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Renaissance Learning, Inc.

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Introduction

Judi and Terry Paul, the founders and principal owners of Renaissance Learning ("RLRN"), were vocal in their objections of the potential sale of RLRN to Plato Learning, Inc. ("Plato"). A bidding war had erupted between Plato and Permira Advisers ("Permira") in response to the announcement on August 15, 2011 that Permira had made an offer to purchase RLRN. On September 10th, 2011, RLRN announced that a special meeting of RLRN's board of directors had been scheduled for Monday, October 17th to vote on the most recent offer from Permira. This announcement resulted in a bid by Plato on October 7th that could have provided a higher price to both the Pauls and the minority shareholders of RLRN than the bid made by Permira. Over the weekend of October 8th and 9th, 2011, Permira Advisers ("Permira") received a request by Renaissance Learning, Inc. ("RLRN") to increase the previous bid that Permira had made to purchase RLRN. The request was potentially made to forestall litigation against RLRN by some of its minority shareholders for not accepting Plato's higher offer. Representatives from Permira informed RLRN that they would need authorization from Permira's investment committee to accept the increase and that they would meet with the investment committee on Monday, October 10th to discuss the offer (Renaissance Learning, 2011c).

Plato's offer of October 7th to purchase RLRN was valued at $496 million. Approximately 69% of RLRN's stock was owned by the Paul family, who were the founders and principals of the firm. The outstanding offer by Permira was to offer $16.60 per share to the non-controlling shareholders and $15.00 per share to the Paul family owners. The total value of Permira's offer was $455 million. RLRN requested that Permira increase its offer to $17.25 per share for the non-controlling shareholders and maintain the price of $15.00 per share to the Paul family. There were approximately 9.227 million shares of RLRN's stock held by non-controlling shareholders and 20.122 million shares held by the Paul family (Renaissance Learning, 2011b and 2011c).

The initial merger agreement, submitted by Permira on August 15th, 2011, provided Renaissance shareholders with a price per share of $14.85. On August 24th, Plato Learning, Inc. submitted an unsolicited bid to acquire Renaissance for $15.50 per share. The principals of Renaissance, Judi and Terry Paul, were unsupportive of Plato's bid although it provided a greater return for them and the non-controlling shareholders of the firm. Permira provided a counter offer of $16.60 per share to the non-controlling shareholders and $15.00 per share to the Pauls on September 27th. The average value per share would have matched Plato's offer of $15.50 per share. On October

7th, Plato made its final offer of $496 million, which provided an average of $16.90 per share for all of the shares of RLRN, however the board of RLRN, per the offer, was allowed to offer a higher price per share to the non-controlling shareholders if the Paul family was willing to accept a lower price per share for their shares (Renaissance Learning, 2011b and 2011c).
The Paul's had given the following reasons to their board of directors for their opposition to Plato's offers:

- A high likelihood that the transaction would not be completed with Plato due to the increased amount of time needed to close the deal and recent turmoil in the financial markets. The existing agreement with Permira was expected to be completed in the middle of October 2011.
- The possibility of the acquisition by Plato not occurring due to anti-trust violations as Plato and Renaissance operate in the same industry segment.
- The proposed agreement with Plato would create a new subsidiary that would be highly leveraged. The offer of October 7th would result in the subsidiary having a capital structure consisting of $410 million in debt and $169 million in equity. The agreement required Plato to reimburse RLRN for a $13 million contract termination fee for the contract with Permira and any other nonreimbursable expenses.
- The capital structure of the new subsidiary created with the Permira agreement would be financed with up to $250 million in term debt, a commitment for a revolving line of credit of up to $20 million, and $215.8 million in equity.
- The offer from Permira was more beneficial than Plato's to "*Renaissance's employees, the students, educators, and schools Renaissance serves, and the communities in which Renaissance operates, especially Wisconsin Rapids, Wisconsin*" (Renaissance Learning, 2011c).

Due to their opposition to the Plato offer, the Pauls indicated that they were unwilling to take a lower price than the non-controlling shareholders if the Plato offer was accepted.
The key players in the case are described in Figure 1.

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Figure 1. Key Players

Name	Role
Renaissance Learning, Inc. (RLRN)	Company founded by Judi and Terry Paul in 1986. RLRN produces, distributes, and maintains educational programs to schools, primarily in the United States. RLRN stock was traded on the NASDAQ.
Judi and Terry Paul	Founders and principal owners of RLRN. In the beginning of October 2011, the Paul's owned approximately 69% of RLRN's stock.
Permira Advisers (Permira)	An investment firm headquartered in the United Kingdom who made the initial offer to purchase RLRN in August 2011. The Paul's indicated that they preferred Permira as a buyer over Plato.
Plato Learning, Inc. (Plato)	Plato was a competitor of RLRN and made rival unsolicited bids for the purchase of RLRN on August 24^{th} and October 7^{th}, 2011.

The following information was supplied to evaluate the proposal:

1. the percent of RLRN's revenues that come from its primary product, Accelerated Reader, for the past several years (**Table 1**),
2. financial information for Renaissance for the past five years (**Tables 2-4**),
3. historic total spending on public K-12 education for the United States, California, and Texas (**Table 5**),
4. historic United States Federal spending for public pre-K through 12^{th} grade spending (**Table 6**),
5. comparison financial information for RLRN and its competitors (**Table 7)**,
6. and a set of valuation assumptions for RLRN (**Table 8**).
7.

A timeline of significant events is found in the Appendix.

Renaissance Learning Background

Renaissance Learning, Inc., a publicly-traded stock on the NASDAQ, was founded in 1986 in Wisconsin Rapids, Wisconsin by Judi and Terry Paul to produce and distribute the Accelerated Reader program to K-12 schools. The Accelerated Reader program is a computer program that was developed by Judi in 1984 to help their children learn to read. In 2005, RLRN reported that Accelerated Reader was the world's most popular reading management program (Stefl-Mabry, 2005; Renaissance Learning, 2016).

In 1993, RLRN began offering professional development programs to educators. Throughout the intervening years, RLRN developed programs to quickly allow educators to assess students' reading levels, pre-K reading programs, and math programs that coincided with the reading programs. With the introduction and rise of the internet, RLRN created Renaissance Place in 2004 which provided an online portal where educators could centralize their assessment data and Accelerated Reader Enterprise and Accelerated Math Enterprise in 2008 which moved the content of the reading and math programs online. In 2011, RLRN introduced the AR Quizzing App, which allowed students to take Accelerated Reader quizzes using an iPhone, iTouch, or iPad (Renaissance Learning, 2016).

Per the firm's 10-K statement filed March 3rd, 2011, RLRN had two product segments: *Educational Software and Services* and *Educational Hardware*. The Accelerated Reader program was the predominant product for RLRN with 40% of RLRN's total revenues coming from sales of the software and 10% of total revenues coming from services related to the Accelerated Reader program in 2010. Table 1 provides the percentage of revenues that historically came from Accelerate Reader. RLRN provided two types of educational hardware: the NEO laptops and the 2Know! Classroom Response System. The revenues and profits provided in Table 2 from the Educational Hardware segment came from the sale of the laptops, the 2Know! system and the professional training associated with the hardware (Renaissance Learning, 2011a).

Table 1. Accelerated Reader Software and Quizzes Revenues as a Percent of Total Revenues by Year

Year	Percent of Total Revenues
2003	36%
2004	40%
2005	37%
2006	37%
2007	38%
2008	38%
2009	40%
2010	40%

(Renaissance Learning 10-K statements)

As of February 1st, 2011 RLRN had 893 full and part-time employees. At the end of 2010, RLRN had approximately 50,000 subscribers for its Accelerated Reader program, 14,000 for the Accelerated Math program, and 43,000 for the STAR Reading or STAR Math programs (Renaissance Learning, 2011a).
The financial statements through June, 30th, 2011 for RLRN are provided in Tables 2 through 4.

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Table 2. Renaissance Learning Income Statements

(dollar amounts in millions)

	Dec. 31st, 2006	Dec. 31st, 2007	Dec. 31st, 2008	Dec. 31st, 2009	Dec. 31st, 2010	LTM June 30th, 2011
Educational Software and Services	-	$ 85.07	$ 92.52	$ 99.33	$ 111.23	
Educational Hardware	-	$ 22.86	$ 22.71	$ 22.19	$ 18.87	
Learning Info. Systems Improvement	$ 111.53	-	-	-	-	
Total Revenue	**$ 111.53**	**$ 107.93**	**$ 115.22**	**$ 121.51**	**$ 130.09**	**$ 136.10**
Cost of Goods Sold	-					
Educational Software and Services		$ 16.93	$ 16.97	$ 14.70	$ 16.88	
Educational Hardware		$ 10.57	$ 10.79	$ 10.72	$ 10.45	
Learning Info. Systems Improvement	$ 26.47					
Gross Profit	**$ 85.06**	**$ 80.43**	**$ 87.47**	**$ 96.09**	**$ 102.76**	**$ 107.60**
Selling General & Admin Exp.	$ 48.07	$ 50.99	$ 50.94	$ 49.37	$ 52.14	$ 53.88
R & D Exp.	$ 17.29	$ 18.01	$ 17.40	$ 16.49	$ 16.37	$ 16.55
Other Operating Exp., Total	**$ 65.36**	**$ 69.00**	**$ 68.33**	**$ 65.87**	**$ 68.51**	**$ 70.43**
Operating Income	**$ 19.70**	**$ 11.43**	**$ 19.13**	**$ 30.23**	**$ 34.26**	**$ 37.21**
Interest Expense	-	-	-	-	-	$ -
Interest and Invest. Income	$ 1.08	$ 1.01	$ 0.70	$ 0.21	$ 0.12	$ 0.10
Net Interest Exp.	**$ 1.08**	**$ 1.01**	**$ 0.70**	**$ 0.21**	**$ 0.12**	
Other Non-Operating Inc. (Exp.)	$ 0.16	$ 0.17	$ 0.12	$ 0.24	$ 0.16	$ (0.10)
EBT Excl. Unusual Items	**$ 20.94**	**$ 12.61**	**$ 19.95**	**$ 30.68**	**$ 34.54**	**$ 37.25**
Restructuring Charges	-	$ (0.50)	-	-	-	
Impairment of Goodwill	-	-	$ (47.90)	-	-	
Legal Settlements	-	-	$ (0.60)	$ 0.30	-	
EBT Incl. Unusual Items	**$ 19.04**	**$ 12.11**	**$ (28.60)**	**$ 30.98**	**$ 34.54**	**$ 37.20**
Income Tax Expense	$ 7.04	$ 4.54	$ 5.85	$ 11.05	$ 10.65	$ 12.64
Net Income	**$ 11.99**	**$ 7.57**	**$ (34.40)**	**$ 19.92**	**$ 23.89**	**$ 24.61**
Per Share Items						
Basic EPS	$ 0.41	$ 0.26	$ (1.18)	$ 0.68	$ 0.82	$ 0.84
Weighted Avg. Basic Shares Out.	$ 29.55	$ 29.01	$ 29.10	$ 29.22	$ 29.29	$ 29.30
Dividends per Share	$ 0.20	$ 0.24	$ 0.28	$ 0.28	$ 0.31	$ 0.32
Effective Tax Rate %	37.0%	37.5%	NM	35.7%	30.8%	33.9%

(Standard and Poor's Capital IQ)

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Table 3. Renaissance Learning Balance Sheets

(dollar amounts in millions)

	Dec. 31st, 2006	Dec. 31st, 2007	Dec. 31st, 2008	Dec. 31st, 2009	Dec. 31st, 2010	June 30th, 2011
ASSETS						
Cash And Equivalents	$ 5.95	$ 7.34	$ 9.51	$ 36.21	$ 9.85	$ 6.70
Short Term Investments	$ 22.53	$ 8.14	$ 4.89	$ 3.28	$ 6.63	$ 2.61
Total Cash & ST Investments	**$ 28.48**	**$ 15.47**	**$ 14.40**	**$ 39.49**	**$ 16.48**	**$ 9.31**
Accounts Receivable	$ 10.53	$ 8.79	$ 8.08	$ 10.54	$ 7.87	$ 17.94
Other Receivables	$ 1.29	$ 1.45	$ 3.30	$ 3.68	$ 0.33	-
Total Receivables	**$ 11.82**	**$ 10.24**	**$ 11.38**	**$ 14.21**	**$ 8.20**	**$ 17.94**
Inventory	$ 4.11	$ 6.27	$ 5.50	$ 4.29	$ 5.04	$ 3.43
Prepaid Exp.	$ 1.90	$ 2.20	$ 2.00	$ 1.96	$ 1.67	$ 1.56
Deferred Tax Assets, Curr.	$ 3.60	$ 4.41	$ 4.18	$ 3.83	$ 2.62	$ 4.07
Other Current Assets	$ 0.10	$ 0.30	$ 0.14	$ 0.63	$ 0.71	$ 0.63
Total Current Assets	**$ 49.99**	**$ 38.89**	**$ 37.62**	**$ 64.41**	**$ 34.71**	**$ 36.95**
Gross Property, Plant & Equipment	$ 29.07	$ 29.87	$ 29.04	$ 28.16	$ 27.68	-
Accumulated Depreciation	$ (17.30)	$ (19.30)	$ (20.40)	$ (21.30)	$ (21.00)	-
Net Property, Plant & Equipment	**$ 11.81**	**$ 10.58**	**$ 8.62**	**$ 6.85**	**$ 6.72**	**$ 6.38**
Long-term Investments	$ 1.63	$ 8.98	$ 3.38	$ 4.65	$ 3.66	$ 2.73
Goodwill	$ 46.97	$ 47.07	$ 2.75	$ 2.83	$ 2.85	$ 2.87
Other Intangibles	$ 6.85	$ 6.03	$ 1.35	$ 0.92	$ 0.78	$ 2.19
Deferred Tax Assets, LT	-	$ 1.59	$ 2.74	$ 2.81	$ 4.66	$ 5.62
Other Long-Term Assets	$ 0.46	$ 0.17	$ 0.46	$ 0.81	$ 0.41	$ 0.31
Total Assets	**$ 117.71**	**$ 113.30**	**$ 56.93**	**$ 83.27**	**$ 53.79**	**$ 57.05**
LIABILITIES						
Accounts Payable	$ 2.78	$ 2.01	$ 1.71	$ 0.92	$ 2.87	$ 3.11
Accrued Exp.	$ 4.75	$ 4.18	$ 3.98	$ 5.40	$ 5.61	$ 7.26
Unearned Revenue, Current	$ 23.75	$ 35.68	$ 43.98	$ 54.22	$ 64.79	$ 54.32
Other Current Liabilities	$ 3.43	$ 3.56	$ 3.28	$ 2.65	$ 2.34	$ 3.63
Total Current Liabilities	**$ 34.71**	**$ 45.43**	**$ 52.95**	**$ 63.20**	**$ 75.61**	**$ 68.32**
Unearned Revenue, Non-Current	$ 0.89	$ 2.71	$ 2.95	$ 5.26	$ 7.05	$ 9.96
Other Non-Current Liabilities	$ 2.54	$ 7.17	$ 6.34	$ 6.86	$ 6.18	$ 6.93
Total Liabilities	**$ 38.14**	**$ 55.31**	**$ 62.25**	**$ 75.32**	**$ 88.84**	**$ 85.21**
Common Stock	$ 0.35	$ 0.35	$ 0.35	$ 0.35	$ 0.35	$ 0.35
Additional Paid In Capital	$ 54.13	$ 52.68	$ 51.74	$ 51.16	$ 50.43	$ 50.23
Retained Earnings	$ 124.29	$ 102.89	$ 38.49	$ 50.26	$ 6.78	$ 12.91
Treasury Stock	$ (99.30)	$ (98.10)	$ (95.60)	$ (93.70)	$ (92.50)	$ (91.60)
Comprehensive Inc. and Other	$ 0.07	$ 0.19	$ (0.30)	$ (0.20)	$ (0.10)	$ (0.10)
Total Equity	**$ 79.57**	**$ 57.99**	**$ (5.30)**	**$ 7.95**	**$ (35.10)**	**$ (28.20)**
Total Liabilities And Equity	**$ 117.71**	**$ 113.30**	**$ 56.93**	**$ 83.27**	**$ 53.79**	**$ 57.05**

(Standard and Poor's Capital IQ)

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Table 4. Renaissance Learning Statement of Cash Flows

(dollar amounts in millions)

	Dec. 31st, 2006	Dec. 31st, 2007	Dec. 31st, 2008	Dec. 31st, 2009	Dec. 31st, 2010
Net Income	**$ 11.99**	**$ 7.57**	**$ (34.40)**	**$ 19.92**	**$ 23.89**
Depreciation & Amort.	$ 2.44	$ 2.84	$ 2.82	$ 2.06	$ 2.21
Amort. of Goodwill and Intangibles	$ 0.70	$ 0.50	$ 0.50	$ 0.30	$ 0.20
Depreciation & Amort., Total	**$ 3.14**	**$ 3.34**	**$ 3.32**	**$ 2.36**	**$ 2.41**
Other Amortization	$ 0.40	$ 0.50	$ 0.40	$ 0.20	-
(Gain) Loss From Sale Of Assets	$ -	$ 0.03	$ 0.22	$ (0.20)	$ 0.01
(Gain) Loss On Sale Of Invest.	$ 0.16	$ 0.03	$ 0.11	$ -	$ 0.01
Asset Writedown & Restructuring Costs	-	-	$ 47.95	-	-
Stock-Based Compensation	$ 0.69	$ 1.11	$ 1.40	$ 1.50	$ 1.81
Tax Benefit from Stock Options	$ (0.40)	$ -	$ (0.10)	$ -	$ (0.30)
Other Operating Activities	$ 2.72	$ (1.30)	$ (1.30)	$ 0.39	$ (0.60)
Change in Acc. Receivable	$ 0.94	$ 1.74	$ 0.71	$ (2.50)	$ 2.66
Change In Inventories	$ (0.30)	$ (2.20)	$ 0.77	$ 1.21	$ (0.80)
Change in Acc. Payable	$ (1.40)	$ (1.10)	$ (0.80)	$ 0.05	$ 1.88
Change in Unearned Rev.	$ 5.71	$ 13.75	$ 8.54	$ 12.56	$ 12.36
Change in Inc. Taxes	$ (1.00)	$ 2.72	$ (1.60)	$ (0.50)	$ 2.28
Change in Other Net Operating Assets	$ (0.40)	$ (0.20)	$ (0.20)	$ (0.60)	$ 0.12
Cash from Ops.	**$ 22.27**	**$ 25.95**	**$ 24.94**	**$ 34.35**	**$ 45.72**
Capital Expenditure	$ (2.80)	$ (2.10)	$ (1.30)	$ (1.10)	$ (1.70)
Sale of Property, Plant, and Equipment	$ 0.02	$ 0.57	$ 0.12	$ 0.92	$ 0.01
Sale (Purchase) of Intangible assets	$ (0.70)	$ (0.20)	$ (0.10)	-	$ (0.10)
Invest. in Marketable & Equity Securt.	$ 3.18	$ 7.31	$ 8.19	$ 0.84	$ (1.60)
Net (Inc.) Dec. in Loans Originated/Sold	$ 5.91	-	-	-	-
Cash from Investing	**$ 5.60**	**$ 5.53**	**$ 6.88**	**$ 0.68**	**$ (3.40)**
Issuance of Common Stock	$ 0.02	$ 0.03	$ 0.35	-	$ 0.00
Repurchase of Common Stock	$ (22.50)	$ (1.40)	$ (0.20)	$ (0.20)	$ (1.60)
Common Dividends Paid	$ (5.90)	$ (28.70)	$ (8.10)	$ (8.20)	$ (9.00)
Special Dividend Paid	-	-	$ (21.80)	-	$ (58.30)
Other Financing Activities	$ (0.60)	$ 0.01	$ 0.11	$ 0.03	$ 0.30
Cash from Financing	**$ (29.00)**	**$ (30.10)**	**$ (29.60)**	**$ (8.30)**	**$ (68.70)**
Net Change in Cash	**$ (1.10)**	**$ 1.38**	**$ 2.17**	**$ 26.70**	**$ (26.40)**

(Standard and Poor's Capital IQ)

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Migration from Software to Online Subscription

In 2004, RLRN introduced Renaissance Place, which was a web portal that allowed instructors to aggregate their assessment data in one place. In 2006, RLRN introduced Renaissance Enterprise, which provided the Accelerated Reader and Accelerated Math programs to students and teachers via web portal rather than through a CD-ROM. The shift in delivery method also shifted the recognition and flow of revenues (Renaissance Learning, 2005; Renaissance Learning, 2008). Revenue from the sale of the CD-ROMs was recognized at the time of sale. The CD-ROM software came with a perpetual license and schools could purchase service contracts and other add-ons annually. The online services (Place and Enterprise) were annual subscriptions, with Enterprise replacing the content of the Accelerated Reader and Math software. All add-ons that were previously purchased separately came with Enterprise. Revenues for Enterprise were received at the time of sale but were recognized ratably over the subscription period, which was generally one year. Until recognized, the revenues were categorized as deferred revenue liabilities on the balance sheet (Renaissance Learning, 2008).

RLRN attributed decreasing revenues for the years 2004 through 2007 to school districts delaying their purchase decisions for the software as they evaluated the new web-based systems (Renaissance Learning, 2008). With perpetual licenses, the existing software on CD-ROM is useable after one year, but does not have the updates. Furthermore, with the CD-ROM software, the decision to purchase was primarily made at the individual school level. For the web-based portals, the decision was made at the district wide level, which entailed a longer time period to decision. By the end of 2010, approximately 50% of active reading product customers had switched to the online subscription service (Renaissance Learning, 2011a).

Economic Downturn Effects on Education Budgets

Historically, approximately 50% of public K-12 spending in the United States has come from the state level, 9% from the federal government, and the remainder from local taxes, primarily property taxes (Checkley, 2008). The recession of 2008 had a sudden impact on state revenues with a decrease in income taxes due to decreasing economic growth and the significant drop in the value of the stock market during the year. State budgets were not expected to reach pre-recession levels until 2014 and at that point state government expenses for medical costs and state retirement system costs were expected to have continued to have grown well past their pre-recession levels. The longer term effect is expected to be felt with the loss of property tax revenue due to the decrease in value of real estate that occurred (Hull, 2010). Table 5 presents the total government spending on K-12 public education for the years 2000 through 2011.

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Table 5. Total US, California, and Texas K-12 Public Education Spending Per School Year

(dollar amounts in thousands)			
School Year	United States	California	Texas
2000-01	$ 348,360,841.43	$ 42,908,787.19	$ 26,546,557.43
2001-02	$ 368,378,006.22	$ 46,265,544.17	$ 28,191,128.27
2002-03	$ 387,593,616.67	$ 47,983,401.59	$ 30,399,602.68
2003-04	$ 403,390,368.52	$ 49,215,865.86	$ 30,974,890.09
2004-05	$ 425,047,565.07	$ 50,918,654.26	$ 31,919,106.85
2005-06	$ 449,131,342.48	$ 53,436,102.81	$ 33,851,773.27
2006-07	$ 476,814,206.09	$ 57,352,599.02	$ 36,105,783.50
2007-08	$ 506,884,219.22	$ 61,570,554.98	$ 39,033,235.19
2008-09	$ 518,922,841.59	$ 60,080,929.32	$ 40,688,181.38
2009-10	$ 524,715,242.10	$ 58,248,662.00	$ 42,621,885.84
2010-11	$ 527,291,338.63	$ 57,526,834.88	$ 42,864,291.40

(National Center for Education Statistics, 2014)

RLRN credited funds from the American Recovery and Reinvestment Act for the increase in revenues for 2009 and 2010. RLRN predicted weak revenues for school districts for the next several years (Renaissance Learning, 2011a). The funding from the American Recovery and Restoration Act ("ARRA") is considered to be one-time funding and is expected to be used up between the 2009-10 and 2010-11 school years (Hull, 2010). The historic US Congressional budget for federal spending on public K-12 education is provided in Table 6.

Table 6. US Congressional Budget for K-12 Spending by Year

(dollar amounts in thousands)

Year	Congressional Appropriation	Title I Appropriation[a]
2000	$ 22,600,399	$ 7,941,397
2001	$ 27,316,893	$ 8,762,721
2002	$ 32,078,434	$ 10,350,000
2003	$ 35,113,253	$ 11,688,664
2004	$ 36,942,478	$ 12,342,309
2005	$ 37,530,257	$ 12,739,571
2006	$ 39,762,172	$ 12,713,125
2007	$ 36,830,689	$ 12,838,125
2008	$ 37,933,513	$ 13,898,875
2009	$ 38,830,088	$ 14,492,401
Recovery Act	$ 79,860,000	$ 10,000,000
2010	$ 38,921,047	$ 14,492,401
2011	$ 37,906,168	$ 14,463,416

[a]Title I Appropriation amount is included in the Congressional Appropriation amount.

(US Department of Education, 2016)

Purchase of AlphaSmart

In June 2005, RLRN purchased AlphaSmart Inc. for $58 million ($34 million in cash and $23 million in RLRN stock). With this purchase RLRN entered into the hardware sector by adding the AlphaSmart 3000, Neo, and Dana laptops in addition to the Renaissance Classroom Response System that it began providing that year. The laptops were designed as rugged word processors with a small screen for text for elementary age children and did not have internet connectivity. RLRN included software on the laptops that provided assessments for the Renaissance reading and learning programs (Renaissance Learning, 2006).

In 2008, RLRN took a non-cash, non-recurring after-tax charge of $46.5 million for impairment of goodwill and other intangible assets related to the 2005 acquisition of AlphaSmart. The write down of goodwill for AlphaSmart did not provide a tax benefit for RLRN. The charge was due to sales forecasts for the laptops not being met as a result of the combination of a poor economic climate and the discretionary nature of school purchases of laptops (Renaissance Learning, 2009). Additionally, netbooks, which are small, inexpensive laptops, were introduced in 2007, followed by the iPad in 2010 (Vaughan-Nichols, 2009; Kastrenakes, 2015). Netbooks offered far greater functionality than the AlphaSmart hardware at a reasonable cost.

No Child Left Behind Act

The No Child Left Behind Act of 2001 (NCLB) was part of the reauthorization of the Elementary and Secondary Education Act and included Title I funding provisions, which apply to disadvantaged students (Klein, 2015). The NCLB emphasizes setting standards and measurable goals for reading and math. To receive federal funding through the Title I program, schools needed to demonstrate through annual assessments of students in 3rd through 8th grade that they are making adequate yearly progress to reach 100% proficiency in reading and math. The provisions of NCLB became active in 2003.

Title I, originally a provision of the Elementary and Secondary Education Act of 1965, provided for the distribution of federal funds to schools and school districts that have high percentages of students from low-income families. The goal of Title I was to reduce educational inequality between impoverished and wealthy communities (Carmichael, 1997).
With the passage of the NCLB Act also came increased funding to implement its provisions.

Discretionary federal funding for elementary and secondary education increased from $42.2 billion in 2001 to $55.7 billion in 2004 (Dept. of Education, 2008). The NCLB Act included the implementation of the Early Reading First and Reading First programs which provided funds for research-backed reading programs for children ages 3 to 5 and children in grades kindergarten through 3rd grade, respectively (Klein, 2015). As noted in the annual reports for RLRN, funding from Title I and other funding associated with the NCLB Act was used by schools to purchase RLRN's programs. Changes to the NCLB Act or research demonstrating that RLRN's programs were ineffective could have resulted in a significant loss in revenues for RLRN.

Geographic Concentration

While RLRN did sell internationally, primarily through its UK subsidiary, less than 5% of sales for RLRN in 2010 were made outside of the US. Within the US, sales were concentrated within a few states, with 25 percent or more of sales consistently coming from California and Texas. As state governments had significant say in the education policies within the states, RLRN risked a significant decrease in revenues if these state governments were to create requirements that were inconsistent with RLRN's products and services (Renaissance Learning, 2011a).

Competitors

Information on RLRN and its two primary competitors is provided in Table 7. RLRN was the market leader based on its revenues. Neither of the two competitors paid dividends or had a history of paying dividends.

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Table 7. Comparison of Financial Information for Renaissance Learning and Competitors

	(dollar amounts in millions)		
	Renaissance Learning, Inc.	Scientific Learning Corp.	Plato, Inc.
	As of 12/31/2010	As of 12/31/2010	As of 1/31/2010
Market Capitalization	$ 313.40	$ 61.19	Private firm
Total Revenues (LTM)	$ 130.09	$ 43.38	$ 64.70
Operating Profit (LTM)	$ 34.26	$ (5.62)	$ 2.00
Net Income (LTM)	$ 23.89	$ (9.69)	$ 1.70
Total Assets	$ 53.79	$ 31.80	$ 68.20
Total Liabilities	$ 88.84	$ 27.47	$ 54.90
Interest Bearing Debt	$ -	$ -	$ 3.10
Current Ratio	0.46	1.06	1.06
Debt Ratio	1.65	0.86	0.80
ROA	44%	-30%	2%
Market Capitalization for Scientific Learning is as of 3/4/2011			
Market Capitalization for Renaissance Learning as of 5/9/2011			

(Standard and Poor's Capital IQ)

Potential Impact of the Paul's Ownership on RLRN's Value

The Paul's control of RLRN may have impacted the value of RLRN to its existing shareholders. Research shows that founding families who have a controlling interest in a firm often adjust dividend payout ratios and debt ratios to increase their wealth at the expense of other stakeholders (e.g. DeAngelo and DeAngelo, 2000; Villalonga and Amit, 2006; and Ampenberger, Schmid, Achleitner, and Kaserer, 2013). The dividend payout ratio for Renaissance at 0.38 in June of 2011 differed from that of its competitors who had no history of paying dividends.

Barriers to acquisition, such as poison pills, have been demonstrated to reduce the value of a firm. Brown and Caylor (2006) found that firm value is positively associated with the absence of staggered boards and poison pills, both barriers to acquisition. The Pauls' controlling ownership, likewise, may reduce the likelihood of offers to purchase the firm and decrease the value of the firm.

Valuation Assumptions

While RLRN was a publicly-traded company, both Plato and Permira were privately-held. Historically, privately-held firms have been shown to be valued at a 20-25% discount compared to similar publicly-traded firms. The discount was attributed to the decreased marketability of the equity of privately-held firms (Block, 2007).

Table 8 provides a set of assumptions to be used in the valuation of RLRN.

Table 8. Valuation Input Assumptions

Implied Equity Risk Premium[a]	6.01%
Yield on the 10 Year US Treasury on October 3rd, 2011[b]	1.73%
RLRN Beta[b]	0.92
Annual Regular Dividend (LTM)[b]	$ 0.32
RLRN Price on October 3rd, 2011[b]	$ 16.60
RLRN Dividend Yield[b]	1.93%
5-year annual average historic dividend growth rate[b]	9.48%
5-year annual average expected dividend growth rate[c]	7.00%
5-year annual average expected cash flow growth rate[c]	13.50%
Expected constant growth rate after 2016	3.00%
AAA Corporate Bond Index Spread[d]	0.92%
AA Corporate Bond Index Spread[d]	1.98%
BBB Corporate Bond Index Spread[d]	3.16%
BB Corporate Bond Index Spread[d]	6.70%

[a]2011 Implied Equity Risk Premium (FCFE) from Damodaran Online.

[b]Source: Standard and Poor’s Capital IQ. Some statistics were calculated by the author from data on the website.

[c]Hellman, 2011.

[d]These are the BofA Merrill Lynch US Corporate Option-Adjusted Spreads for each bond index for October 3rd, 2011 from the Federal Reserve Bank of St. Louis.

Conclusion

The investment committee of Permira is expecting your recommendation on whether to increase the bid for RLRN from the existing $455 million to $461 million on Monday, October 10th. Your recommendation should include a valuation of RLRN and any risks or other qualitative issues that you might expect to affect the value or the Paul’s decision to accept an offer.

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Appendix

RLRN Timeline

Date	Event
1986	Judi and Terry Paul found RLRN to produce and distribute the Accelerated Reader program.
1993	RLRN began providing professional development programs to educators
2001	Passage of the No Child Left Behind Act resulted in increased funding to public K-12 schools for programs like RLRN's Accelerated Reader and Accelerated Math programs
2005	RLRN purchased AlphaSmart, which produced educational hardware that could be used to run RLRN software.
2008	RLRN began providing its programs over the internet.
2008	RLRN wrote off most of the value of the goodwill from the purchase of AlphaSmart as an impairment charge due to poor sales of the hardware and low expected demand.
2008	Housing market bubble burst resulted in decreased education funding through the next several years.
2009	American Recovery and Reinvestment Act provided a one-time increase in funding for public schools for the academic years 2009-2010 and 2010-2011
2011	RLRN introduced quizzing applications for use on Apple devices.
August 15th, 2011	Permira Advisers made a bid of approximately $426 million for RLRN
August 24th, 2011	Plato Learning made an unsolicited bid of approximately $455 million for RLRN
September 27th, 2011	Permira made a counter offer valued at $455 million for RLRN.
October 7th, 2011	Plato made a final offer of $469 million for RLRN.

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