



Plato Learning shows profit



Glen Stubbe, Star Tribune

Tony LaValle, a junior at Tartan Senior High School in Oakdale, used Plato software during his reading-skills class. The Plato Learning product MN GRAD Reading Learning Path helps students pass the state reading test.

A new revenue philosophy leads the online educational company to its first quarter in the black since 2004.

By **STEVE ALEXANDER**, Star Tribune

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Profitability has been a long time coming to Plato Learning Inc., a Bloomington-based online education company that just turned its first quarterly profit since 2004.

It was a small profit -- \$259,000, or 1 cent per share on revenue of \$16 million -- but a milestone for the perpetually struggling firm, which serves about 1,200 public school districts nationwide and has posted annual losses for the past seven years.

The question is, can Plato Learning maintain its upward momentum? These are not boom times for Plato's customers: kindergarten-to-12th-grade public schools and community colleges. But the firm says it has retooled for the times.

Plato Learning's software lets students interact with lessons on a computer. A writing lesson invites students to underline words and phrases in Lincoln's Gettysburg Address that show how he used repetition to get his ideas across. The program gives students feedback about how well they did, and later tests them.

"It's a wonderful alternative to traditional classroom learning," said Nancy Stalland, a reading specialist at 1,800-student Tartan Senior High School in Oakdale, where 37 students are part of a four-month test to see if the learning software can help them pass a state reading test required for graduation. "Students can work at a pace that is individual to them, and spend more time in the areas that are harder for them."

Stalland can monitor their progress, right down to the number of minutes they spend on a lesson or test.

How did Plato Learning -- which has its roots in the old Control Data Corp. -- reinvent itself? Most importantly, the company radically changed its business model beginning in 2006, and now mostly collects its software licensing fees over several years (subscription model) rather than as a lump sum (perpetual license model).

"It makes earnings smoother, and investors like predictability," said Rob Rueckl, Plato's chief financial officer. The first-quarter profit came during what previously would have been a slow quarter, he said.

"Their business model has clearly turned for the better," said Robert Evans, an analyst with Craig-Hallum Capital in Minneapolis. "I expect every quarter this year will be a nice improvement over a year ago," although steady profitability will be elusive.

Evans predicts a second-quarter loss of \$1.6 million, or 7 cents a share, on revenue of \$15.7 million, and an annual

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loss of \$2.7 million or 11 cents a share on revenue of \$65 million.

Changed delivery model

The company also shifted the way it delivers its product. Instead of providing software that schools ran on their own computers, Plato Learning began "hosting" the software on its own machines -- essentially taking over the management of computer learning. The online software is easier for schools to use because the only computer requirement is a Web browser.

"Customers don't have to worry about what processor chip or configuration their computer has, or whether it's a PC or a Mac," Rueckl said. "All that complexity goes away."

The software also was upgraded.

"We offer full-semester courses now, and we didn't before," said Vin Riera, Plato Learning's CEO. "We're also adding value for the schools, because we align the course with national standards, and add reporting features such as online grading." Courses include math, social studies, science and language arts; schools can license them individually or in groups.

Software licensing costs are based on the number of computer workstations a school has, no matter how many students use a single workstation during the school day. Fees range from \$90 a year per workstation for a single subject to \$1,000 a year per workstation for a collection of subjects designed for multiple grade levels.

Analysts are divided about Plato Learning. Some say that its prospects are good while its stock is attractively priced at \$1.88 a share. Others say that, whatever the merits of its software business, the turnaround has already been priced into the stock, limiting its upside potential.

"We view the stock as very cheap," said Evans, who has a buy recommendation. "You've got a company with an enterprise value (market capitalization minus cash on hand) of \$20 million, but which is expected to have annual revenue of \$65 million and a lot of recurring license

revenue."

Not everyone is convinced.

"It may be a good company, but it's not a good stock because the market has already given them credit for the turnaround," said David Trainer, president of New Constructs, a Nashville equity research company that evaluates firms strictly on their finances. "The way I model it, they've got to grow 10 percent a year for the next 15 years to justify the current stock price. How many companies are going to be able to do that?"

Rueckl disputed Trainer's analysis.

"Those number-cruncher metrics are not a good measure of a company going through our transition to a subscription software business," he said. "We've made great progress in growing the new business, but we still have a piece of our older business remaining."

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