SEI

STRATEGIC EDUCATION, INC.

2019 ANNUAL REPORT

Strategic Education, Inc.
Letter to Shareholders 2019

Dear Fellow Shareholders,

Strategic Education, Inc. (or SEI) was formed by the merger of Strayer Education, Inc. and Capella Education Company, on August 1, 2018. In this letter, I will review our strong academic, operational, and financial results in 2019 (our first full year of operation), as well as discuss our plans for 2020. In addition, I have included as an appendix to this letter both an excerpt from Strayer University's 1912 student catalog, as well as an excerpt from my first letter to shareholders, written in 2001. These two excerpts have been reprinted in each of our annual reports since 2001, and shareholders who are new to SEI may wish to read them prior to reading this letter, as I believe they provide helpful background on both our culture and operating model.

2019 Results

I will describe SEI's 2019 performance in this letter assuming our founding merger had taken place on *January* 1, 2018 (vs. August 1), so shareholders will see a full year over year comparison of our constituent businesses. While less impressive than the actual results presented in the 10K accompanying this annual report, I believe this "pro-forma" comparison provides a clearer picture of what is actually going on in our enterprise, and is frankly impressive enough.

SEI's two main operating assets are Strayer University (founded in 1892) and Capella University (founded in 1993). Both Universities hold regional accreditation, the most prestigious academic accreditation a university in the United States may hold. Both Universities provide undergraduate and graduate degrees to working adult students. In 2019, the combined student enrollment of both Universities grew 7%, from roughly 86,000 students to 92,000. More importantly, the number of students who graduated from both Universities in 2019 also grew 7% from 18,450 to 19,800. Propelled by this student enrollment, SEI's revenue in 2019 grew 8% from $924mm to $997mm. Shareholders should note that this slightly larger rate of revenue growth vs student enrollment growth (8% vs. 7%) was mostly caused by non-tuition revenue sources, and not by significant increases in tuition. Indeed, as I will return to later in this letter, one of our most important strategic objectives at SEI is to *reduce* both the cost of tuition for our students, and the amount of debt they incur to finance their education.

SEI's expenses in 2019 increased only 2%, from $788mm to $803mm. This led to an increase in our adjusted operating income of over 40%, from $136mm to $194mm. While our *academic* costs to serve our students did grow proportionally with our student population, we were able during the year to achieve $50mm in reductions to our *non-academic, corporate, and administrative operating* costs. Our operating margin increased in 2019 from 14.7% to 19.5%, and our adjusted earnings per share, even after accounting for the roughly 10mm shares we issued in 2018 to acquire Capella Education, increased by 40%, from $4.79 to $6.67.

Underlying these impressive financial results in 2019 were significant academic developments at both Strayer and Capella Universities. In last year's Letter to Shareholders, I described Strayer University's major new initiative to overhaul its entire General Education curriculum. This overhaul was based on work completed by the University's faculty and curriculum development staff, in conjunction with research performed by McKinsey & Company and the Lumina Foundation. The overhaul of the curriculum is designed to embed in our General Education courses those essential skills and behaviors which companies find most critical to the success of their employees. By year end 2019, we had rebuilt five of the University's 14 required General Education courses (Math 100, English 100, Communications 100, Computer Information Science 100, and Psychology 100), and the remainder of the courses will be completed by mid-year 2020. The early results on the five new courses are very promising in terms of student performance and satisfaction, and we are excited about the impact that embedding these key employability skills into our academic curricula will have on our graduates' success in the workforce.

During 2019, Strayer University's curriculum development staff also rolled out an exciting new undergraduate and graduate program in sports performance management. This program was designed in collaboration with Joe Gibbs, the former three time Super Bowl winning NFL head coach, five time championship winning NASCAR team owner, and the only person in history to be elected to two separate major professional sports Halls of Fame. Joe cares deeply about education, and was instrumental in designing the actual coursework for the program, which is named for him. While still small (a few hundred students in 2019), we have high hopes for the future of this program, and it is indicative of the way that Strayer University is constantly seeking to make its course offerings more relevant and attractive to students.

Another of Strayer University's marquee offerings, the MBA program at the Jack Welch Management Institute (JWMI), is no longer small. Under Jack's guidance and leadership, the program grew in 2019 to over 2,000 students. Since its inception in 2012, JWMI has awarded over 2,000 MBA degrees. Jack and I were both very proud when in 2019, JWMI was recognized by the Princeton Review for the *fourth* year in a row as one of the top 20 online MBA degrees in the country.

In 2019, Strayer University's academic results were significantly advanced by the work of our internal video production staff - Strayer Studios. We are on a multi-year investment plan to rebuild all of Strayer University's online courses in a new more engaging and compelling viewing format. This format uses documentary filmmakers, working with our faculty, to build story-driven narratives around our case studies. To put the impact of this investment in context, in the Fall 2019 academic term, roughly 52% of our 107,000 online course enrollments were taught in this new Strayer Studios course format. The academic results in these courses (course completion rates, grade point averages, student reviews, and student continuation rates) were all significantly higher in the Strayer Studio courses than in our old online format. This makes intuitive sense as our research has shown, particularly in online courses, that the largest predictor of student success is student engagement. We use the term "binge learning" to describe our objective. We want the academic material to be so interesting that the student literally cannot turn it off. So far, our investment in Strayer Studios appears to be paying off. We are so excited by the results to date that we are partnering with the Sundance Film Institute to identify new, young, documentary filmmakers who will be awarded a six month writer-in-residency assignment at Strayer Studios.

The improved academic outcomes at Strayer University in 2019 from all these initiatives led to an increase in our annual student continuation rate of 100 basis points, from 81% to 82%. Strayer University's cohort default rate, an important indicator of our students' ability to service the debt they incur to finance their education, also improved slightly in 2019 from 10.6% to 10.4%.

Finally, Strayer University opened six new campuses in 2019; three in the state of Texas (El Paso, Fort Worth, and Killeen); two in the state of Alabama (Mobile and Decatur); and one in Chattanooga, Tennessee. These new campuses are all built in our new, smaller footprint model (approximately 2,500 square feet) and are designed to support students who largely prefer to take their courses online. Notwithstanding this accelerating shift to online classes, we are pleased to make this investment in opening new physical campuses because our research has shown that, even if students take *all* their classes online, they perform better academically if there is a physical campus nearby, at which the student can access tutoring, guidance, and administrative support.

Capella University also made a number of significant investments in academic quality in 2019. During the year, Capella instituted a new proprietary academic planning tool that helps students manage their program completion, and also established a new online faculty action center. This faculty action center allows Capella's faculty (who teach entirely online and are geographically dispersed) to more quickly share best practices in teaching strategies. We piloted these initiatives in 15 courses in 2019 and saw significant increases in student engagement, higher course completion rates, and improved academic outcomes.

During 2019 Capella University's faculty accomplished a full redesign of its Doctoral program in Education, and continued to roll out additional academic programs in their unique direct assessment "FlexPath" model. Roughly 25% of Capella's students are now enrolled in this direct assessment model. FlexPath allows the student to proceed as quickly (or slowly) through the course material as they wish, liberated from the traditional credit hour schedule. Students who are better academically prepared, or less encumbered by work or family obligations, can earn their degrees faster, at less cost, than in traditional academic programs. It is a mark of the high regard that the educational community holds in Capella University's academic rigor and quality, that we are one of just nine institutions in the country which is allowed to use this direct assessment model.

Notwithstanding Capella's 30 year history as a solely online university, we were very excited in 2019 to pilot a new Capella University physical campus center in Atlanta, Georgia. We are making this investment because of our aforementioned experience at Strayer University, where our online students have always performed better academically if there is a physical campus presence nearby, *even if the student takes all of their classes online.* The reason for this may be as simple as the self-selection of more serious students applying to enroll, but the phenomenon has been a statistically proven fact at Strayer University. We are eager to see if it has a similar effect on Capella University's academic results.

Capella University did have a minor increase in its cohort default rate in 2019, from 6.5% to 6.8%. However, Capella's cohort default rate is still well below the national average of 10.1%, and is indeed even well below the average of all public state universities of 9.6%. During 2019, Capella also had a slight decrease in its student continuation rate, from 84% to 83%. While the slight deterioration in both of these quality metrics certainly caught our attention, we are not particularly concerned by either of them, as we believe both are mostly related to a mix-shift at Capella University towards undergraduate students, whose performance on these quality metrics is, as a group, generally below that of graduate students.

In fact, we were extremely proud in 2019 when Capella University was recognized by the Georgetown University Center for Education and Workforce as having one of the highest long-term returns on student investment of any university in the country. The Georgetown University study ranked Capella University alumni 95th out of 4,500 universities (top 2%) in terms of the economic benefit of their college degree. We believe that Capella University's very strong academic results in their School of Nursing and Health Science (high growth employment areas) are a large driver of the University's high ranking on return on student investment.

In addition to Strayer University and Capella University, SEI's third operating segment, non-degree programs, also performed better in 2019 than in 2018. This segment, while small, contains all of our non-degree granting programs, such as our coding academies, and Sophia, our low cost general education online course library. This segment incurred a pro-forma operating loss in 2018 of $9mm, but improved to $1mm in operating income in 2019 on $15mm of revenue.

2019 Capital Allocation

We started 2019 with $387mm in cash and marketable securities on SEI's balance sheet. The strong operating results across all of SEI's segments generated $242mm in cash flow before taxes in 2019. We used this generated capital during the year as follows. First, we paid $49mm in federal and state taxes. Next, we allocated $42mm to capital expenditures and other investments in our business. Roughly onehalf of that amount went to information technology upgrades and infrastructure. One-quarter went to physical campus facilities (both new openings and routine maintenance). The final one-quarter was invested in course development, academic technologies, and artificial intelligence. We were then left with $151mm of what we refer to as owners' distributable cash flow.

Readers of last year's letter to shareholders will remember that I stated that SEI's owners' distributable cash flow per share should roughly equal our reported adjusted net income per share. Our 2019 owners' distributable cash of $151mm ($6.86 per share) actually slightly exceeded our adjusted net income of $147mm ($6.67 per share). Out of this owners' distributable cash flow we paid $47mm in dividends, including raising the annual dividend by 20% to $2.40 per share in the fourth quarter of 2019. We added the remaining $104mm to our cash and marketable securities, leaving us at year-end with a rock solid balance sheet of $491mm in cash, an undrawn $250mm revolver, and no debt. In 2020, we are well positioned to financially support both of our Universities, to continue to return capital to owners, and to take advantage of any opportunities that come our way.

2020 Plans

At SEI, we exist to create a healthy return on our students' investment in their education. By doing so we know that we will create economic opportunity and income mobility for our alumni. In 2020, in order to improve our students' return on their investment, we will continue to work to lower the *cost* of their investment. Like in prior years, we anticipate little to no increase in tuition rates at either Strayer University or Capella University. We think it is crucial to the long term sustainability of our institutions that we use our scale and financial discipline to hold the line on the systemic inflation in the cost of higher education. In addition to keeping tuition essentially flat, we are also seeking to *lower* the overall cost of our University degrees through three initiatives in 2020. First, through the expansion of Capella's FlexPath program, we are lowering the average total cost of earning a Capella University degree by a significant amount. Allowing students to proceed through their academic program faster (if they are able), clearly allows those students to finish their degrees at lower cost, and incur less debt.

Our second initiative addresses the phenomenon, particularly at the graduate level, of students borrowing significantly more funds under the federal student loan program than they need for their actual tuition. For part-time working-adult students, the need for funds above and beyond tuition is significantly lessened, and in many cases is a lifestyle choice as opposed to a necessity. Using our extensive data on students' borrowing patterns (both current and historical), in 2019 we introduced the SEI Smart Borrowing Program. This program identified students who were susceptible to over-borrowing, and counseled them to carefully consider how much they actually needed in the way of loans, with a focus on long term financial impact and responsible borrowing. We piloted this program to a small group of students in 2019, and the results were remarkable. For the test cohort, the average amount per academic quarter that the students borrowed above the cost of tuition, was reduced by almost 90%, from $2,900 to $300. Given the success of that pilot, in 2020 we are investing in rolling out the Smart Borrowing Program across all of Strayer University and Capella University.

Finally, our third initiative in 2020 to reduce the cost that students incur to fund their university education is to continue to build out our corporate alliance programs at both Strayer and Capella University. In these programs, the cost of a working adult's education is provided, in whole or in part, by their employer. We currently have over 750 such employer relationship at our two Universities, and we intend to increase that number in 2020. One of our most successful such relationships is our arrangement with Fiat Chrysler Automobiles (FCA), in which employees at FCA dealerships (and their immediate family members) can attend Strayer University with 100% of their tuition paid by the dealership. In this program the employee graduates with a degree from Strayer University after *zero* out of pocket costs and *zero* debt. In the Fall 2019 term, over 1,700 FCA employees were enrolled at Strayer University in this program. FCA is delighted with the results because the program has significantly decreased costly employee turnover at the participating dealerships, more than offsetting the tuition benefit expense. We think the FCA program is both a model for the future, and a potential solution to the nationwide problem of excessive student debt.

In addition to these student cost reduction initiatives, we also plan in 2020 to continue to invest in our academic quality and student outcomes. With the success of our recent new campus openings, we plan to open 4-6 new Strayer University campuses in 2020, and 2-4 new Capella University campus centers[1]. We also plan to experiment with 1 or 2 co-located Strayer/Capella facilities in 2020.

In 2020, we plan to continue to invest heavily in our online curricula, academic technologies, and artificial intelligence capabilities. At SEI we believe that the future of education is digital, and that we must have best-in-class online academic infrastructure. One important point for shareholders to note is that we are indifferent as to whether these investments take the form of capitalized expenditures or expenses. We make them if we believe them to be high return uses of our owners' capital, regardless of their accounting treatment. In some years these investments may have a large impact on capex. In other years, the impact will be seen more on our income statement and our operating margins.

Finally, in 2020 we will continue to review opportunities to deploy our owners' capital in select acquisitions. Admittedly, we have only done one major acquisition in 19 years. However, we are always on the lookout for first-rate academic institutions which can benefit from our scale and technology. We know that in 2019 we generated significant distributable cash, and we believe that in 2020 that amount will increase. We are therefore cognizant of the fact that at the start of 2020 we have already fully funded the needs of our two Universities, and in the absence of a major use of capital for an acquisition, we will be in position at the end of 2020 to significantly increase our return of capital to owners.

Conclusion

Reviewing our 2019 results, I believe it is clear that the 2018 merger of Strayer Education and Capella Education into SEI has been an unalloyed success. Under SEI's stewardship, Strayer University and Capella University are both stronger academic institutions, with better student outcomes, and greater financial resources. In 2020 we intend to use these greater financial resources to continually improve our students experience and performance, and thus continue to increase the value of your investment in SEI.

SEI's success in 2019 would not have been possible without the inspired leadership of our CEO, Karl McDonnell, and his entire senior team; including our two outstanding University presidents, Richard Senese, Ph.D. at Capella University; and Brian Jones at Strayer University. In 2019, Brian has shown all of us the true meaning of both grace and courage, as he has shepherded Strayer University while simultaneously battling ALS.

Shareholders are always fortunate to own a business with great management, but even more so when that management team has the added benefit of a long operating history *together.* Excellence as a team is both developed, and proven, over time. Our leadership team at SEI has worked together for well over a decade, successfully navigating two academic institutions through all sorts of operating, macro-economic, and regulatory cycles. As shareholders we can be confident in, and grateful for, our leadership teams' competence, commitment, and dedication to the mission of our enterprise.

[1] Strayer University's facilities are called campuses, Capella University facilities are called campus centers. The difference in terminology between the two Universities reflects the fact that due to regulatory and accreditation requirements, the Capella facilities may not host actual classes, but only offer tutoring, advising, and administrative support. Strayer University facilities may hold classes, but as I have reported in this letter, do so infrequently with the shift in preference of Strayer University students towards taking all of their classes online.

I look forward to seeing all of you at SEI's 2020 Annual Meeting of Shareholders, to be held at our corporate headquarters in Herndon, Virginia at 8:00am on April 28, 2020. I also urge any shareholder who can find the time to attend one of Strayer University's or Capella University's 2020 graduation ceremonies. The dates, times, and locations of all the ceremonies can be found on our website (www.strategiceducation.com). The graduations are wonderful opportunities for shareholders to see firsthand what our enterprise actually does, and why so many of us find our mission so fulfilling.

Finally, on behalf of our entire Board of Directors, I want to thank you once again for the opportunity to have been the stewards of your financial capital over the last year. We are using that capital to improve people's lives through education. It is a worthy investment.

Sincerely,

Robert S. Silberman

Robert S. Silberman
Executive Chairman
Strategic Education, Inc.

OUR HERITAGE

Reprinted from the Strayer Business College
1912 student catalog

This catalog was written with a view of setting before the men and women of this community some of the advantages of a business education, and of acquainting them with the superior facilities of this school for giving high-grade business training.

The courses have been designed and presented to meet the needs of the business office of today. The teachers are men and women who are specialists in their respective subjects. The school rooms have been chosen and equipped with special reference to light, comfort and sanitation, so as to make it an ideal place for study.

We ask that the public, in determining which school it shall attend, to consider the facts in connection with this school, as are outlined in this catalog and supplementary literature. It is twenty years old. It has grown steadily since the beginning. It attributes its growth to correct ideals, careful management and successful, enthusiastic, and rapidly increasing alumni.

While it is essential to its success that a school should give thorough instruction in the subjects that comprise its courses, yet the school that does only this, falls short of its full mission. The development of those traits of character which make for reliability in business and good citizenship are the peculiar province of the school as well as the home. This school, then, has nothing in common, can have nothing in common, with those so-called business schools offering cheap and superficial courses. Such courses, while inexpensive, and possibly of short duration, cannot result in anything but disappointment in the end.

This school, then, stands for high ideals, it courts investigation, welcomes comparison, and stands by its promises. It is a school to which you may attend with the knowledge that you will be in pleasant surroundings, will be accorded fair treatment, and will be given thorough and painstaking instruction.

Finally, in presenting this catalog, we want to thank a discerning public for its support, and assure it that we shall endeavor to continue to merit the bountiful confidence it has heretofore placed in us.

STRAYER BUSINESS COLLEGE
CIRCA 1912

OUR BUSINESS MODEL

Reprinted from SEI's
2001 Letter to Shareholders

Strayer Education, Inc. is an education services holding company whose primary asset is Strayer University, a 110 year old institution of higher learning focused on educating working adults. In this letter, when I use the term "Strayer", I am referring to the company, as opposed to the university. Strayer University, founded in 1892, offers associate, bachelor's, and master's level degree programs in Business Administration, Accounting, and Computer Information Systems. Strayer University serves students at 17 physical campuses in Maryland, the District of Columbia, and Virginia. In addition, Strayer University serves students in all 50 states and 39 foreign countries worldwide on the Internet through Strayer University Online.

Strayer's revenue comes from tuition payments and fees paid by, or on behalf of, Strayer University students. That revenue comes in essentially three forms. Roughly 70% is paid through federal student loans, approximately 20% is paid directly to Strayer by corporations or institutions on behalf of their employees who attend Strayer University, and the remainder is paid by students through their own sources of credit.

Strayer's expenses include salaries paid to the faculty at the University who perform the teaching duties, salaries paid to the administrative and admissions staff who manage the campuses, and salaries paid to the corporate staff who manage the Company's affairs. Expenses also include lease payments for the campus buildings we lease and depreciation for the campus buildings we own, as well as advertising and marketing costs which serve to attract prospective students to Strayer University. Finally, our expenses include supplies; such as books and computers necessary to support the educational process. Some of the furniture and electronic equipment is capitalized on our balance sheet and the expense is recorded as amortization over the period we expect the equipment to last, in accordance with generally accepted accounting principles.

The difference between the revenue we take in and the expenses we pay out is used to first pay taxes and is then added to the after-tax income generated by our financial assets (cash and marketable securities on our balance sheet) to make up our reported net income on a fully diluted basis.

Two of the attractive attributes of our business are that it generates significant after-tax free cash flow from operations, and that it has a high return on invested capital. The required capital expenditures to keep our existing assets functioning are roughly equal to our depreciation expenses. The investment capital required to fund our growth initiatives is not major. This investment capital includes traditional GAAP defined capitalized expenses, as well as increased spending which runs through our income statement. We are therefore in the enviable position of generating almost our entire net income as distributable free cash flow, even after investing in our growth. Some of this cash we do distribute back to our shareholders as dividends (common and preferred). The rest of the cash we intend to maintain as liquidity to either fund new opportunities, or ultimately return to our shareholders in a tax efficient manner. We understand that the redeployment of this cash is crucial to creating shareholder value.

As both shareholders and management, we are excited by this business model because we believe that the value of a college degree is rising with the transition to a knowledge economy, and that working adult students in search of an accredited college degree are underserved. We know that Strayer University's academic quality and convenience make it ideally suited to meet this growing demand. We have the right product, at the right time for a growing market. Our product, a quality college degree, is valued highly both by students and employers.

In 2001, we developed and committed to a new strategic plan, geared to expanding beyond our current regional focus to serve unmet nationwide demand for working adult post-secondary education. This plan consists of:

- Opening new campuses, particularly beyond our current geographic scope.
- Investing in our online university.
- Maintaining strong alliances and outreach to the major employers of our students.
- Carefully screening opportunities to invest capital through acquisitions.

CORPORATE INFORMATION

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Executive Chairman

Karl McDonnell
Chief Executive Officer

Daniel W. Jackson
Executive Vice President and
Chief Financial Officer

Andrew E. Watt
Senior Vice President and
Chief Operating Officer

Lizette B. Herraiz
Senior Vice President and
General Counsel

Christa E. Hokenson
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Thomas J. Aprahamian
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Chief Accounting Officer

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Founder and Managing
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Karl McDonnell
Chief Executive Officer,
Strategic Education, Inc.

Todd A. Milano
President Emeritus, Central
Penn College

G. Thomas Waite, III
Former Treasurer and CFO,
Humane Society of the United
States

Corporate Headquarters
2303 Dulles Station Boulevard
Herndon, VA 20171

Web Sites
Strategic Education, Inc.
www.strategiceducation.com

Strayer University
www.strayer.edu

Capella University
www.capella.edu

Annual Meeting
The Annual Meeting of Stockholders will be held on April 28, 2020 at 8:00am ET at Strategic Education, Inc.'s corporate headquarters located at 2303 Dulles Station Boulevard Herndon, VA 20171

Transfer Agent
American Stock Transfer &
Trust Company, LLC
6201 15th Avenue
Brooklyn, NY 11219

Stock Listing
Strategic Education, Inc.'s common stock is traded on the NASDAQ Global Select Market under the symbol "STRA"

Independent Registered Public Accounting Firm
PricewaterhouseCoopers LLP
1800 Tysons Boulevard
McLean, VA 22102

Additional Investor Information
Contact the Investor Relations department at (612) 977-6331

STRATEGIC EDUCATION, INC.
2303 DULLES STATION BLVD., 6TH FLOOR
HERNDON, VA 20171
WWW.STRATEGICEDUCATION.COM