

CAPELLA EDUCATION CO
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Sard Verbinnen & Co.

Moderator: TJ White

October 30, 2017

8:00 a.m. ET

Operator: This is conference # 6889128.

Operator: Good morning. Welcome to the conference call regarding today's announcement that Strayer Education Inc. and Capella Education Company have agreed to combine and merge as equals.

All lines have been placed on mute to prevent any background noise. And after the speaker's remarks there will be a question-and-answer session. To ask a question during this time please press star then the number one on your telephone keypad. Today's call is being recorded.

I would now like to turn the conference call over to Sonya Udler. Ms. Udler, please go ahead.

Sonya G. Udler: Good morning, everyone. Thank you for joining us on the call to discuss today's announcement of a merger of equals between Strayer Education Inc. and Capella Education Company. On the call this morning are Robert Silberman, Executive Chairman of Strayer Education; Kevin Gilligan, Capella Education's Chairman and Chief Executive Officer; Karl McDonnell, Strayer's Chief Executive Officer; Dan Jackson, CFO of Strayer; and Steve Polacek, CFO of Capella.

In addition to the announcement of this transaction, Strayer and Capella also released their respective third quarter earnings announcement. While today's call will be focused on discussing the transaction, the management teams will also take questions related to their third quarter earnings following the prepared remarks.

Before we start, we need to go through some required housekeeping. Please note that this call may include forward-looking statements made pursuant to the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995. Any such forward-looking statements may involve risk and uncertainties.

Although management believes that the expectations reflected in such statements are based upon reasonable assumptions, actual results for both companies could differ materially from those described in the forward-looking statements and are said uncertainties and risks, including those identified in the third quarter earnings news releases from both companies. These and other factors are discussed in recently filed 10-Q or 10-K with the Securities and Exchange Commission as well as future 8-K, 10-Q and 10-K for the companies.

All filings and reconciliations of non-GAAP financial information represented in this call are available by visiting the Investor Relations section of Strayer's or Capella's website.

In addition, today's press release announcing the transaction includes important disclosures that apply to this call. Please also note this call does not constitute an offer to sell or buy or the solicitation of an offer to buy or sell any securities nor shall there be any sale of securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities law of any such jurisdiction. No offering of securities shall be made except by means of prospective, meeting the requirements of Section 10 of the Securities Act of 1933 -- in 1933, pardon me.

Thank you for your patience with that. Now I'll turn the call over to Robert Silberman. Mr. Silberman, please go ahead.

Robert S. Silberman: Thank you and good morning, ladies and gentlemen. Thank you all for joining us today. I'm very excited to be here with Kevin and Karl this morning to discuss what we believe is a powerful combination of 2 very complementary institutions. In our prepared remarks, we want to share with you why we are so excited about the benefits this transaction will bring to our students, our faculty, our staff and our shareholders. Accompanying our remarks this morning, there are a few slides which provide an overview of the transaction, which are available on either of our companies' websites. And of course, at the end of our prepared remarks, we'll be happy to take your questions.

Now let me just start by saying that at Strayer, we have long been admirers of Capella's innovation and expertise and online education. We are absolutely delighted to have the opportunity with today's transaction to combine Capella's many capabilities with our own 125-year heritage of educating working adults.

Bringing together our 2 companies will create corporate level scale and synergies that will benefit both of our universities and allow us to accelerate investments in the educational experience we deliver to our respective students. As you saw in our release, this is an all stock merger of equals, which will result in Strayer's shareholders owning 52 percent of the combined entity and Capella shareholders owning 48 percent.

Importantly, I want to stress this, we are proposing to combine the corporate end of our platforms, not the actual universities. The universities will remain independent and separately accredited. They will maintain their separate boards of trustees, be led by their current presidents and maintain separate faculty and academic support service positions at each respective University.

We expect the transaction to close in the third quarter of 2018 subject to approvals by the Department of Education, state regulators and relevant accreditation bodies as well as shareholder approvals from both companies.

Together, we will offer nearly 135 degree and certificate programs, educating approximately 80,000 students across all 50 states and over 80 foreign countries. Both our companies bring considerable strengths that will enhance our collective ability to deliver better academic outcomes to more working adults at more affordable prices.

As institutions, we share cultures that value integrity, innovation and a mission to make education achievable for working adults. Bottom line is that this is a compelling opportunity to drive a greater program affordability, improve both the learning experiences and career outcomes for students and create value for our shareholders. Now let me walk you through some of the key elements of the transaction, which are highlighted on Slide 8 of the presentation.

This is a true merger of equals as demonstrated by the shareholder ownership of the combined entity and the agreed governance and organizational structure. Under the terms of that merger, Capella shareholders will receive 0.875 Strayer shares for each Capella share. As I mentioned, on a fully diluted basis, this will lead to Strayer shareholders owning approximately 52 percent and Capella shareholders owning approximately 48 percent of the combined company.

Strayer Education Inc., which at closing, we intend to rename Strategic Education Inc. will be the surviving corporate entity under which universities will operate. We will retain our current ticker symbol, STRA.

The leadership of the combined company will reflect the strength and capabilities of both Strayer and Capella. I'll serve as the combined company's Executive Chairman. I'm delighted to have Kevin Gilligan joining us in serving as Vice Chairman of the board and the company, and Karl McDonnell will continue in his role as Chief Executive Officer. Each University will operate as an independent institution.

Our corporate headquarters will remain here in Herndon, Virginia, but we will maintain a significant presence in Minneapolis, Minnesota, which will include Capella University headquarters as well as the combined companies' IT resources and online support functions.

Financially, we expect the transaction to deliver significant benefits. We expect it will be accretive to Strayer's 2019 EPS by approximately 20 percent to 25 percent based on annual cost savings of approximately \$50 million.

And with that, let me turn the it over to Kevin and Karl for some of their comments. Kevin?

J. Kevin Gilligan: Thanks, Rob, and good morning, everyone. Let me begin by echoing that we at Capella are as excited about this merger as the Strayer team, and we have great admiration for Strayer's accomplishments. Strayer's 125-year track record speaks for itself, and our companies compliment each other in powerful ways. Having worked closely with Rob, Karl and their team over the last few months, I am truly excited about joining forces and partnering with them to further support all our students and grow our business.

Capella Education Company flagship institution is Capella University, which is an graduate and undergraduate degree programs and focus on helping working adults build the competencies necessary for today's modern workforce. Capella University is a leader in online higher education and offers 1,900 online courses and 54 degree programs. Across these programs, we serve over 37,000 students, with about 70 percent enrolled in graduate programs. And similar to strayer, we are focused on offering degree programs that are truly in touch with the workforce needs of employers today.

Outside of Capella University, we are offering validated alternative credentials through Capella Learning Solutions in partnership with CareerBuilder, which prepares jobseekers for in demand carriers while partnering with employers who are looking for job-ready candidates. In addition, we have 2 software engineering and coding schools, DevMountain, which is focused on accessibility and affordability, and Hackbright Academy, a school focused on increasing opportunities for women in technology. Finally, our portfolio includes SOPHIA, which is an industry leader in offering self-paced courses for college credit.

We are serving over 37,000 students and we are working closely with employers to meet the demand for skilled professionals in the 21st century economy, a goal that we share with Strayer.

On Slide 10, you can see that our 2 companies bring tremendous educational expertise in a unique family of leading institutions. Across our collective institutions, we will serve approximately 80,000 students across nearly 135 degree and certificate programs.

The scale that this platform provides will allow each respective institution to leverage best-in-class processes and benefit from increased resources to further drive the quality learning experience and career outcomes for students. We will have greater capabilities, integrated backend technologies and a wealth of industry knowledge to facilitate the sharing of best practices and ultimately benefit our students and faculty.

While the universities will remain independent, students and faculty at both institutions will benefit from their complementary offerings, including Capella University's competency-based learning infrastructure, assessment capabilities and track record of improving student success as well as Strayer University's video and simulation classroom and content capabilities and close relationships with employers.

In addition, Strayer's extensive ground-based footprint creates the potential opportunity for Capella to extend its competency-based model into hybrid learning. Both institutions will work towards seamless transferability of credits between the universities, and we expect to honor employer discounts from either institution, further improving overall affordability.

Financially, we'll have an even stronger corporate profile with a more diversified revenue mix which generated pro forma trailing 12-month revenues of approximately \$895 million and approximately [\$182 million] in pro forma EBITDA, excluding a benefit of \$50 million of synergies we expect to achieve.

As Rob mentioned, organization share a culture of integrity and innovation. Across our institutions, our mission is to make learning work for adults in a modern economy. Today's modern job market requires upscaling and rescaling and employers increasingly value modular, career-long learning. At Capella, we've been focusing in creating new models that help employers address supply demand imbalances as they seek to fill open positions and help those same employers rescale and upscale their existing workforce with job-ready skills.

We think the long-term market opportunity is significant in this area. As a combined company, we'll have additional resources to innovate and expand our platform of job ready programs. This will allow us to offer students the flexibility and result-oriented outcomes that address the most pressing needs of working adults today.

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As you can see on Slide 12, whether it's doctoral programs in public health, education or IT related areas, masters degrees in business or bachelors in certificate programs across a range of different areas, we collectively have developed programs designed to work for our students and help them advance in their careers. Together, Strayer and Capella students will continue to be well served across a wide spectrum of programs with additional resources to invest to help them succeed in the modern workforce.

With that, let me turn it over to the CEO of the combined entity, Karl McDonnell.

Karl McDonnell: Thank you, Kevin. Good morning, everybody. First, I'd like to give a quick overview of Strayer before turning our attention to the pro forma combined entity.

At Strayer, we have built a diversified education company with a long heritage of serving working adults across both undergraduate and graduate level degree programs. Our core institution, Strayer University, has 73 campuses across 16 states in the District of Columbia, and our Jack Welch Management Institute is a top 25 ranked online MBA program by Princeton Review. We also have our Strayer at work program, in which we partnered with 325 corporations to help them meet the educational needs of their workforces. And finally, we have our New York Code & Design Academy, a dedicated coding and design school which we acquired last year.

Across these programs, we serve over 42,000 students, 83 percent through our online course environment. Our 2 organizations have a shared principle of making sure our students are provided an affordable education experience with the support they need to drive successful learning and career outcomes. This combination will allow us to leverage these shared values and truly benefit our students.

One of the highest priorities of both organizations has been addressing affordability, and both Strayer and Capella have made significant progress in this area. In 2014, Strayer University introduced our Graduation Fund, which allow students the opportunity to earn their last 10 courses for free, resulting in a 25 percent reduction in the cost of their undergraduate degree. We went further by also reducing our undergraduate tuition by 20 percent. Together, these 2 initiatives resulted in a nearly 50 percent reduction in the cost of a Strayer University bachelor's degree.

Capella University introduced FlexPath, its direct assessment competency-based instruction model. This innovative program provides the potential for motivated students to complete certain degrees in half the time and at half the cost. In addition, they offer over \$30 million in scholarships to students.

Overall, we believe both of our universities are among the most affordable institutions and largely in line with the average in-state 4-year institution on a public basis.

In addition to affordability, creating a strong value proposition for students is critical, and Strayer and Capella are both at the forefront of using advanced analytics to help support over students in making better decisions about, assessing where they are in their learning process and achieving successful outcomes. We are using data to identify areas to improve efficiencies and to create better experiences for our students. Investments in data-driven resources are essential as we continue to innovate and drive even better outcomes.

In addition to the substantial strategic benefits of this merger, we expect to achieve cost savings of approximately \$50 million. Our expectation is for these synergies to be fully phased in within 18 months of closing and approximately half realized during the first 12 months.

Steven Polacek will leading our efforts to realize our savings across the organization which will largely be driven by the consolidation of executive functions, some marketing capabilities and IT operations across our 2 companies. To achieve these synergies, we expect one-time costs of approximately \$50 million. And as Rob said, we expect these savings will enable us to deliver accretion to Strayer's EPS of approximately 20 percent to 25 percent by 2019.

Additionally, we expect to reinvest some of the savings to strengthening academic offerings, innovation and affordability. Importantly, by bringing our 2 institutions together, investing behind our offerings, we believe we will be able to achieve even greater levels of growth together than either of our organizations could achieve on a standalone basis.

The corporate level savings we can achieve along with the strength of our business will create a combined company with strong cash flow. On a trailing 12-month pro forma basis, our combined company generated approximately \$80 million of distributable free cash flow, which we expect to significantly increase with the benefits of this merger.

This strong cash flow will allow us to accelerate reinvestment into the educational experience for students of both universities while also returning capital to shareholders through an attractive dividend. And our current expectation is for the combined company to pay an annual dividend of \$2 per share.

And with that, let me turn the call back over to Rob.

Robert S. Thank you, Karl. As you can see, Karl, Kevin and I all believe that this is a tremendous opportunity to
Silberman: allow shareholders of both companies to jointly participate in the value creation potential of this exciting platform. Our accredited institutions will continue to operate separately and continue to deliver successful academic and employment outcomes while having access to even greater resources and the ability to share best practices. Together, our single corporate platform will facilitate greater investment to provide an enhanced and more affordable student experience.

By capturing the efficiencies of bringing our 2 corporate level functions together, we will have the ability to invest more in the academic and employment outcomes for students, which will ultimately deliver the real increase in value for our shareholders.

We're excited about this opportunity. We're looking forward to the process of finalizing it. And with that, operator, we'd be pleased to take any questions.

Operator: At this time I would like to remind everyone in order to ask a question please press star one on your telephone keypad. Again, to ask a question, please press star one.

And our first question comes from the line of Jeff Silber with BMO Capital Markets.

Jeffrey Marc Congratulations to both of you for what to be an exciting combination. I don't have the slides in front of
Silber: me and I know in your filings to discuss a little bit more, can you give us a little bit of background in terms of what precipitated these discussions and the combination?

Robert S. Sure, Jeff. Thank you. I just tell you from my perspective and then ask Kevin. And as I said, we have
Silberman: long admired Capella and particularly their expertise in their online platform. And my view over the last couple of years has been that scale is actually going to be of increased importance in our sector.

But more importantly, when we have the opportunity to find academic excellence, that's always something that we're on the hunt for. And so, we will provide more detail on the proxies, but I think I first contacted Kevin about 18 months ago and we took it from there.

J. Kevin Gilligan: Yes. Good morning, Jeff. I would just add to that. We certainly agree with the comments on scale that ultimately, in this industry, the key to value creation and the key to long-term sustainable growth is student success. And while both Strayer and Capella excel on this area, the prospects of putting our combined capabilities together really got us excited. It's going to allow us to serve learners in ways beyond what we could do as independent companies, and I think it just creates that much more opportunity for the long term.

Jeffrey Marc Silber: OK, great. And in terms of the structure by keeping the university separate, would you consider the 2 universities complementary? Obviously, you do, but have you ever been somewhat competitive in terms of either the students you go after or the type of programs that you both have?

Robert S. Silberman: As we started to get deeper into the study, I was actually surprised at how little actual competitive overlap there was. And from our standpoint, the thing that we saw as most complementary was the opportunity to have within our organization the doctoral and a higher percentage of graduate level programs.

We haven't offered anything in any of the health, sociology, psychology kinds of areas before. We just have a nascent nursing program. We were very impressed with Capella's nursing program. So clearly, from our standpoint, it's very complementary. Those areas where we do overlap, we think we can just add more benefits to students.

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- Karl McDonnell: Yes, I would just add to that. The portfolio is far more complementary than overlapping, and that's going to be good for learners because we can offer learners more choices and more -- a different alternatives for career development and career advancement. And for me, it's going to be exciting the prospects of being able to take our graduate portfolio to Strayer graduates and into the employers that Strayer works with, create some exciting revenue synergy opportunities.
- Jeffrey Marc Silber: OK, great. One more for me and then I'll jump back into the queue and forgive me if these are in the slides. Can you give us an overview in terms of the legal and regulatory hurdles you have to overcome before getting the deal close?
- Robert S. Silberman: Well, we'll have all of those details, obviously, in the various proxies. But in general, Jeff, it's Department of Education, regional accreditors, some state licensing agencies. We spent a lot of time looking at this, and we're well prepared and actually eager to tell our story to these important stakeholders in the process.
- Jeffrey Marc Silber: OK, great. And I'm assuming you'll be notifying us when some of the major regulatory hurdles had been overcome?
- Robert S. Silberman: Absolutely. We'll keep the investment community up to speed.
- Operator: Your next question comes from the line of Peter Appert from Piper Jaffray.
- Peter Perry Appert: Just speaking on the regulatory process for a second, have you had any preliminary discussions at this point with accreditors or BOE to get a sense of their temperature on a potential transaction?
- Robert S. Silberman: Well, first off, Peter, I would say that even from our own standpoint, the thing that what most important to us was that quality of the academic offerings because I think that that more than anything will else affect that accreditors and regulators' view of the potential transaction.
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