

THE WALL STREET JOURNAL.

Purdue University to Acquire Kaplan University

Purdue President Mitch Daniels calls deal major push into online education



The campus of Purdue University in West Lafayette, Ind.

By Douglas Belkin and Melissa Korn

April 27, 2017

Purdue University, a flagship public institution in Indiana, is jumping into online education by buying for-profit Kaplan University with the aim of creating a new, public online university. The highly unusual acquisition will extend Purdue's reach to more working adults while building an additional revenue stream at a time when state funding is uncertain.

Purdue President Mitch Daniels said the school wanted to stay true to its land grant mission of educating as many people as possible, but he recognized it couldn't build an online presence alone. "We took a long build-or-buy analysis and came to the honest recognition that we would be very unlikely to succeed building it ourselves," said Mr. Daniels.

The venture highlights the shifting higher-education market as public funding declines, tuitions rise and college students grow older, busier and more indebted. These broad changes come as

attaining some sort of post-secondary education grows increasingly critical to earn a middle-class salary.

Purdue said Thursday that it plans to acquire Kaplan University's 32,000 students, 3,000 employees and 15 bricks-and-mortar campuses and learning centers from Graham Holdings Co., which will maintain Kaplan's international, professional and test-prep businesses. Although Kaplan has struggled in recent years amid a wave of problems for for-profit schools, Purdue has built protections for itself into the deal and views the nonprofit online sector as a growth area.

The new university, as yet unnamed, will be a nonprofit, public-benefit corporation, according to a securities filing by Graham Holdings. It will have its own board of trustees, but members will be appointed by Purdue, and will maintain a separate accreditation from the main Purdue system. If approved, Purdue will pay Kaplan \$1 upfront for the transfer of its institutional assets to Purdue, and then Kaplan can earn up to 12.5% of the new school's revenue if certain conditions are met.

Graham Holdings shares closed Thursday off 0.6% at \$609.90. Graham also owns seven television stations, the publishers of Slate and Foreign Policy magazines, a home health and hospice service and some manufacturing companies.

Under a 30-year contract, Kaplan will continue to provide the new university with technical support, human resources for transferred employees, admissions and financial-aid assistance, marketing and other back-office functions. Purdue can opt out after six years.

Kaplan's service business has a strong incentive to get the new university in the black quickly. Deal terms dictate that Kaplan won't get any costs reimbursed until the new university has covered all its operating expenses. During each of the new school's first five years, the new school will also be able to get a \$10 million priority payment beyond costs, paid out of its revenue. If revenue isn't sufficient for that payout, Kaplan has to advance the money.

The deal also includes bonus payments to the university if it achieves certain cost-savings goals. Only after all those payments are made will Kaplan receive cost reimbursements and a fee of 12.5% of the university's revenue. Either side can cancel the deal if the new school generates \$25 million in cash operating losses for three consecutive years or aggregate cash operating losses top \$75 million at any point in the initial 30-year term.

The deal comes after a yearslong slide for Kaplan, as it and other for-profit colleges were battered by public scrutiny and new regulatory oversight designed to curb the number of students leaving those schools with debt they wouldn't be able to repay. In early 2010, before that crackdown gained steam, Kaplan had nearly 120,000 students across its programs, including more than 70,000 at Kaplan University. It's fallen a long way since then, enrolling 32,000 at the online university segment being acquired by Purdue.

Kaplan University's 2016 revenue fell to \$617 million from \$1.01 billion two years earlier. Part of that decline was prompted by the 2015 sale of 38 campuses and shuttering of two others. The majority of Kaplan's classes are taught online but it retains 15 locations, mostly in the Midwest,

including Indiana. In recent months, shares of online colleges have climbed as President Donald Trump has talked of easing regulations proposed and implemented by President Barack Obama.

Mr. Daniels likened the acquisition to Purdue's creation of regional campuses after World War II when soldiers with families demanded colleges in their communities. If that was Purdue's second level for its second century, the Kaplan acquisition is "our third level for our third century." The deal is still subject to approvals from the U.S. Department of Education, the Indiana Commission for Higher Education and the Higher Learning Commission, which already accredits Purdue and Kaplan. Graham Holdings said in a securities filing Thursday that it doesn't expect to get all those approvals until the fourth quarter of 2017.

Trace Urdan, an independent analyst who follows for-profit colleges, called the Purdue acquisition "wild" but said he doesn't expect it to be the last such deal in the sector. Jeff Silber, managing director of business services and education research for BMO Capital Markets, said the Purdue deal is a sign that most traditional universities just can't scale up online on their own.

"The better universities, the more progressive schools, are relying on outside firms for help," he said. But he warned that some elite nonprofit schools may think the brand risk is too great. "There may be a certain segment that would never do this. Dealing with a for-profit entity in any form would probably be anathema to them."

Still, a number of schools have already chosen to build up their online presence with partners like 2U Inc., which helps run web-based—but not inexpensive—graduate degree programs for American University, the University of North Carolina and others.

Public colleges are increasingly seeking online opportunities. Arizona State University now enrolls 25,063 students in its online programs, while the University of Maryland University College, which is entirely online, has 85,122 students.

Mr. Urdan noted that the Purdue-Kaplan deal isn't unlike one proposed by Grand Canyon University, which wanted to slice off its services business and then turn the school into a nonprofit entity that contracted with the for-profit company for operating support. The Higher Learning Commission, which also accredits Purdue and Kaplan, rejected the proposal about a year ago. Mr. Urdan said the fact that Purdue can cancel the service agreement after six years and the new school's board of trustees will be chosen by Purdue "offers more signaling that this is truly independent."

Purdue has a history of nontraditional moves, especially with Mr. Daniels—a two-term Indiana governor who took over the school in 2013—at the helm. The school in 2016 launched an income-share agreement that allows students to pay back tuition costs with a percentage of their future earnings.

Mr. Daniels has also instituted a string of tuition freezes, lowered room and board costs and partnered with Amazon to reduce textbook costs for students.

Instructions: How would you describe the strategy that Purdue is following? What alternatives could they have considered and why do you think they made the choice they did?