This will increase the revenue faster than expected.

Then, more students are expecting to live on campus. At the end of 2014, 60% of students were living on campus. LOPE is expecting almost 7,800 new students. Adding more students should reduce the percentage of students living on campus. However, LOPE is expecting 70% of students living on campus increasing considerably revenues per student for the university.

In addition, online enrollment is increasing slower than traditional enrollment. Ground students now represent 18.8%, symbolizing an increase of 2% from 2013. With low house costs and new buildings, ground students should represent more students in the future years to come. They represent higher revenue per student; therefore will generate more revenue for LOPE.

LOPE revenue guidance has been calculated without taking into account a possible increase in tuition or in housing prices. Over the last 6 years, LOPE did not increase its prices and said for the first time in the last earnings call that they would have the possibility to do it and still be competitive. LOPE is able to increase its tuition by 2% to 3% as well as its housing prices. The university will still be a low cost provider and will be able to increase even more its revenue stream.

All these factors show that LOPE has the possibility to increase its revenue faster than expected.

Concerning costs, LOPE has been able to control them over the past years. Advertising expenses decreased from 2013 to 2014 by 40 basis points and are not expected to grow in the next future years. Marketing expenses are not expected to increase also.

Bad debt expenses decreased to 2.2% from 3.1% due to better quality students. Also, revenue is now recognized only when payment is made. This explains the slower revenue growth from 2013 to 2014.

General and administrative expenses as a percentage of revenues decreased from 6.7% in quarter four of 2013 to 5.5% in quarter four of 2014 primarily due to the company's decision to make contributions to school sponsoring organizations in lieu of state income taxes of $2.8 million in the third quarter 2014. These costs are not expected to increase either.

On the other hand, instructional and services expenses increased from $68 million to $78.6 million between 2013 and 2014, an increase of 15.6%. These costs are expecting to grow over the next year due to the increase in the number of faculty and staff to support the increasing number of students.

LOPE is focusing on improving its existing campus to match demand before going in new areas. CAPEX more than doubled last year to $168.6 million and is expecting to keep increasing to $191.2 million in 2015 due to new building, the new science department and new sports areas.

Costs are expecting to increase but revenue is expected to increase much faster. EBITDA margin are expecting to increase again in 2015 from 31.1% to 31.9%. When looking at possible growth, EBITDA margin could increase even faster meaning more value creation for LOPE.

Another reason to buy

LOPE considers a conversion back to a nonprofit status. This will allow enhancing shareholders value, improving value proposition to students through lower tuition; they will be able to obtain grants and other tax deductible donation and will avoid for-profit organization regulations. They had continued conversations with the department of education and Moody's about potential structures. A take-private transaction will be done as a premium and will beneficiate shareholders. LOPE management is confident about the conversion. They will have to do it with debt because donation won't be enough to cover the conversion. LOPE has a negative net debt; therefore they will probably not have any problems to have access to debt financing. LOPE will give more information in April but seems determined to do the conversion. Buying back their shares at a premium could be a real opportunity for investors.

Valuation

Revenue has been increased from 10.7% (Analyst estimates) in 2015 to 12% and from 8.3% in to 10.5% in 2014. The long term growth is expecting to be 3.5%. These increases of growth are due to higher expected demand, higher revenue per students and a possible increase in prices.

Operating costs have been increased from 69.6% to 75% over the long term due to a future increase in instructional and services expenses. It is lower than the overall industry as 81% of students are online students allowing reducing the university's costs.

Unlevered beta has been raised from 0.84 (0.57 in the last 5years) to 0.90 due to uncertainty in regulations and to be closer to the industry beta over the long run.

ROIC has been reduced to 12% compared to 28% the previous year to be conservative.

Conclusion

As a result, LOPE's intrinsic value is calculated at $52 per share and the 1 year target price is $56.2 per share, a potential upside of 25.53%. Revenue is the most important driver of value creation for the years to come. ROIC is expected to grow as well with the capital invested in the university. The company is mainly focused on investing free cash flows in the university and focused on doing the conversion to a nonprofit organization. The stock price of $44.79 per share is considered undervalued. The recommendation is a **buy**.

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1st week of March 2015

CENTER FOR GLOBAL FINANCIAL STUDIES

Grand Canyon Education, Inc.	lope	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	Target Return	NEUTRAL
		Benjamin Lunaud	$44.79	$52.01	$56.23	0%	25.53%	

General Info	
Sector	Consumer Discretionary
Industry	Diversified Consumer Services
Last Guidance	Feb-18-2015
Next earnings date	5/5/2015

Market Data	
Enterprise value	$2,024.89
Market Capitalization	$2,103.93
Daily volume	0.10
Shares outstanding	46.70
Diluted shares outstanding	47.01
% shares held by institutions	100.31%
% shares held by insiders	1.52%
Short interest	2.77%
Days to cover short interest	5.92
52 week high	$51.99
52-week low	$36.95
5y Beta	0.84
6-month volatility	26.13%

Peers	Market Cap.
Strayer Education Inc.	$646.91
Capella Education Co.	$798.84
DeVry Education Group Inc.	$2,287.58
K12, Inc.	$664.53
Apollo Education Group, Inc.	$3,053.92

Current Capital Structure	
Total debt/market cap	4.30%
Cost of Borrowing	2.41%
Interest Coverage	10039.70%
Altman Z	7.00
Debt Rating	AA
Levered Beta	0.94
WACC (based on market value weights)	7.65%

Management

Professional	Title	Comp. FY2012	Comp. FY2013	Comp. FY2014
Richardson, Brent	Executive Chairman	$ 206,494.00	$ 154,638.00	$ -
Mueller, Brian	Chief Executive Officer, Presiden	$ 2,677,289.00	$ 3,161,128.00	$ -
Bachus, Daniel	Chief Financial Officer and Princi	$ 1,369,751.00	$ 1,624,370.00	$ -
Meyer, W.	Chief Operating Officer	$ 1,375,171.00	$ 1,639,505.00	$ -
Mildenhall, Joseph	Chief Information Officer	$ 1,390,322.00	$ 1,409,118.00	$ -
Roberts, Brian	Senior Vice President, General Co	$ 537,713.00	$ 810,443.00	$ -

Historical Performance

	lope	Peers	Industry	All U.S. firms
Growth	41.6%	7.8%	10.1%	6.0%
Retention Ratio	8.7%	45.4%	68.6%	61.6%
ROIC		21.9%	13.1%	11.8%
EBITA Margin	18.5%	21.1%	14.6%	13.7%
Revenues/Invested capital	190.0%	159.2%	219.7%	202.3%
Excess Cash/Revenue	#DIV/0!	16.8%	16.6%	18.5%
Unlevered Beta	0.57	0.57	0.71	0.95
TEV/REV	3.0x	2.0x	2.2x	2.4x
TEV/EBITDA	10.9x	7.9x	11.2x	11.3x
TEV/EBITA	12.9x	9.3x	14.1x	15.4x
TEV/UFCF	53.6x	39.1x	23.1x	26.8x

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS
Last Quarter	2.6%	0.6%	4.5%
Last Quarter-1	3.3%	14.9%	24.1%
Last Quarter -2	1.5%	10.2%	17.8%
Last Quarter -3	1.3%	5.9%	11.5%
Last Quarter -4	2.1%	3.8%	17.3%

Non GAAP Adjustments

Operating Leases Capitalization	100%	Straightline	10 years
R&D Exp. Capitalization	100%	Straightline	10 years
Expl./Drilling Exp. Capitalization	0%	N/A	N/A
SG&A Capitalization	0%	N/A	N/A

Proforma Assumptions / **Forecasted Profitability**

		Period	Rev. Growth	Adj. Op. Cost/Rev	Revenue	NOPLAT	Invested capital	UFCF
Operating. Cash/Cash	0.0%	LTM	15%	68%	$691.06	$129.67	$463.14	$129.67
Unlevered Beta	0.90	LTM+1Y	12%	68%	$773.98	$134.98	$480.63	$117.49
Rev/Invested Capital	149.0%	LTM+2Y	11%	69%	$855.25	$143.47	$476.02	$148.08
Continuing Period Revenue Growth	3.5%	LTM+3Y	7%	69%	$915.12	$149.54	$473.64	$151.93
Long Term ROIC	12.0%	LTM+4Y	5%	70%	$960.87	$154.49	$472.41	$155.72
Invested Capital Growth	Equals to Maintenance	LTM+5Y	5%	70%	$1,004.88	$159.93	$471.30	$161.03
Justified TEV/REV	2.0x	LTM+6Y	4%	70%	$1,047.63	$165.01	$486.81	$149.50
Justified TEV/EBITDA	7.9x	LTM+7Y	4%	70%	$1,089.78	$170.63	$486.65	$170.80
Justified TEV/EBITA	9.3x	LTM+8Y	4%	70%	$1,131.73	$176.20	$485.26	$177.59
Justified TEV/UFCF	23.1x	LTM+9Y	4%	70%	$1,173.74	$181.87	$482.74	$184.39

Valuation

	ROIC	WACC	EVA	Enterprise Value	Total Debt	Other claims	Equity	Adjusted Price
LTM	28.0%	7.6%	$94.24	$2,481.63	$86.99	-$48.39	$2,443.04	$52.97
LTM+1Y	29.1%	7.8%	$102.81	$2,550.77	$86.99	-$154.84	$2,618.62	$56.98
LTM+2Y	29.9%	7.9%	$104.69	$2,610.28	$86.99	-$295.52	$2,818.81	$61.06
LTM+3Y	31.4%	8.0%	$111.08	$2,653.25	$86.99	-$442.52	$3,008.78	$65.15
LTM+4Y	32.6%	8.1%	$116.00	$2,697.71	$86.99	-$595.25	$3,205.98	$69.41
LTM+5Y	33.9%	8.2%	$121.11	$2,743.93	$86.99	-$754.96	$3,411.90	$74.04
LTM+6Y	35.0%	8.3%	$130.23	$2,805.97	$86.99	-$905.30	$3,624.28	$78.42
LTM+7Y	35.1%	8.4%	$129.89	$2,856.47	$86.99	-$1,078.71	$3,848.19	$83.24
LTM+8Y	36.2%	8.5%	$134.63	$2,906.57	$86.99	-$1,260.90	$4,080.47	$88.24
LTM+9Y	37.5%	8.6%	$139.61	$2,954.46	$86.99	-$1,451.94	$4,319.41	$92.49

Monte Carlo Simulation Assumptions

	Base	Stdev	Min	Max	Distribution
Revenue Variation	0	10%	N/A	N/A	Normal
Op. Costs Variation	0	10%	N/A	N/A	Normal
Market Risk Premium	6%	N/A	5%	7%	Triangular
Long term Growth	4%	N/A	3%	42%	Triangular
Terminal Value	0	0.1	N/A	N/A	Normal

Monte Carlo Simulation Results

	Intrinsic Value	1y-Target
Mean est.	$52.97	$56.98
σ(ε)	$0.32	$0.25
3 σ(ε) adjusted price	$52.01	$56.23
Current Price	$44.79	
Analysts' median est.		$53.25