A B C D E

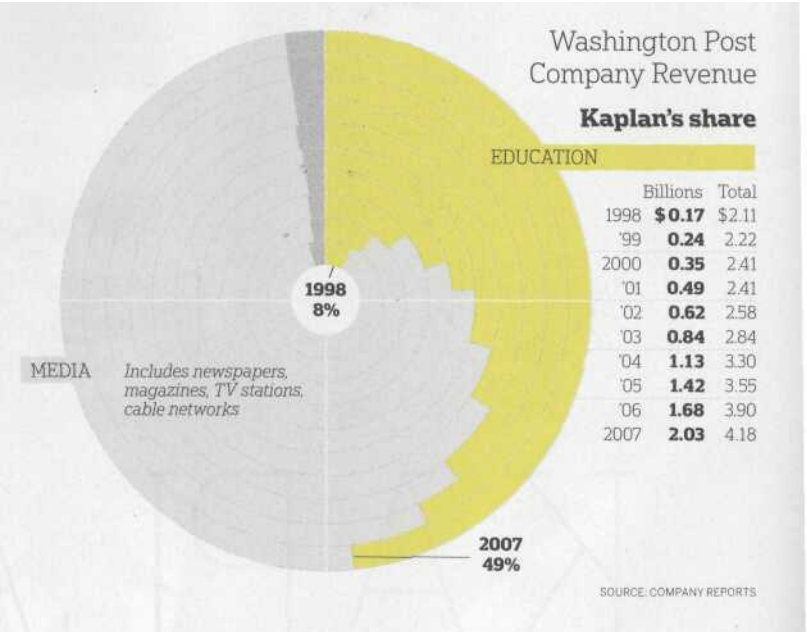
KAPLAN'S NEXT TEST

The education powerhouse, which grants college diplomas on its 70 campuses worldwide, now generates half the Washington Post Co.'s revenues. Can it keep the magic going?

BY SUZANNE KAPNER /// PHOTOGRAPH BY SARAH A. FRIEDMAN

WHEN THE *WASHINGTON POST* won six Pulitzer Prizes earlier this year, CEO Don Graham sent an unlikely missive along with the usual congratulatory e-mails. Addressed to Jonathan Grayer, the soft-spoken executive who runs the company's Kaplan education division, it read: "Thanks to you, we can do this." Behind the scenes and with little fanfare, Grayer has quietly transformed Kaplan from a stodgy test-preparation provider into one of the country's largest education companies, with one million students, 70 campuses, and an online law school. Sales in 2007 totaled $2 billion, compared with $80 million in 1994, the year Grayer was named CEO. Along the way, Kaplan's stunning growth also has had a profound impact on its parent, the Washington Post Co., which in addition to its namesake newspaper also owns *Newsweek* magazine and a clutch of cable networks and TV stations. As the Post Co.'s print businesses have taken a hit from sharply lower advertising revenue, Kaplan has provided an important cushion—one that not every publisher possesses. Kaplan now accounts for half of the Washington Post Co.'s $4 billion in annual sales. Partially as a result, the Post's stock, which at $603 is off 20% from a year ago, has fallen less than the shares of other newspaper companies. "What Jonathan has done is tremendously important," Graham says. "We are pouring money into building Kaplan for a much bigger future."

To reflect its newfound dependence on Kaplan, the Post Co. has started to call itself an "education and media company." Historically it had been the other way around. For Kaplan executives, tired of toiling in the shadow of their more prominent parent, the shift is long overdue. But for old-time Post loyalists, the change is bittersweet. "Their heart is with newspapers, so the changes have been sad," says Warren Buffett, a board member for 24 years. "But they weren't going to put more money into an area that wasn't generating attractive returns. Considering how much they love the newspaper business, that required overcoming the heart with the head—something most publishers have had trouble doing." Over the past decade, due in large part to Kaplan, the Post's market cap has grown 8%, to $5.6 billion, while the New York Times's has plummeted 67%, to $1.9 billion.



If Kaplan is going to keep generating the kind of growth that will make Graham happy, it will need to overcome some stiff challenges ahead, including a slowdown in the U.S., where—because of the credit crunch—student loans have become harder to obtain. To make up for that, Kaplan is undertaking a risky expansion overseas. The company is also facing its share of legal tussles, part of a broader web of student-loan scandals that has enmeshed higher education in recent years. Kaplan is the target of a civil lawsuit brought by three former employees who accuse the company of defrauding the U.S. Department of Education of millions of dollars by running an "online diploma mill." Kaplan has filed a motion to dismiss the suit, but more on that later.

HEROES AT THE WASHINGTON POST CO., stretching back to Watergate, have tended to be swashbuckling journalists, not mild-mannered business executives, and Grayer falls into the latter mold. He is a history fanatic who dreamed of becoming an academic until Alan Spoon, the former Post Co. president and current partner in private equity firm Polaris Venture Partners, convinced him otherwise. A voracious reader with a near-photographic memory, Grayer, 43, is known as something of a Trivial Pursuit buff. "You never want to bet against him," says Andrew Rosen, Kaplan's president. "Whatever the question, whether it's 'What year did Jimmy Durante die?' [1980] or 'How many trees are in Central Park?' [26,000], he will always get it right."

A C D E

GRAYER POCKETED CLOSE TO $45 MILLION FROM RESTRICTED STOCK GRANTS AND OPTIONS IN 2007—MORE IN LINE WITH WALL STREET HOTSHOTS THAN THE CEO OF A SLEEPY EDUCATION COMPANY.

Despite his considerable talents, Grayer would never have made much headway with Kaplan if he hadn't had an important ally early on in Graham, 63, who has voting control over 72.2% of the Class A shares. Today, colleagues jokingly call the pair "the Don and Jon Show" to reflect their closeness. But back in the early days, Grayer's ideas were foreign territory. "They were far removed from the company's basic vision," says Donald Keough, chairman of Allen & Co. and former Post board member. "Jonathan needed protection, and he needed a believer—and he found one in Don." At times friction between the print devotees and education newbies simmered just below the surface. Fueling the sense of inequality is Grayer's plush office on West 56th Street in New York City with master-of-the-universe views of Central Park and a compensation package to match. In 2007, according to a *Fortune* estimate based on company filings, he pocketed close to $45 million from restricted stock grants and exercising options (in 2006 the amount was roughly $16 million)—more than any other Post Co. executive and more in line with Wall Street hotshots, not the CEO of a sleepy education company. "As the size of the stock rewards got bigger for me, Don had to deal with that," Grayer says. "I think he shielded me from a lot of the feelings of resentment that others had."

Being part of the Post Co. may have its advantages today, but that wasn't always the case. Back in the early 199os, Kaplan was the company's equivalent of Siberia. "We used to joke that Don didn't know he owned us," Rosen says. When former Post Co. president Richard Simmons proposed in 1984 buying what was then called the Stanley H. Kaplan Educational Centers, Katharine Graham, who preceded her son Don as CEO, said, according to her autobiography *Personal History*, "I don't give a shit about it, but if you think it will be profitable, let's do it."

While Kaplan for years made its money as a test-prep company, it wasn't until the late 199os that a light bulb went off for Grayer: He realized that the company could be a platform for anything

related to education. At the time, the for-profit higher-education market was just taking off. In 2000, Kaplan struck a deal to acquire Quest Education for $178 million. Today, Kaplan's higher-education business has $1 billion in annual sales. "The return on this investment has been stratospheric," he says.

At Kaplan College's Hagerstown, Md., campus, there are no marching bands, no student center—almost nothing that resembles a typical university except for a string of red brick buildings. "Our schools have none of the ancillary costs of a traditional university," Grayer tells me over lunch. "Instead, we are focused on helping our students get the jobs they want"—something Grayer calls "learning to earn." Rick Brandenburg, 47, is a prime example. A burly man with tattoos, Brandenburg spent most of his working life delivering 50-pound boxes of nails to construction sites. He recently completed an associate's degree in criminal justice at Hagerstown and now works for the state of Maryland's child-support enforcement division.

In that regard, Kaplan's mission is similar to other large for-profit colleges such as Apollo Group or Corinthian Colleges, which cater to mostly blue-collar, working-class adults—but with one important difference. Kaplan, which had a 2007 profit of $149 million, badly lags behind its peers when it comes to return on invested capital. The measure stands at just 5% for Kaplan, compared with 30% for Apollo Group, the largest for-profit higher-education provider, with $2.7 billion in annual sales, according to the New York City research firm Matrix USA. Grayer says the comparison is unfair because Apollo is a pure higher-education provider, while Kaplan derives half its revenue from other businesses that can be more cyclical, such as certification for real estate and securities professionals. When those industries go through a downturn, as they are now, Kaplan's profits are hurt. "We could have higher margins if we cut back services, but that's not the way we run the business," Grayer says.

Taking a long-term view may have its advantages, but Grayer has some immediate challenges to deal with now. Revenue growth for the $20 billion for-profit higher-education industry, which averaged 15% earlier in the decade, has slowed to 10%. (Unlike traditional colleges, which receive money from endowments and state tax coffers, for-profit schools derive all of their revenue from tuition.) "There is only so much demand for higher education," says Sean Gallagher, a senior analyst with Eduventures, a Boston research and consulting firm. "Some regions are becoming saturated." And that's driving up recruitment costs, which now average 20% of sales, up from 15% in 2003—placing for-profit education companies a close second to the pharmaceutical industry in terms of the percentage of revenue spent on marketing, according to Gallagher. Grayer's answer is to look overseas, specifically to the U.K., where Kaplan operates online degree programs, and more recently to China. In November, Kaplan bought a majority stake in a Shanghai-based operator of higher-education campuses, giving it a significant foothold there. But overseas expansion is risky. Each country has its own regulatory requirements, which means Kaplan must navigate a sea of disparate rules.

B C D E
IT WON'T BE EASY FOR KAPLAN TO KEEP SPINNING OFF THE KIND OF PROFITS THAT WILL ALLOW ITS MORE FAMOUS NEWSPAPER SIBLING TO CONTINUE RACKING UP THOSE PRIZES.

Then there is the credit crisis, which has made student loans harder to obtain. Although Congress passed emergency legislation this spring giving the U.S. Department of Education temporary authority to buy unsold loan packages, thereby injecting short-term liquidity into the market, some analysts worry the measure doesn't go far enough. A handful of schools have started making loans directly to students, a strategy that carries higher costs. Kaplan has also been the target of a lawsuit that raises questions about recruiting methods. In March, three former Kaplan University employees filed a federal suit accusing the company of "fraudulently obtaining federal funds" by improperly enrolling students and keeping them enrolled even if course work was not completed. Kaplan denies the charges. Kaplan has also received requests from the attorneys general of Arizona, Iowa, and Maryland about its relationships with student-loan providers, part of an industrywide government investigation into kickbacks and perks that loan officers allegedly received from some lenders. Kaplan says it has cooperated and has not received further inquiries.

Maybe because of the litigation and the fact that Kaplan is so disparate from the Post Co.'s other holdings, there has been talk over the years, usually fueled by analysts and investors, of a potential sale or spinoff. Neither option is currently on the table, according to Graham. If anything, the Post is likely to add to its education holdings. In February it disclosed an 8% stake in Corinthian. If Kaplan is no longer the stepchild it once was, the division is now cast in another role, that of breadwinner. Yet, it won't be easy for Kaplan to keep spinning off the kind of profits that will allow its more famous newspaper sibling to continue racking up those prizes.

A THIRST FOR LEARNING WASHINGTON POST CO. CEO GRAHAM IS EXPANDING HIS EDUCATION BUSINESS.

KAPNER, Suzanne. Kaplan's Next Test. **Fortune**, Amsterdan, v. 158, n. 4, p. 70-73, September. 2008.