

## Lisa Rapuano on Ambassadors Group

*Lisa Rapuano founded Lane Five in January, 2007. She managed a long/short equity hedge fund for Matador Capital Management for over two years prior to founding Lane Five, and spent over ten years at Legg Mason Capital Management. At Legg Mason, she was the Director of Research and portfolio manager of the Legg Mason Special Investment Trust. She co-managed this fund with Bill Miller from 1997-2000. As sole manager of the fund from 2001-2003 she achieved top-decile returns as tracked by Lipper. Lisa graduated from Yale in 1988 and received her CFA designation in 1994.*

Ambassadors Group (EPAX) runs high-end student travel under the People to People and Discovery brand names. This business used to be terrific, showing high teens enrollment growth, high 20%-range revenue growth and triple digit returns on invested capital from the early 2000s through its peak in 2007. However, the fundamentals have declined precipitously since then. This decline began in 2009, when the company saw a dramatic downturn in the number of students travelled during the financial crisis and recession. Unlike most other travel and education related companies, however, there has been no rebound in sales, and the number of enrolled travelers continues to contract. For 2011, the company should end the year with travelers down ~10%, and down over 54% from the 2007 peak.

During this time, the company has increased its selling and marketing expenses related to the travel business by about 5% and general and administrative spending related to the travel business is down only 13% from the peak. This is obviously very poor performance when what was a triple-digit return business is likely to earn only about 3% on equity and capital in the year we just completed.

Despite the disappointing results for the last four enrollment years, we think the business could be revived to at least some level of its former level of performance, and at \$5.50 today, it trades at a ridiculously compelling valuation. At today's price of ~\$5.62, the company has a market capitalization of ~\$98 million. Cash at year end was ~\$58.6 million, plus student deposits of \$27.4 million, which we treat as debt, puts the enterprise value at ~\$70 million.

This company has historically generated outsized free cash flow due to high margins and low capital expenditure needs. Since the students put down significant deposits ahead of their travel dates, the company holds a large amount of "float". Working capital can be very volatile. In most years it is a benefit to cash but in 2011 we expect working capital to use cash because of lower student deposits and the company's choice to prepay a lot of future travel expenses. In 2010, however, working capital was positive. So let's leave working capital aside for this exercise. The company's pre-working capital free cash flow yield to EV is as follows:

2011: 9.9%  
2010: 25.7%  
2009: 66.7%

The company is trading at 5.1x the amount of cash it generated just a year ago. We rarely see these sorts of free cash flow multiples for any type of business.

Clearly, the market is pricing the stock as if these cash flow numbers will never be repeated, but we think that with the right strategy free cash flow can return to previous levels. We are not advocating a particular approach at this time, but we see multiple ways that costs can be cut, money-losing programs can be closed, program itineraries and possibly pricing can be revamped to meet customer

needs more appropriately, assets can be sold or optimized, and marketing and sales can be made more efficient. In December we asked the Board to consider these issues and come back to us with proposals, and we intend to continue this conversation.

The core People to People Student Ambassadors program is less awful than the aggregate business appears to be, and we think there are opportunities to isolate that value while lowering or eliminating losses in the non-core programs. In addition, we think there are costs that are redundant, marketing approaches that are outdated and expensive, overcapacity of real estate that can be optimized and possibly sellable assets that are not core to the student travel operation.

Overall we think Ambassadors Group is worth at least \$10 if it is run in a low growth, asset optimized manner that returns capital to shareholders and possibly as much as \$20 if the business can be reinvigorated and repositioned to begin growing again.

*This analysis was made in 2012.*

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