Valuation Viewpoint

SHENEHON COMPANY
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CAPTURING THE FULL VALUE OF UNIQUE ASSETS

BY: JOHN T. SCHMICK AND CHRISTOPHER J. STOCKNESS

Minnesota is known as the "Land of Ten Thousand Lakes" because it offers a diverse landscape and a wide range of lakes from small, natural lakes to large, recreational lakes. Each lake provides opportunities for Minnesotans and visitors to enjoy natural habitats through boating, fishing, swimming and a variety of other recreational activities. As a result, lakeshore property and property in close proximity to lakes are in high demand in the Twin Cities and surrounding areas. Because of the limited supply of land on or near the water, there is also a steady and significant increase in price. In today's market, lakeshore property sales may lead to redevelopment because the value of the land itself outstrips the value of the existing improvements.

Traditionally, residential lakeshore development was tied to the maximum number of water front lots allowed under the city's zoning regulations. If the zoning code allowed for many dock spots but the land area only supported the construction of four homes, four homes were built and the excess dock rights went unused. However, as the demand for lake access continues to increase and the supply dwindles, the market has reacted with some very creative solutions to the problem of how to utilize those excess dock rights. It is not unusual to find redevelopments which actually extend the benefits of lakeshore access beyond the lakeshore site itself. Projects like these result in significant additional value to the main site as well as to the adjacent sites. The developer carves out the maximum number of waterfront lots permitted, purchases additional land nearby and sells the excess dock rights to potential buyers who want a permanent access on that lake but either cannot afford the high cost of lakeshore property directly or are limited by the availability of lakeshore in the area.

Aging resort properties close to urban areas present unique development opportunities. With lakefront

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MARKET TRENDS AND INDICATORS

Office Buildings	↑	3%
Retail Centers	→	3%
Industrial Buildings	↑	3%
Apartments	↑	4%
New Housing Starts	↓	38%
Productivity	↑	1.7%
Composite PE	↓	24.41
Consumer Confidence Index	↓	104

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MARKET TRENDS AND INDICATORS

ECONOMIC INDICATOR

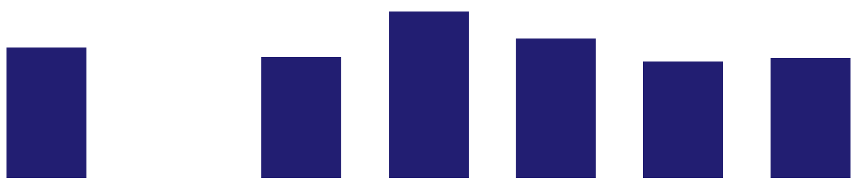
	2001	2002	2003	2004	2005	2006	1Q 2007
New Housing Starts—Yearly Totals	330,400	349,600	374, 100	355,700	357,400	279,500	35,700

*Midwest Region re-defined in 2002

P/E RATIOS IN SELECT INDUSTRIES

Reporting categories changed in spring of 2006. Data for the current categories is presented for the Year 2006 and January through May of 2007.

Industry	2006	Jan 07	Feb 07	Mar 07	Apr 07	May 07
Basic Materials	13.68	11.84	17.54	15.35	13.24	12.66
Conglomerates	20.15	20.20	21.25	18.10	18.40	17.45
Consumer Goods	25.78	33.14	27.84	26.18	29.59	28.34
Financials	14.27	14.45	17.39	15.66	14.07	14.20
Healthcare	38.83	30.06	73.32	64.91	30.40	43.67
Industrial Goods	25.09	16.83	21.18	18.82	18.96	19.17
Services	25.64	25.71	29.54	26.35	26.57	25.50
Technology	26.27	27.06	30.78	25.14	23.38	22.24
Utilities	24.04	26.12	41.34	23.40	19.96	19.50



	2006	Jan 07	Feb 07	Mar 07	Apr 07	May 07
All Industry Composite P/E Ratios	**24.41**	**22.6**	**31.13**	**26.13**	**21.84**	**22.41**

ECONOMIC INDICATORS

Indicator (5 yr. avg.)	1985	1990	1995	2000	2005	2006	1Q 2007
Inflation	5.0%	4.0%	3.1%	3.4%	3.4%	2.0%	2.6%
Productivity	1.7%	0.6%	1.5%	2.9%	1.8%	1.5%	1.7%
GDP	4.0%	1.8%	2.7%	3.8%	3.5%	3.2%	1.3%
Consumer Confidence	84.9	104.2	99.2	128.6	107.2	105.6	104

RATES OF RETURN AND RISK HIERARCHY

Investment	Current
30 Year Treasury	4.9%
Aaa Bond	5.3%
Bbb Bond	6.2%
Commercial Mortgage	5.75–6.5%
Institutional Real Estate	7–8%
Non-Institutional Real Estate	8.5–10.5%

Investment	Current
Speculative Real Estate	11–15%
S & P Equity (Ibbotson)	11.9%
Land Development	13–18%
Equipment Finance Rates	14%
NYSE/OTC Equity (Ibbotson)	15.9%
NYSE Smallest Cap. Equity (Ibbotson)	21.75%

Sources: National Real Estate Index (2007), Appraisal Institute; F.W. Dodge Division, Business Week, Value Line, U.S. Chamber of Commerce, Standard & Poors, Investment Dealers Digest, U.S. Government Census, Yahoo Finance.

FAIR VALUE MEASUREMENT USING FASB STATEMENT 157

BY: G. DENNIS BINGHAM

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement 157 (*Fair Value Measurements*). Statement 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007.

This Statement applies to 67 FASB pronouncements that require or allow fair value measures and amends over 20 previously issued accounting announcements, including Statements 141 (*Business Combinations*) and 142 (*Goodwill and Other Intangible Assets*). It applies to both financial assets (for example, securities and derivative instruments) and non-financial assets (for example, land and intangible assets) as well as to liabilities. Statement 157 does not apply to (1) share-based payment transactions (Statement 123R), (2) accounting pronouncements that permit practicability exceptions, and (3) inventory pricing.

> *The highest and best use of an asset may be measured using either an "in-use" or an "in exchange" premise.*

This article discusses the changes to current practices, from a valuation viewpoint, resulting from the implementation of this Statement.

Fair Value Definition

The main purpose of Statement 157 is to increase the consistency and comparability of fair value measurements by providing a single definition of fair value. Fair value is defined in Paragraph 5 as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

Historically, fair value has been determined from a *buyer's perspective* ("entry price") based on what a company would pay to acquire an asset or would receive to assume a liability. The new standard now determines fair value from a *seller's perspective* ("exit price") based on the price a company would receive if it were to sell an asset or be paid if it were to transfer a liability.

The fair value measurement assumes the transaction to sell an asset, or transfer a liability, occurs in the principal or most advantageous market for the asset or liability. The principal market is defined in Paragraph 8 as "the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability." An example of possible principal markets for the sale of financial instruments would include exchange markets, dealer markets, broker markets, and principal-to-principal markets.

> *The new standard now determines fair value from a seller's perspective ("exit price") based on the price a company would receive if it were to sell an asset or be paid if it were to transfer a liability.*

Market participants are assumed to be buyers and sellers in the principal or most advantageous market and are assumed to be unrelated parties, knowledgeable, as well as able and willing to transact for the asset or liability. Market participants may be strategic and/or financial buyers.

The orderly transaction is assumed to be a hypothetical transaction that has been placed for sale on the open market for a reasonable amount of time (for customary marketing) and that the asset or liability is exchanged between market participants.

Fair Value of an Asset

The fair value measurement of an asset assumes the highest and best use of the asset from the perspective of the market participants, "even if the intended use of the asset by the reporting entity is different".

The highest and best use of an asset may be measured using either an "in-use" or an "in exchange" premise. The "in-use" premise is generally appropriate if the assets being valued are used in combination with other assets (for example, non-financial assets); while the "in exchange" premise is generally appropriate if the assets are valued on a stand-alone basis (for example, financial instruments).

"If multiple approaches are used the fair value measurement should be the point within the range that is most representative of the given circumstances."

Example: Assume a reporting company acquires land as part of a business combination. The land is currently being used as a manufacturing site and is zoned as for industrial use and has a fair value of $2.5 million. However, the reporting entity determines the land could be developed for residential use and neighboring land has been developed for condominiums. If zoned residential, the land would have a fair value of $5 million.

Statement 157 indicates the highest and best use of the land would be based on the higher of the values. Therefore, the fair value of the land would be $5 million.

Fair Value of a Liability

The fair value measurement of a liability assumes the liability is transferred to a market participant and the entity's nonperformance risk of the liability is the same before and after the exchange. "Nonperformance risk refers to the risk that the obligation will not be fulfilled and affects the value at which the liability is transferred." (Paragraph 15)

Example: Nonperformance risk includes consideration of the reporting entity's credit risk.

Valuation Techniques

Traditional income, market, and cost approaches shall be used to measure fair value. In some cases, a single valuation method may be appropriate and in other cases multiple methods may be appropriate; it depends upon the circumstances. If multiple approaches are used the fair value measurement should be the point within the range that is most representative of the given circumstances.

Example: Assume a reporting entity acquires a group of assets that includes income-producing software that was internally developed for license to customers. It is determined that sufficient information is available to use an income approach and a cost approach but not a market approach.

The fair value determined by the income approach is $15 million while the cost approach indicates the fair value is $10 million. The reporting entity determines that the software cannot be readily replicated due to the use of proprietary technology. Therefore, the reporting entity believes the fair value of the software is $15 million—using only the income approach.

"Inputs refer to the assumptions used by market participants in pricing the asset or liability."

Fair Value Hierarchy

To increase the consistency, comparability, and reliability of fair value estimates, Statement 157 establishes a fair value hierarchy that prioritizes the inputs used in determining fair value from most reliable (Level 1) to least reliable (Level 3). Inputs refer to the assumptions used by market participants in pricing the asset or liability. Statement 157 requires reporting entities to maximize the use of observable inputs and minimize the use of unobservable inputs. A brief description of the types of inputs follows:

- Level 1 inputs are observable inputs that reflect quoted prices (unadjusted) in active markets for identical assets or liabilities. For example: publicly traded stock prices.
- Level 2 inputs include additional inputs (other than Level 1 inputs), that are directly or indirectly observable in the marketplace. For example: interest rates and royalty rates.
- Level 3 inputs are unobservable inputs for the asset or liability. For example: a reporting entity's own data, which is "based on the best information available under the circumstances."

Most business appraisers will be valuing assets and liabilities using Level 3 inputs.

Disclosures

Statement 157 requires separate disclosures for items measured on a recurring basis versus items measured on a non-recurring basis.

Discounts

Block discounts, adjustments to quoted market prices based on the size of the units held versus the total daily trading volume, are now prohibited.

Restricted Assets

The fair value of an asset with restrictions on the sale or use of that asset may differ depending on how a market participant would consider the restrictions in determining the fair value of an asset.

Conclusion

Statement 157 addresses the need for consistency and comparability of fair market value measures by defining fair value, establishing a framework for measuring fair value, and expanding disclosures. However, the Statement introduces several new and difficult questions:

- Who are the market participants?
- What is the highest and best use of the asset or liability?
- What is the most advantageous market for the asset or liability?
- What valuation approach is most appropriate given the nature of the inputs available for decision making?

Clearly, valuation experts and reporting entities must work together to determine the most reasonable, defensible answers to these questions.

If you would like information concerning how this Statement may impact you, please contact us. VV

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land available for residential use and a number of existing dock permits, the creative developer recognizes the potential for marketing lake-access lots in addition to lakefront lots. As urban sprawl approaches lakeshore areas, the highest and best use (HBU) of resort land often changes from recreational/resort use to residential use. Because resort properties typically have conditional use permits for docks/slips above and beyond what is necessary for the lake lots themselves, there exists the potential to transfer the excess dock rights to those who desire water access but own non-lakefront lots.

> *"As the demand for lake access continues to increase and the supply dwindles, the market has reacted with some very creative solutions to the problem of how to utilize those excess dock rights."*

Typically, transferring conditional use permits for excess dock rights to developers for these maximum-use projects is at the discretion of the local municipality and its current policies. However, because the new development adds to the existing tax base, creates homes to meet the market demand, limits the development of large estates on lakeshore land and satisfies the community's desire to maintain the natural, pristine aspects of the lake, the community has much to gain from renewing the conditional use permits. Once the transfer of dock rights is guaranteed, there is still the issue of determining the value of the subject property.

In the process of appraising, it is essential to determine the highest and best use (HBU) of the subject property. During the HBU analysis, the appraiser ascertains what is physically possible, legally permitted and financially feasible in order for a prospective owner to realize the maximum productive use for the property. The process of determining the HBU is very similar to the process a developer employs to evaluate the merits of proposed development opportunities. The developer assesses the potential of vacant or improved land to see if there is potential above and beyond its current use. If an opportunity for development proves to be financially feasible, this will generally indicate a value for the land that is greater than that of the land under its current use. As mentioned earlier, with the demand for lakeshore land in the Twin Cities increasing and the supply diminishing, the prices for lakeshore land have skyrocketed.

Eager to redevelop existing properties, these developers and entrepreneurs have taken this opportunity to recognize and unlock the full value of lakeshore land. Many old resorts were constructed decades ago, during an era when the government followed a more hands-off approach to land use than it does now. Existing boat houses, guest or resort cabins, deeded accesses and excess dock rights offer additional flexibility for the developer who seeks to maximize the potential of the site. As local and state government agencies try to limit or prevent excessive development along lakeshore lands, conditional uses and grandfathered-in uses for existing improvements create strong incentives for developers.

A Case Study

An irregularly shaped lakeshore property with 1,750 feet of lakefront and a gross area of approximately 10 acres operated as a seasonal resort and boat marina for over 40 years. The lake is located in an area that was primarily rural/agricultural. Over the last ten years, however, urban sprawl from nearby cities makes the surrounding area more residential in nature. The subject property is on a large, recreational lake which is now becoming more residential as well. Located less than half an hour from the Twin Cities and within 5 miles of other suburban developments, the property presents a unique opportunity for private development. Operating as a resort and marina, the resort features a single family home, several lakeshore cabins, a camping and RV area, various outbuildings and a marina with 30 dock/slip spaces. The owners, mindful of the increasing assessed value of their land and the fact that they are experiencing a stabilized net income from their resort/marina operation, are looking for a change.

A survey of the site indicates that, based on shoreline setbacks, approximately six of the ten acres are located above the ordinary high water mark. Those six acres are considered the net developable area. Zoning guidelines generally limit the site to single family residential use with a restriction of two developable acres per single family lot. Based on current zoning, the subject site can support three single family lots. A local land planner confirms that the site can be developed with three lots on the northern half of the property and, based on the layout of the site, the best subdivision of the site is for three lots of approximately 250 feet of frontage for each lot. The remaining 1,000 feet of shoreline is located along approximately four acres of land considered un-buildable due to the historical high water mark for the site.

"As urban sprawl approaches lakeshore areas, the highest and best use (HBU) of resort land often changes from recreational/resort use to residential use."

Appraisal analysis indicates lakeshore lot values at the site in the range of $1,000 - $5,000 per frontage foot. Overall, the retail selling value as a single-family development is $2,250,000. In comparison, the resort is experiencing a stable income of roughly $100,000 per year. Assuming a capitalization rate of 9%, we see an "as is" value of $1,100,000. Based on this analysis, one can further determine that the value as a single family residential development significantly exceeds the existing value as a resort. But, does a single-family development represent the highest and best use of the site? What is the value of the un-buildable portion of the site? What might the market be willing to pay for an un-buildable lot? The answers to these questions take the developer in an entirely different direction.

Continued use as a resort is no longer economically feasible due to rising land values. However, the subject is permitted for 30 docks/slips which create additional value for the site. With high demand for lakeshore property and a severely limited supply available, buyers will pay significant premiums just for lake access rights, if they live nearby. A search of the sales of deeded accesses, un-buildable lots and dock rights revealed that the right to sell a permanent dock easement ranged from $50,000 to $200,000 per dock/slip. Assuming that three of the 30 dock rights will be assigned to the single family development, there are still 27 docks that can be included in the development, with a retail value of at least $1,350,000.

Thus, the subject's remaining acres have measurable value despite the fact that they are considered un-buildable; alternatively, a marina can be developed on the site to fully utilize the site's conditional use permit for 30 docks/slips. Therefore, in addition to its value as a single family development, the site has additional value due to the opportunity to provide lake access for as many as 27 additional boats. Overall, the value of the subject land is determined by the development potential of the site and the ability to extend lake access rights beyond the lakeshore itself. In this case, the appraiser and a land planning firm identified the potential for up to three residential lots on the lake, each with its own dock. In and of itself, this represents substantial value for the land over that of its continued use as a seasonal resort.

"Existing boat houses, guest or resort cabins, deeded accesses and excess dock rights offer additional flexibility for the developer who seeks to maximize the potential of the site."

However, with its 27 additional docks/slips and four un-buildable acres, this site has far more to offer than three single-family lots. To realize this untapped potential, it was determined that the developers could offer lakeshore and non-lakeshore lots as well as a communal marina. If necessary, one or more of the single-family lots could be sacrificed to create a community marina. By buying up land around the lake itself, which was relatively cheap, they created up to 3 single-family lots on the lake and 27 non-lakeshore lots – each with its own dock. Determining the market demand for such a unique development is essential.

Market demand can be determined in several ways. One of the best ways to gauge the market is to research similar developments in the area. From the research it is possible to calculate not only the demand but also the potential price points. In this case, there was a similar residential development of 25 lots on a comparable lake nearby. As with our subject, the site had an allowance for 25 docks, accommodating 10 lakeshore lots with private docks and 15 docks/slips available for the non-waterfront lots. As a result of the site's topography and the amount of lake-frontage, the most suitable development was that of a central marina with 15 dock/slips – the maximum allowed. The dock rights for those 15 boat slips were included in the purchase prices of the non-lakeshore lots. The asking price for a non-lakeshore lot with boat slip rights was approximately $400,000. The lakeshore lots, including dock rights, ranged from $500,000 to $1,500,000 depending upon the location of the site and the amount of lakeshore frontage. This particular project proved to the developers not only that the market for this type of development exists, it also provided a benchmark for the price a potential home buyer will pay for a lot with dock rights in close proximity to the water.

Additional research of sales for similar, comparable lots (same size and location) without a permissible access to the lake revealed a price range of $225,000 to $275,000. Overall, the market indicated that a typical 2 acre lot in the same general area but without lake access sold, on average, for $250,000. In comparison, lots with a shared dock/slip and lots with private dock access sold for $400,000. In the final analysis, it appears that the additional value of access to permitted docks/slips is worth, on average, $150,000.

> *"Based on this analysis, one can further determine that the value as a single family residential development significantly exceeds the existing value as a resort."*

It is important that a buyer/developer recognizes the potential of lakeshore property with its excess dock rights and plans accordingly. To maximize economic return on investment, the knowledgeable buyer seeks to purchase land from nearby owners, thus creating additional lots with non-lakeshore access. The subject property, with its existing dock rights, is the "crown jewel" for a water access development. Without the dock rights, it is just another subdivision development with no signature features; the lot prices and the market demand will be significantly lower. The subject property, with its excess dock rights, is worth a significant premium in the open market. That extra premium is captured when additional non-lakeshore lots (with dock access) are included in the development along with up to three single-family lakeshore lots permitted under current zoning regulations.

To realize the additional premium associated with this particular lakeshore land parcel, the developer evaluated the costs of similar projects in neighboring areas. The results of the HBU analysis indicated that assemblage for residential development with water access was, indeed, the highest and best use for the subject property. The potential economic value of this scenario is far greater than that of the initial proposal for a residential development consisting of three single-family lakeshore lots and excess land. It appears that using the subject property as the cornerstone of a larger water access residential development provides the largest return on investment to the developer. In this example, the three lot scenario creates a retail value of approximately $2,250,000 for the subject whereas incorporating the subject property and its excess dock rights into an assemblage for development creates an additional value of roughly $4,000,000. At this point, the developers, land planners and appraisers will evaluate the economic projections by way of a sales comparison analysis based on the current market and a subdivision analysis.

In a subdivision analysis, the appraiser first analyzes the subject to determine its maximum productive use and its value based on the current market. Next, he or she estimates reasonable development costs and potential absorption periods as well as the projected retail prices for the lots to come up with a present value: the value of the land itself prior to development. For our example, it was necessary to use a reverse subdivision analysis. Because this scenario deals with excess dock rights, the appraiser worked backwards starting with an analysis of the former resort property and its 30 permitted docks/slips. Once the number of excess docks/slips was identified, the appraiser determined how much land must be acquired to fully maximize those 27excess dock/slips. The developer used this information to calculate the total projected cost of the development: purchasing the resort and the additional land, anticipated development costs and a reasonable profit.

Continuing with our example, the subdivision analysis indicated that a 30-lot scenario had a present value of $7,000,000. This number represents the total purchase price the developer is willing to pay to assemble the excess land and the resort. If the developer is able to purchase the adjacent land for assemblage for $4,000,000, the remaining budgeted $3,000,000 can be used to cover the cost of the main resort parcel. The original "as is" value of the main resort parcel was $1,100,000. Clearly, the developer identified a development opportunity which maximized the excess dock rights and, in doing so, created a financially feasible scenario for achieving the maximum productive use of the subject resort.

"*The valuation of a land parcel is not always about what you see today, it may be that capturing its full value depends upon your vision for tomorrow.*"

This article touches briefly on some of the techniques used in the market place for capturing the full value of unique assets. Identifying and applying ordinary methods of valuation to unusual properties may reveal the hidden value. This is especially true for lakeshore properties where the number of permitted docks/slips on a given lake far exceeds the number of residential homes allowed under current zoning ordinances. Developers are exploring creative ways to maximize the existing permitted uses of a site at a time when development standards are becoming more and more restrictive. Appraisers must identify all existing uses as well as all potential uses and how they impact the value of a property. Developers, land planners architects and contractors can all contribute to the process of providing creative solutions to complex development problems. The valuation of a land parcel is not always about what you see today, it may be that capturing its full value depends upon your vision for tomorrow. VV

POSSIBLE USES OF LAND AND DOCK RIGHTS	CONCLUDED VALUE
Continued Operation as Resort/Marina	$1,100,000
Residential: Scenario 1 3 lakeshore lots: 2 acres of land and one boat slip per lot. 4 acres of lakeshore land and 27 permitted dock slips remain unused.	$2,250,000
Residential: Scenario 2 3 lakeshore lots: 2 acres of land and a boat slip per lot. Assemble nearby land for 27 non-lakeshore lots with boat slip access in a marina. Maximizes use of all 30 permitted dock slips.	$7,000,000

MARKET TRANSACTION: BUSINESS VALUATION

CAPELLA EDUCATION COMPANY (Capella University)

Capella is an online post secondary education services company. Capella offers a variety of doctoral, master's and bachelor's programs in markets such as health and human services, business management, technology and education. The company went public November 15, 2006 with 4,600,000 shares offered and sold at an initial public offering price of $20.00 per share. On May 16, 2007, the selling shareholders and the company put 3,485,000 shares on the market at a price of $36.00 per share. As of 5/22/07 the stock closed at $42.22. The financial statement below indicates strong growth over the last several years.

	Year Ended December 31,			Three Months Ended March 31,	
	2006	2005	2004	2007	2006
	(In thousands, except per share and enrollment data)				
Statement of Operations Data:					
Revenues	$179,881	$149,240	$117,689	$52,824	$41,858
Costs and Expenses:					
Instructional costs and services	83,627	71,243	58,850	23,523	20,375
Marketing and promotional	56,646	45,623	35,089	18,320	14,309
General and administrative	21,765	17,501	13,885	5,981	5,290
Total costs and expenses	162,038	134,367	107,824	47,824	39,974
Operating income	17,843	14,873	9,865	5,000	1,884
Other income, net	4,472	2,306	724	1,092	916
Income before income taxes	22,315	17,179	10,589	6,092	2,800
Income tax expense (benefit)	8,904	6,929	(8,196)	2,248	1,158
Net Income	$13,411	$10,250	$18,785	$3,844	$1,642
Net income per common share					
Basic	$1.09	$0.89	$1.68	$0.24	$0.14
Diluted	$1.06	$0.86	$1.62	$0.23	$0.14
Weighted average number of common shares outstanding:					
Basic	12,271	11,476	11,189	16,015	11,653
Diluted	12,629	11,975	11,599	16,700	11,988
Other Data:					
Depreciation and amortization	$8,195	$6,474	$5,454	$2,410	$2,059
Net cash provided by operating activities	$28,901	$28,940	$16,049	$6,281	$6,343
Capital expenditures	$15,354	$9,079	$7,541	$3,556	$3,818
EBITDA	$26,038	$21,347	$15,319	$7,410	$3,943
Enrollment	17,976	14,613	12,252	19,151	15,972

The first of the following charts shows the increase in value of the company over the last almost six months. The second chart compares the value of each student based on its market cap compared to the cash flow produced by each student.

To value the progress of a company on the cash flow basis divided by the number of students may be unconventional, but in this industry it may be very appropriate. With online education being highly technical, capital improvements are always necessary to stay competitive. Therefore, cash flow may be a better measurement than EBITDA of the true earning power of Capella. As indicated by the chart below, the value per student based on a market cap has dramatically increased over the last almost six months, while the cash flow per student has declined over the same six month period.

There may be other factors such as pricing increases that have not taken effect, or seasonality of the cash flow that would affect the cash flow per student. However, if you believe that cash flow per student is a valid measurement of overall company performance, in the long run, cash flow per student must increase significantly or the market price of the stock will fall.

MARKET CAPITALIZATION

	Shares Outstanding		Share Price	Market Cap	% Increase
12/31/06	16,002,371	X	24.25	388 million	
3/31/07	16,607,830	X	33.54	557 million	44%
5/22/07	16,607,830	X	42.25	701 million	26%

	Market Cap / Student	/ Value per Student	Cash Flow per Student	
12/31/06	388 million / 17,976	$21,584	28,901,000 / 17,976	1,608
3/31/07	557 million / 19,151	$29,085	*25,124,000 / 19,151	1,312
5/22/07	701 million / 19,951	$35,136	**30,000,000 / 19,951	1,504

* *Annualized first quarter.* ** *Shenehon estimate.*

Has Capella come out of the gate like a sprinter with a pace sustainable for only 50 to 100 meters? Or is Capella like a marathon runner, capable of sustaining its grueling growth pace over the long run?

MARKET TRANSACTION: REAL ESTATE

Property:	1016 Marquette Avenue
Buyer:	MINN 3 LLC
Seller:	MSP 1016 Marquette LLC
Source:	Seller and Certificate of Real Estate Value
Sale Date:	March 28, 2007
Sale Price:	$1,200,000 Gross*, $600,000 Net
Unit Price:	$230.42 /sq. ft. (Gross), $115.21/sq. ft. (Net)
Net Rentable Area:	N/A
Gross Building Area:	5,004 sq. ft. (to be razed)
Zoning:	B4-1, Downtown Business District
Utilities:	Full municipal services
Topography and Soil:	Level and assumed stable
Visibility and Access:	Good, on Marquette Avenue
Age:	1931
Land Size:	5,208 sq. ft.
Remarks:	Sale price* included $600,000 of personal property claimed on the Certificate of Real Estate Value. This included Phase I environmental reports, survey, architectural plans, engineering reports and consulting services. Seller reported this was only a partial recovery of the cost incurred for the proposed development of a condominium project on the site. Buyer now plans a 48,000 square foot office building development. This sale is useful for illustrating that a transaction may be more than a simple land sale. In this case it is really a "project sale". It also reflects the growth in downtown land values. Last sold in November of 2004 for $450,000, the current sale, at a $600,000 allocation for the land, indicates an annual growth rate in land value of 12.2% over 30 months.

SCOPE OF SERVICES

Shenehon Company is a Real Estate and Business Valuation firm, serving both the private and public sectors throughout the United States. Our unique combination of real estate and business valuation expertise allows us to provide a wide range of services and to offer innovative solutions to difficult valuation issues. Obtaining accurate and reliable industry information and expertise should play a key role in any decision-making process, and Shenehon Company is dedicated to equipping its clients with the tools necessary to make informed and knowledgeable decisions regarding their capital investments.

Areas of Expertise:

- Allocation of purchase price
- Asset depreciation studies
- Bankruptcy proceedings
- Charitable donations
- Commercial properties
- Condemnation
- Contamination impact studies
- ESOP/ESOT
- Estate planning
- Feasibility analyses
- General and limited partnership interests
- Gift tax evaluations
- Going public or private
- Highest and best use studies
- Industrial properties
- Insurance indemnification
- Intangible asset valuation
- Internal management decisions
- Investment counseling
- Land development cost studies
- Lease and rental analyses
- Lost profit analyses
- Marriage dissolution
- Mortgage financing
- Multi-family residential properties
- Municipal redevelopment studies
- Potential sales and purchases
- Railroad right-of-ways
- Special assessment appeals
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- Tax abatement proceedings
- Tax increment financing
- Utility and communication easements

Shenehon Company
BUSINESS & REAL ESTATE VALUATIONS

88 South Tenth Street
Minneapolis, Minnesota 55403
(612) 333-6533
Fax: (612) 344-1635
e-mail: value@shenehon.com
www.shenehon.com

Contributors:
G. Dennis Bingham, John Flaherty, William Herber, Karen Johansen, Denise O'Leary, John Schmick, Christopher Stockness