ITT EDUCATIONAL SERVICES INC
Form 10-Q
July 27, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 1-13144

ITT EDUCATIONAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-2061311**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
13000 North Meridian Street Carmel, Indiana	**46032-1404**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (317) 706-9200

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

23,319,140

Number of shares of Common Stock, $.01 par value, outstanding at June 30, 2012

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ITT EDUCATIONAL SERVICES, INC.

Carmel, Indiana

Quarterly Report to Securities and Exchange Commission

June 30, 2012

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

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ITT EDUCATIONAL SERVICES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	As of		
	June 30, 2012 (unaudited)	**December 31, 2011**	**June 30, 2011 (unaudited)**
Assets			
Current assets:			
Cash and cash equivalents	$ 167,234	$ 228,993	$ 158,235
Short-term investments	0	148,488	147,136
Restricted cash	751	2,128	387
Accounts receivable, net	73,675	48,106	47,041
Deferred income taxes	16,859	9,759	4,804
Prepaid expenses and other current assets	14,571	18,814	24,567
Total current assets	273,090	456,288	382,170
Property and equipment, net	198,175	201,257	198,207
Deferred income taxes	36,016	33,267	33,165
Other assets	49,360	38,006	45,610
Total assets	$ 556,641	$ 728,818	$ 659,152
Liabilities and Shareholders Equity			
Current liabilities:			
Accounts payable	$ 80,777	$ 78,876	$ 66,008
Accrued compensation and benefits	25,711	21,438	23,610
Other current liabilities	19,454	18,190	8,421
Deferred revenue	121,873	226,543	266,847
Total current liabilities	247,815	345,047	364,886
Long-term debt	150,000	150,000	150,000
Other liabilities	74,615	64,972	57,791
Total liabilities	472,430	560,019	572,677
Shareholders equity:			
Preferred stock, $.01 par value, 5,000,000 shares authorized, none issued	0	0	0
Common stock, $.01 par value, 300,000,000 shares authorized, 37,068,904 issued	371	371	371
Capital surplus	198,812	189,573	181,954
Retained earnings	925,781	827,675	684,905
Accumulated other comprehensive (loss)	(9,147)	(9,479)	(4,438)
Treasury stock, 13,749,764, 10,969,425 and 10,045,948 shares, at cost	(1,031,606)	(839,341)	(776,317)
Total shareholders equity	84,211	168,799	86,475
Total liabilities and shareholders equity	$ 556,641	$ 728,818	$ 659,152

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ITT EDUCATIONAL SERVICES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Amounts in thousands, except per share data)

(unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Revenue	$ 329,825	$ 387,877	$ 671,619	$ 771,048
Costs and expenses:				
Cost of educational services	140,940	142,272	275,881	280,198
Student services and administrative expenses	111,467	115,626	217,733	220,209
Total costs and expenses	252,407	257,898	493,614	500,407
Operating income	77,418	129,979	178,005	270,641
Interest income	502	790	1,183	1,625
Interest (expense)	(1,254)	(507)	(1,801)	(1,064)
Income before provision for income taxes	76,666	130,262	177,387	271,202
Provision for income taxes	30,664	51,262	70,314	106,816
Net income	$ 46,002	$ 79,000	$ 107,073	$ 164,386
Earnings per share:				
Basic	$ 1.97	$ 2.88	$ 4.39	$ 5.81
Diluted	$ 1.96	$ 2.85	$ 4.36	$ 5.77
Weighted average shares outstanding:				
Basic	23,390	27,474	24,405	28,275
Diluted	23,529	27,719	24,583	28,511

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ITT EDUCATIONAL SERVICES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net Income	$ 46,002	$ 79,000	$ 107,073	$ 164,386
Other comprehensive income, net of tax:				
Prior service cost amortization, net of income tax of $152, $135, $303 and $270	(237)	(211)	(474)	(422)
Net actuarial pension loss amortization, net of income tax of $259, $186, $531 and $372	404	290	827	580
Unrealized gains (losses) on available-for-sale securities, net of income tax of $0, $0, $0 and $0	2	46	(21)	(87)
Other comprehensive income, net of tax	169	125	332	71
Comprehensive Income	$ 46,171	$ 79,125	$ 107,405	$ 164,457

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ITT EDUCATIONAL SERVICES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Cash flows from operating activities:				
Net income	$ 46,002	$ 79,000	$ 107,073	$ 164,386
Adjustments to reconcile net income to net cash flows from operating activities:				
Depreciation and amortization	7,695	7,040	15,115	13,882
Provision for doubtful accounts	19,006	17,487	34,607	30,154
Deferred income taxes	(6,334)	(4,492)	(10,076)	(7,177)
Excess tax benefit from stock option exercises	(574)	(627)	(1,379)	(978)
Stock-based compensation expense	4,272	4,758	8,755	8,672
Other	96	(987)	(243)	(2,417)
Changes in operating assets and liabilities:				
Restricted cash	372	1,433	1,377	(132)
Accounts receivable	(38,270)	(4,730)	(60,176)	(8,258)
Accounts payable	3,113	(6,681)	1,901	(1,912)
Other operating assets and liabilities	(15,400)	(32,886)	6,766	24,036
Deferred revenue	(58,274)	1,307	(104,670)	22,485
Net cash flows from operating activities	(38,296)	60,622	(950)	242,741
Cash flows from investing activities:				
Facility expenditures and land purchases	(253)	(1,173)	(385)	(1,675)
Capital expenditures, net	(7,117)	(7,487)	(11,635)	(12,186)
Proceeds from sales and maturities of investments and repayment of notes	117,216	118,307	216,171	260,392
Purchase of investments and note advances	0	(123,104)	(63,545)	(281,693)
Net cash flows from investing activities	109,846	(13,457)	140,606	(35,162)
Cash flows from financing activities:				
Excess tax benefit from stock option exercises	574	627	1,379	978
Proceeds from exercise of stock options	3,423	1,955	8,091	4,983
Debt issue costs	0	0	(1,525)	0
Proceeds from revolving borrowings	0	0	175,000	0
Repayment of revolving borrowings	(25,000)	0	(175,000)	0
Repurchase of common stock and shares tendered for taxes	(61,789)	(79,434)	(209,360)	(219,084)
Net cash flows from financing activities	(82,792)	(76,852)	(201,415)	(213,123)
Net change in cash and cash equivalents	(11,242)	(29,687)	(61,759)	(5,544)
Cash and cash equivalents at beginning of period	178,476	187,922	228,993	163,779
Cash and cash equivalents at end of period	$ 167,234	$ 158,235	$ 167,234	$ 158,235

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ITT EDUCATIONAL SERVICES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(Dollars and shares in thousands)

	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Common Stock in Treasury Shares	Common Stock in Treasury Amount	Total
Balance as of December 31, 2010	37,069	$ 371	$ 173,935	$ 524,678	($4,509)	(7,076)	($566,405)	$ 128,070
For the six months ended June 30, 2011 (unaudited):								
Net income				164,386				164,386
Other comprehensive income:								
Prior service costs, net of $270 of income tax					(422)			(422)
Net actuarial pension loss, net of $372 of income tax					580			580
Unrealized (loss)					(87)			(87)
Comprehensive income								164,457
Exercise of stock options and equity awards				(4,160)		138	9,143	4,983
Tax benefit from exercise of stock options and equity award vesting			989					989
Stock-based compensation			7,030					7,030
Common shares repurchased						(3,100)	(218,520)	(218,520)
Issuance of shares for Directors compensation				1		1	29	30
Shares tendered for taxes						(9)	(564)	(564)
Balance as of June 30, 2011	37,069	371	181,954	684,905	(4,438)	(10,046)	(776,317)	86,475
For the six months ended December 31, 2011 (unaudited):								
Net income				143,366				143,366
Other comprehensive income:								
Prior service costs, net of $337 of income tax					(526)			(526)
Net actuarial pension loss, net of $3,377 of income tax					(5,276)			(5,276)
Pension settlement loss, net of $470 of income tax					734			734
Unrealized gain					27			27
Comprehensive income								138,325
Exercise of stock options and equity awards				(596)		17	1,212	616
Tax benefit from exercise of stock options and equity award vesting			201					201
Stock-based compensation			7,418					7,418
Common shares repurchased						(940)	(64,181)	(64,181)
Shares tendered for taxes							(55)	(55)
Balance as of December 31, 2011	37,069	371	189,573	827,675	(9,479)	(10,969)	(839,341)	168,799
For the six months ended June 30, 2012 (unaudited):								
Net income				107,073				107,073

Other comprehensive income:								
Prior service costs, net of $303 of income tax					(474)			(474)
Net actuarial pension loss, net of $531 of income tax					827			827
Unrealized (loss)					(21)			(21)
Comprehensive income								107,405
Exercise of stock options and equity awards				(8,966)		266	17,057	8,091
Tax benefit from exercise of stock options and equity award vesting			930					930
Stock-based compensation			8,309					8,309
Common shares repurchased						(3,026)	(207,918)	(207,918)
Issuance of shares for Directors compensation				(1)		1	38	37
Shares tendered for taxes						(22)	(1,442)	(1,442)
Balance as of June 30, 2012	37,069	$ 371	$ 198,812	$ 925,781	($9,147)	(13,750)	($1,031,606)	$ 84,211

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ITT EDUCATIONAL SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012

(Dollars in thousands, except per share data and unless otherwise stated)

1. The Company and Basis of Presentation

We are a leading proprietary provider of postsecondary degree programs in the United States based on revenue and student enrollment. As of June 30, 2012, we were offering master, bachelor and associate degree programs to approximately 66,000 students at ITT Technical Institute and Daniel Webster College locations. In addition, we offered one or more of our online programs to students who are located in 48 states. As of June 30, 2012, we had 149 college locations (including 146 campuses and three learning sites) in 39 states. All of our college locations are authorized by the applicable education authorities of the states in which they operate and are accredited by an accrediting commission recognized by the U.S. Department of Education (ED). We have provided career-oriented education programs since 1969 under the ITT Technical Institute name and since June 2009 under the Daniel Webster College name. Our corporate headquarters are located in Carmel, Indiana.

The accompanying unaudited condensed consolidated financial statements include our wholly-owned subsidiaries accounts and have been prepared in accordance with generally accepted accounting principles in the United States of America for interim periods and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC). Certain information and footnote disclosures, including significant accounting policies, normally included in a complete presentation of financial statements prepared in accordance with those principles, rules and regulations have been omitted. The Condensed Consolidated Balance Sheet as of December 31, 2011 was derived from audited financial statements but, as presented in this report, may not include all disclosures required by accounting principles generally accepted in the United States. Arrangements where we may have a variable interest in another party are evaluated in accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC or Codification) 810, Consolidation (ASC 810), to determine whether we would be required to include the financial results of the other party in our consolidated financial statements. Based on our most recent evaluation, we were not required to include the financial results of any variable interest entity in our condensed consolidated financial statements. See Note 8 Variable Interests, for additional discussion of our variable interests.

In the opinion of our management, the financial statements contain all adjustments necessary to fairly state our financial condition and results of operations. The interim financial information should be read in conjunction with the audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K as filed with the SEC for the year ended December 31, 2011.

2. New Accounting Guidance

In December 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-12, which is included in the Codification under ASC 220, Comprehensive Income (ASC 220). This update defers the effective date of ASU No. 2011-05 for changes that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. None of the other requirements in ASU 2011-05 are affected by this update. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

Also in December 2011, the FASB issued ASU No. 2011-11, which is included in the Codification under ASC 210, Balance Sheet (ASC 210). This update provides for enhanced disclosures to help users of financial statements evaluate the effect or potential effect of netting arrangements on an entity s financial position. This guidance is effective for interim and annual reporting periods beginning January 1, 2013. We have not yet determined the effect that the adoption of this guidance will have on our condensed consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, which is included in the Codification under ASC 350, Intangibles Goodwill and Other (ASC 350). This update allows an entity to assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, which is included in the Codification under ASC 220. This update requires total comprehensive income, the components of net income and the components of other comprehensive income to be presented either in a single continuous statement or in two separate but consecutive statements. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. Prior to January 1, 2012, we presented total Comprehensive income and the components of Other comprehensive income in our Condensed Consolidated Statements of Shareholders Equity. After December 31, 2011, we present total Comprehensive income and the components of Other comprehensive income in our Condensed Consolidated Statements of Comprehensive Income.

In May 2011, the FASB issued ASU No. 2011-04, which is included in the Codification under ASC 820, Fair Value Measurements (ASC 820). This update provides guidance and clarification about the application of existing fair value measurements and disclosure requirements. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

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3. Fair Value

Fair value for financial reporting is defined as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants at the measurement date. The fair value measurement of our financial assets recorded on our Condensed Consolidated Balance Sheets utilized assumptions categorized as observable inputs under the accounting guidance. Observable inputs are assumptions based on independent market data sources.

The following table sets forth information regarding the fair value measurement of our financial assets as of June 30, 2012:

Description	As of June 30, 2012	Fair Value Measurements at Reporting Date Using (Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Cash equivalents:				
Money market funds	$ 166,267	$ 166,267	$ 0	$ 0
Other assets:				
Money market fund	8,620	8,620	0	0
	$ 174,887	$ 174,887	$ 0	$ 0

We used quoted prices in active markets for identical assets as of the measurement date to value our financial assets that were categorized as Level 1.

The carrying amounts for cash and cash equivalents, restricted cash, accounts receivable, accounts payable, other current liabilities and deferred revenue approximate fair value, because of the immediate or short-term maturity of these financial instruments.

As of June 30, 2012, each of the carrying value and the estimated fair value of the notes receivable included in Other assets on our Condensed Consolidated Balance Sheet was approximately $19,000. We estimated the fair value of the notes receivable by discounting the future cash flows using current rates for similar arrangements. The assumptions used in this estimate are considered unobservable inputs. Fair value measurements that utilize significant unobservable inputs are categorized as Level 3 measurements under the accounting guidance.

As of June 30, 2012, each of the carrying value and the estimated fair value of our long-term debt was approximately $150,000. The fair value of our long-term debt was estimated by discounting the future cash flows using current rates for similar loans with similar characteristics and remaining maturities. We utilized inputs that were observable or were principally derived from observable market data to estimate the fair value of our long-term debt. Fair value measurements that utilize significant other observable inputs are categorized as Level 2 measurements under the accounting guidance.

4. Equity Compensation

The stock-based compensation expense and related income tax benefit recognized in our Condensed Consolidated Statements of Income in the periods indicated were as follows:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Stock-based compensation expense	$ 4,272	$ 4,758	$ 8,755	$ 8,672
Income tax (benefit)	($ 1,645)	($ 1,832)	($ 3,371)	($ 3,339)

We did not capitalize any stock-based compensation cost in the three or six months ended June 30, 2012 or 2011.

As of June 30, 2012, we estimated that pre-tax compensation expense for unvested stock-based compensation grants in the amount of approximately $30,300, net of estimated forfeitures, will be recognized in future periods. This expense will be recognized over the remaining service period applicable to the grantees which, on a weighted-average basis, is approximately 2.3 years.

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The stock options granted, forfeited, exercised and expired in the period indicated were as follows:

	Six Months Ended June 30, 2012				
	# of Shares	Weighted Average Exercise Price	Aggregate Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (1)
Outstanding at beginning of period	1,765,881	$ 79.24	$ 139,922		
Granted	156,500	$ 75.16	11,763		
Forfeited	(6,667)	$ 90.45	(603)		
Exercised	(197,965)	$ 40.87	(8,091)		
Expired	(1,734)	$ 17.25	(30)		
Outstanding at end of period	1,716,015	$ 83.31	$ 142,961	3.5	$ 5,875
Exercisable at end of period	1,358,175	$ 83.12	$ 112,887	2.9	$ 5,875

(1) The aggregate intrinsic value of the stock options was calculated by identifying those stock options that had a lower exercise price than the closing market price of our common stock on June 29, 2012 and multiplying the difference between the closing market price of our common stock and the exercise price of each of those stock options by the number of shares subject to those stock options that were outstanding or exercisable, as applicable.

The following table sets forth information regarding the stock options granted and exercised in the periods indicated:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Shares subject to stock options granted	0	0	156,500	159,500
Weighted average grant date fair value per share	$ 0	$ 0	$ 31.36	$ 28.90
Shares subject to stock options exercised	93,911	42,780	197,965	103,310
Intrinsic value of stock options exercised	$ 2,299	$ 1,659	$ 4,788	$ 2,570
Proceeds received from stock options exercised	$ 3,423	$ 1,955	$ 8,091	$ 4,983
Tax benefits realized from stock options exercised	$ 733	$ 638	$ 1,597	$ 989

The intrinsic value of a stock option is the difference between the fair market value of the stock and the option exercise price.

The fair value of each stock option grant was estimated on the date of grant using the following assumptions:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Risk-free interest rates	Not applicable	Not applicable	0.7%	1.8%
Expected lives (in years)	Not applicable	Not applicable	4.5	4.7
Volatility	Not applicable	Not applicable	51%	48%
Dividend yield	Not applicable	Not applicable	None	None

The following table sets forth the number of restricted stock units (RSUs) that were granted, forfeited and vested in the period indicated:

	Six Months Ended June 30, 2012	
	# of RSUs	Weighted Average Grant Date Fair Value
Unvested at beginning of period	314,006	$ 79.44
Granted	272,578	$ 74.20
Forfeited	(30,397)	$ 75.05
Vested	(117,038)	$ 82.59
Unvested at end of period	439,149	$ 75.65

In the six months ended June 30, 2012:

48,935 RSUs vested and were settled in cash for $3,073; and

68,103 RSUs vested and were settled in shares of our common stock having a fair market value of $4,536.

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5. Stock Repurchases

As of June 30, 2012, approximately 7.8 million shares remained available for repurchase under the share repurchase program (the Repurchase Program) authorized by our Board of Directors. The terms of the Repurchase Program provide that we may repurchase shares of our common stock, from time to time depending on market conditions and other considerations, in the open market or through privately negotiated transactions in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended (the Exchange Act). Unless earlier terminated by our Board of Directors, the Repurchase Program will expire when we repurchase all shares authorized for repurchase thereunder.

The following table sets forth information regarding the shares of our common stock that we repurchased in the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Number of shares	928,500	1,100,000	3,025,700	3,100,000
Total cost	$ 61,261	$ 79,423	$ 207,918	$ 218,520
Average cost per share	$ 65.98	$ 72.20	$ 68.72	$ 70.49

6. Debt

We were a party to a Second Amended and Restated Credit Agreement dated as of January 11, 2010, as amended (the Prior Credit Agreement), to borrow up to $150,000 under two revolving credit facilities: one in the maximum principal amount of $50,000; and the other in the maximum principal amount of $100,000. The borrowings under each credit facility could have been secured or unsecured at our election, provided that we had not defaulted under the Prior Credit Agreement.

Borrowings under the Prior Credit Agreement bore interest, at our option, at the London Interbank Offered Rate (LIBOR) plus an applicable margin or at an alternative base rate, as defined under the Prior Credit Agreement. We paid a facility fee equal to 0.25% per annum on the daily amount of the commitment (whether used or unused) under the Prior Credit Agreement.

On March 21, 2012, we entered into a credit agreement (the New Credit Agreement) that provides for a $325,000 senior revolving credit facility (the Revolver). The New Credit Agreement also provides that we may seek additional revolving commitments or term loan commitments in an aggregate principal amount not to exceed $125,000. The lenders under the New Credit Agreement are not under any obligation to provide any such additional revolving commitments or term loan commitments. The New Credit Agreement has a maturity date of March 21, 2015.

A portion of the borrowings under the Revolver were used to prepay the entire outstanding indebtedness under the Prior Credit Agreement. The Prior Credit Agreement was also terminated on March 21, 2012. In addition to the prepayment of the outstanding indebtedness under the Prior Credit Agreement, borrowings under the New Credit Agreement will be used for general corporate purposes.

Borrowings under the New Credit Agreement bear interest, at our option, at LIBOR plus an applicable margin or at an alternative base rate, as defined under the New Credit Agreement, plus an applicable margin. The applicable margin for borrowings under the Revolver is determined based on the ratio of our total Indebtedness (as defined in the New Credit Agreement) to EBITDA (as defined in the New Credit Agreement) (the Leverage Ratio) as of the end of each fiscal quarter. We also pay a commitment fee on the amount of the unutilized commitments under the New Credit Agreement. The amount of the commitment fee is determined based on the Leverage Ratio as of the end of each fiscal quarter.

The New Credit Agreement contains, among other things, covenants, representations and warranties and events of default customary for credit facilities. The New Credit Agreement is secured by a pledge of the equity interests of our subsidiaries and is guaranteed by one of our subsidiaries. We are required to maintain compliance with a maximum Leverage Ratio, a minimum interest coverage ratio, a minimum liquidity amount and several ratios related to the ED s regulations. We were in compliance with those requirements as of June 30, 2012.

As of June 30, 2012, the borrowings under the New Credit Agreement totaled $150,000 and bore interest at a weighted average rate of 2.25% per annum. The effective interest rate on our borrowings was approximately 2.70% per annum in the three months ended June 30, 2012 and approximately 1.30% per annum in the three months ended June 30, 2011. In the six months ended June 30, 2012, the effective interest rate on our borrowings was approximately 2.10% per annum compared to approximately 1.40% per annum in the six months ended June 30, 2011. The commitment fee under the New Credit Agreement was 0.30% as of June 30, 2012.

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The following table sets forth the interest expense (including the facility fee and commitment fee) that we recognized on our borrowings under the New Credit Agreement and under the Prior Credit Agreement in the periods indicated:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	$1,115	$ 507	$ 1,662	$ 1,064

7. Investments

Our available-for-sale investments were classified as short-term investments on our June 30, 2012, December 31, 2011 and June 30, 2011 Condensed Consolidated Balance Sheets. The following table sets forth the aggregate fair value, amortized cost basis and the net unrealized gains and losses included in accumulated other comprehensive income (loss) of our available-for-sale investments as of the dates indicated:

	As of: June 30, 2012			December 31, 2011			June 30, 2011		
	Aggregate Fair Value	Amortized Cost	Net Unrealized Gains (Losses)	Aggregate Fair Value	Amortized Cost	Net Unrealized Gains (Losses)	Aggregate Fair Value	Amortized Cost	Net Unrealized Gains (Losses)
Available- for-Sale Investments:									
Government obligations	$ 0	$ 0	$ 0	$ 100,517	$ 100,480	$ 37	$ 100,679	$ 100,664	$ 15
Government agency obligations	0	0	0	31,351	31,354	(3)	26,235	26,237	(2)
Corporate obligations	0	0	0	16,620	16,633	(13)	20,222	20,241	(19)
	$ 0	$ 0	$ 0	$ 148,488	$ 148,467	$ 21	$ 147,136	$ 147,142	($6)

The following table sets forth the unrealized gains and losses on available-for-sale investments that were included in other comprehensive income (loss) in the periods indicated:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Unrealized gains	$ 2	$ 46	$ 0	$ 0
Unrealized losses	$ 0	$ 0	($21)	($87)

The following table sets forth the components of investment income included in Interest income in our Condensed Consolidated Statements of Income in the periods indicated:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Interest income on investments	$ 75	$ 116	$ 216	$ 271
Realized net gains on the sale of investments	26	51	40	196
Total investment income	$ 101	$ 167	$ 256	$ 467

8. Variable Interests

On January 20, 2010, we entered into agreements with unrelated third parties to establish the PEAKS Private Student Loan Program (PEAKS Program), which is a private education loan program for our students. Under the PEAKS Program, an unaffiliated lender originated private education loans to our eligible students and, subsequently, sold those loans to an unaffiliated trust that purchased, owns and collects private education loans (PEAKS Trust). The PEAKS Trust issued senior debt in the aggregate principal amount of $300,000 (PEAKS Senior Debt) to investors. The lender disbursed the proceeds of the private education loans to us for application to the students account balances with us that represented their unpaid education costs. We transferred a portion of the amount of each private education loan disbursed to us under the PEAKS Program to the PEAKS Trust in exchange for a subordinated note issued by the PEAKS Trust (Subordinated Note). No new private education loans were or will be originated under the PEAKS Program after July 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through March 2012.

The Subordinated Note is non-interest bearing and has been recorded net of an unamortized discount based on an imputed interest rate of 9.0% in Other assets on our Condensed Consolidated Balance Sheets. The discount is amortized and recognized in Interest income in our Condensed Consolidated Statements of Income over the term of the Subordinated Note. The maturity date of the Subordinated Note is in March 2026. The face value of the Subordinated Note as of June 30, 2012 was approximately $73,700.

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The PEAKS Trust utilized the proceeds from the issuance of the PEAKS Senior Debt and the Subordinated Note to purchase the private education loans made by the lender to our students. The assets of the PEAKS Trust (which include, among other assets, the private education loans owned by the PEAKS Trust) serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt and the Subordinated Note. The PEAKS Trust is required to maintain assets having an aggregate value that exceeds the outstanding balance of the PEAKS Senior Debt. As of June 30, 2012, the value of the assets of the PEAKS Trust satisfied this requirement. We guarantee payment of the principal, interest and certain call premiums owed on the PEAKS Senior Debt, and the administrative fees and expenses of the PEAKS Trust (PEAKS Guarantee). See Note 11 Contingencies, for further discussion of the PEAKS Guarantee.

We did not explicitly or implicitly provide any financial or other support to the PEAKS Trust during the three or six months ended June 30, 2012 or 2011 that we were not contractually required to provide, and we do not intend to provide any such support to the PEAKS Trust in the foreseeable future, other than what we are contractually required to provide.

The PEAKS Trust is a variable interest entity as defined under ASC 810. We held variable interests in the PEAKS Trust as of June 30, 2012 as a result of the Subordinated Note and PEAKS Guarantee. To determine whether we were the primary beneficiary of the PEAKS Trust, we:

- assessed the risks that the PEAKS Trust was designed to create and pass through to its variable interest holders;
- identified the variable interests in the PEAKS Trust;
- identified the other variable interest holders and their involvement in the activities of the PEAKS Trust;
- identified the activities that most significantly impact the PEAKS Trust s economic performance;
- determined whether we have the power to direct those activities; and
- determined whether we have the right to receive the benefits from, or the obligation to absorb the losses of, the PEAKS Trust that could potentially be significant to the PEAKS Trust.

We determined that the activities of the PEAKS Trust that most significantly impact the economic performance of the PEAKS Trust involve:

- establishing the underwriting criteria of, and the interest rates and fees charged on, the private education loans acquired by the PEAKS Trust; and
- the servicing (which includes the collection) of the private education loans owned by the PEAKS Trust.

To make that determination, we analyzed various possible scenarios of student loan portfolio performance to evaluate the potential economic impact on the PEAKS Trust. In our analysis, we made what we believe are conservative assumptions based on historical data for the following key variables:

- the composition of the credit profiles of the borrowers;
- the interest rates and fees charged on the loans;

- the default rates and the timing of defaults associated with similar types of loans; and

- the prepayment and the speed of repayment associated with similar types of loans.

Based on our analysis, we concluded that we are not the primary beneficiary of the PEAKS Trust, because we do not have the power to direct the activities that most significantly impact the economic performance of the PEAKS Trust. As a result, we are not required under ASC 810 to include the financial results of the PEAKS Trust in our condensed consolidated financial statements for the three or six months ended June 30, 2012. Our conclusion that we are not the primary beneficiary of the PEAKS Trust did not change from the prior reporting period. Therefore, there was no effect on our condensed consolidated financial statements.

On February 20, 2009, we entered into agreements with an unaffiliated entity (the 2009 Entity) to create a program that makes private education loans available to our students to help pay the students cost of education that student financial aid from federal, state and other sources do not cover (the 2009 Loan Program). Under the 2009 Loan Program, an unaffiliated lender originated private education loans to our eligible students and, subsequently, sold those loans to the 2009 Entity. The 2009 Entity purchased the private education loans from the lender utilizing funds received from its owners in exchange for participation interests in the private education loans acquired by the 2009 Entity. The lender disbursed the proceeds of the private education loans to us for application to the students account balances with us that represent their unpaid education costs. No new private education loans were or will be originated under the 2009 Loan Program after December 31, 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through June 2012.

In connection with the 2009 Loan Program, we entered into a risk sharing agreement (the 2009 RSA) with the 2009 Entity. Under the 2009 RSA, we guarantee the repayment of any private education loans that are charged off above a certain percentage of the private education loans made under the 2009 Loan Program, based on the annual dollar volume. See Note 11 Contingencies, for further discussion of the 2009 RSA.

In addition, we have made advances to the 2009 Entity under a revolving promissory note (the Revolving Note). We did not make any advances in the three and six months ended June 30, 2012 to the 2009 Entity under the Revolving Note that we were not contractually required to make. In the three and six months ended June 30, 2011, we made advances of $200 to the 2009 Entity under the Revolving Note that we were not contractually required to make. Substantially all of the assets of the 2009 Entity serve as collateral for the Revolving Note. The Revolving Note bears interest, is subject to customary terms and conditions and may be repaid at any time without penalty prior to its 2026 maturity date.

The advances under the Revolving Note were primarily used by the 2009 Entity to purchase additional private education loans under the 2009 Loan Program that otherwise may not have been originated. We have no immediate plans to significantly increase the amount of advances that we make to the 2009 Entity under the Revolving Note, but we may decide to do so in the foreseeable future.

The 2009 Entity is a variable interest entity as defined under ASC 810. We held variable interests in the 2009 Entity as of June 30, 2012 as a result of the Revolving Note and 2009 RSA. To determine whether we were the primary beneficiary of the 2009 Entity, we:

- assessed the risks that the 2009 Entity was designed to create and pass through to its variable interest holders;
- identified the variable interests in the 2009 Entity;
- identified the other variable interest holders and their involvement in the activities of the 2009 Entity;
- identified the activities that most significantly impact the 2009 Entity s economic performance;
- determined whether we have the power to direct those activities; and
- determined whether we have the right to receive the benefits from, or the obligation to absorb the losses of, the 2009 Entity that could potentially be significant to the 2009 Entity.

To identify the activities of the 2009 Entity that most significantly impact the economic performance of the 2009 Entity, we analyzed various possible scenarios of private education loan portfolio performance. In our analysis, we made what we believe are conservative assumptions based on historical data for the following key variables:

- the composition of the credit profiles of the borrowers;
- the interest rates and fees charged on the loans;
- the default rates and the timing of defaults associated with similar types of loans; and
- the prepayment and the speed of repayment associated with similar types of loans.

We determined that the activities of the 2009 Entity that most significantly impact its economic performance involve:

establishing the underwriting criteria of, and the interest rates and fees charged on, the private education loans acquired by the 2009 Entity; and

the servicing (which includes the collection) of the private education loans owned by the 2009 Entity.

Based on our analysis, we concluded that we are not the primary beneficiary of the 2009 Entity, because we do not direct those activities. As a result, we are not required under ASC 810 to include the financial results of the 2009 Entity in our condensed consolidated financial statements for the three or six months ended June 30, 2012. Our conclusion that we are not the primary beneficiary of the 2009 Entity did not change from the prior reporting period. Therefore, there was no effect on our condensed consolidated financial statements.

The carrying value of the Subordinated Note and the Revolving Note as of June 30, 2012 was approximately $19,000 and is included in Other assets on our Condensed Consolidated Balance Sheet.

9. Earnings Per Common Share

Earnings per common share for all periods have been calculated in conformity with ASC 260, Earnings Per Share . This data is based on historical net income and the weighted average number of shares of our common stock outstanding during each period as set forth in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)			
Shares:				
Weighted average number of shares of common stock outstanding	23,390	27,474	24,405	28,275
Shares assumed issued (less shares assumed purchased for treasury) for stock-based compensation	139	245	178	236
Outstanding shares for diluted earnings per share calculation	23,529	27,719	24,583	28,511

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A total of 1,520,036 shares at June 30, 2012 and 1,107,236 shares at June 30, 2011 were excluded from the calculation of our diluted earnings per common share, because the effect was anti-dilutive.

10. Employee Pension Benefits

The following table sets forth the components of net periodic pension benefit of the ESI Pension Plan and ESI Excess Pension Plan for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Interest cost	$ 502	$ 598	$ 1,032	$ 1,196
Expected return on assets	(1,110)	(1,147)	(2,257)	(2,294)
Recognized net actuarial loss	663	476	1,358	952
Amortization of prior service (credit)	(389)	(346)	(777)	(692)
Net periodic pension (benefit)	($334)	($419)	($644)	($838)

The benefit accruals under the ESI Pension Plan and ESI Excess Pension Plan were frozen effective March 31, 2006. As a result, no service cost has been included in the net periodic pension benefit.

We did not make any contributions to the ESI Pension Plan or the ESI Excess Pension Plan in the three or six months ended June 30, 2012 or 2011. We do not expect to make any contributions to the ESI Pension Plan or the ESI Excess Pension Plan in 2012.

11. Contingencies

As part of our normal operations, one of our insurers issues surety bonds for us that are required by various education authorities that regulate us. We are obligated to reimburse our insurer for any of those surety bonds that are paid by the insurer. As of June 30, 2012, the total face amount of those surety bonds was approximately $33,000.

We are also subject to various claims and contingencies, including those related to litigation, business transactions, guarantee arrangements and employee-related matters, among others. We record a liability for those claims and contingencies, if it is probable that a loss will result and the amount of the loss can be reasonably estimated. Although we believe that our estimates related to any claims and contingencies are reasonable, we cannot make any assurances with regard to the accuracy of our estimates, and actual results could differ materially. As of June 30, 2012, our recorded liability for these claims and contingencies was approximately $41,600, the substantial majority of which pertained to our guarantee arrangements. Approximately $6,000 of the recorded liability was included in Other current liabilities and approximately $35,600 was included in Other liabilities on our Condensed Consolidated Balance Sheet as of June 30, 2012.

We also considered whether additional losses for claims and contingencies were reasonably possible, could be estimated and might be material to our financial condition, results of operations or cash flows. With respect to our guarantee arrangements under the PEAKS Guarantee and the 2009 RSA and the risk sharing agreement that we entered into in 2007 (the 2007 RSA and, collectively with the PEAKS Guarantee and the 2009 RSA, the RSAs), we believe that it is reasonably possible that we may incur losses in an estimated range of $15,000 less than to $15,000 greater than the recorded liability for those contingencies. As with any estimate, as facts and circumstances change, the recorded liability and estimated range of reasonably possible losses could change significantly. With respect to legal proceedings, we determined that we cannot provide an estimate of the possible losses, or the range of possible losses, in excess of the amount, if any, accrued, for various reasons, including but not limited to some or all of the following:

- there are significant factual issues to be resolved;

- there are novel or unsettled legal issues presented;

- the proceedings are in the early stages;
- there is uncertainty as to the likelihood of a class being certified or decertified or the ultimate size and scope of the class;
- there is uncertainty as to the outcome of pending appeals or motions; and
- in many cases, the plaintiffs have not specified damages in their complaint or in court filings.

Litigation. We are subject to various litigation in the ordinary course of our business. We cannot assure you of the ultimate outcome of any litigation involving us. Although we believe that our estimates related to any litigation are reasonable, deviations from our estimates could produce a materially different result. Any litigation alleging violations of education or consumer protection laws and/or regulations, misrepresentation, fraud or deceptive practices may also subject our affected campuses to additional regulatory scrutiny. The following is a description of pending litigation that falls outside the scope of litigation incidental to the ordinary course of our business.

On November 3, 2010, a complaint in a securities class action lawsuit was filed against us and two of our current executive officers in the United States District Court for the Southern District of New York under the following caption: *Operating Engineers Construction Industry and Miscellaneous Pension Fund, Individually and On Behalf of All Others Similarly Situated v. ITT Educational Services, Inc., et al.* (the Securities Litigation). On January 21, 2011, the court named the Wyoming Retirement System as the lead plaintiff in the Securities Litigation. On April 1, 2011, an amended complaint was filed in the Securities Litigation under the following caption: *In re ITT Educational Services, Inc. Securities and Shareholder Derivative Litigation*. The amended complaint alleged, among other things, that:

- the defendants violated Section 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder by creating and implementing a systemically predatory business model that operated as a fraud or deceit on purchasers of our common stock during the class period by misrepresenting our financials and future business prospects;

- the defendants misrepresentations and material omissions caused our common stock to trade at artificially inflated prices throughout the class period; and

- the market s expectations were ultimately corrected on August 13, 2010 when the ED published the loan repayment rate of our students under a formula contained in proposed regulations published by the ED on July 26, 2010.

The putative class period in this action was from October 23, 2008 through August 13, 2010. The plaintiff sought, among other things, the designation of this action as a class action, and an award of unspecified compensatory damages, interest, costs, expenses, attorneys fees and expert fees.

On November 12, 2010, a complaint in a shareholder derivative lawsuit was filed against three of our current executive officers, all of our current Directors and one of our former Directors in the United States District Court for the Southern District of New York under the following caption: *Antonio Cosing, Derivatively and On Behalf of ITT Educational Services, Inc. v. Kevin M. Modany, et al.* (the Cosing Lawsuit). The complaint alleged, among other things, that from October 23, 2008 through August 13, 2010, the defendants breached their fiduciary duties to us, abused their ability to control and influence us, grossly mismanaged us, caused us to waste corporate assets and were unjustly enriched, by making false and misleading statements and engaging in fraudulent business practices. The complaint sought, among other things, unspecified damages, equitable and/or injunctive relief, restitution, disgorgement of profits, benefits and other compensation, an order directing us to reform our corporate governance and internal procedures, costs, disbursements and attorneys fees. On December 14, 2010, the Cosing Lawsuit was consolidated into the Securities Litigation.

On December 3, 2010, another complaint in a shareholder derivative lawsuit was filed against two of our current executive officers, all of our current Directors and one of our former Directors in the United States District Court for the Southern District of New York under the following caption: *J. Kent Gregory, derivatively on behalf of ITT Educational Services, Inc. v. Kevin M. Modany, et al.* (the Gregory Lawsuit). The complaint alleged, among other things, that the defendants breached their fiduciary duties to us, were unjustly enriched by us and misappropriated information about us, by making false and misleading statements and engaging in fraudulent business practices. The complaint sought, among other things, unspecified damages, restitution, disgorgement of profits, benefits and other compensation, an order directing us to reform our corporate governance and internal procedures, costs, disbursements and attorneys fees. The Gregory Lawsuit was consolidated into the Cosing Lawsuit on December 13, 2010 and further consolidated into the Securities Litigation on December 14, 2010.

On March 30, 2012, all of the claims alleged in the Securities Litigation were dismissed with prejudice, including the claims in the Cosing Lawsuit and Gregory Lawsuit.

On November 22, 2010, another complaint in a shareholder derivative lawsuit was filed against seven of our current and former officers, all of our current Directors and one of our former Directors in the United States District Court for the Southern District of Indiana under the following caption: *Roger B. Orensteen, derivatively on behalf of ITT Educational Services, Inc. v. Kevin M. Modany, et al* (the Orensteen Lawsuit). The complaint alleged, among other things, that, from January 2008 through August 2010, the defendants violated Sections 10(b) and 20(a) of the Exchange Act, breached their fiduciary duties to us, abused their ability to control and influence us, grossly mismanaged us, caused us to waste corporate assets and were unjustly enriched, by making false and misleading statements and engaging in fraudulent business practices. The complaint sought, among other things, unspecified damages, restitution, disgorgement of profits, benefits and other compensation, an order directing us to reform our corporate governance and internal procedures, costs, disbursements and attorneys fees. On June 27, 2012, the Orensteen Lawsuit was dismissed without prejudice.

There can be no assurance that the ultimate outcome of derivative actions, federal or state securities law claims or other actions would not have a material adverse effect on our financial condition, results of operations or cash flows.

Guarantees. We entered into the PEAKS Guarantee in connection with the PEAKS Program. Under the PEAKS Guarantee, we guarantee payment of the principal, interest and certain call premiums owed on the PEAKS Senior Debt, and the administrative fees and expenses of the PEAKS Trust. The PEAKS Senior Debt bears interest at a variable rate based on the LIBOR plus an applicable margin and matures in January 2020. The PEAKS Guarantee agreement contains, among other things, representations and warranties and events of default customary for guarantees. In addition, under the PEAKS Program, some or all of the holders of the PEAKS Senior Debt could require us to purchase their PEAKS Senior Debt in certain limited circumstances that pertain to our continued eligibility to participate in the federal student financial aid programs under Title IV (the Title IV Programs) of the

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Higher Education Act of 1965, as amended (the HEA). We believe that the likelihood of those limited circumstances occurring is remote. Our guarantee and purchase obligations under the PEAKS Program remain in effect until the PEAKS Senior Debt and the PEAKS Trust s fees and expenses are paid in full. At such time, we will be entitled to repayment of the amount of any payments made under the PEAKS Guarantee to the extent that funds are remaining in the PEAKS Trust.

The maximum future payments that we could be required to make under the PEAKS Guarantee include:

- up to $284,000 in principal of PEAKS Senior Debt, which was the approximate outstanding principal balance of the PEAKS Senior Debt as of June 30, 2012;
- accrued interest on the PEAKS Senior Debt;
- certain call premiums associated with the PEAKS Senior Debt; and
- the fees and expenses of the PEAKS Trust.

We are not able to estimate the undiscounted maximum potential amount of future payments that we could be required to make under the PEAKS Guarantee, because those payments will be affected by:

- the repayment performance of the private education loans made under the PEAKS Program, the proceeds from which will be used to repay the PEAKS Senior Debt and to pay the fees and expenses of the PEAKS Trust;
- the fact that those loans consist of a large number of loans of individually immaterial amounts;
- the fact that the interest rate on the PEAKS Senior Debt is a variable rate based on the LIBOR plus a margin;
- whether certain call premiums will be payable in connection with the PEAKS Senior Debt; and
- the amount of fees and expenses of the PEAKS Trust, much of which is based on the principal balance of the private education loans held by the PEAKS Trust.

No new private education loans were or will be originated under the PEAKS Program after July 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through March 2012.

We entered into the 2009 RSA in connection with the 2009 Loan Program. Under the 2009 RSA, we guarantee the repayment of the principal amount (including capitalized origination fees) and accrued interest payable on any private education loans that are charged off above a certain percentage of the private education loans made under the 2009 Loan Program, based on the annual dollar volume. The total initial principal amount of private education loans that the 2009 Entity purchased under the 2009 Loan Program was approximately $141,000. No new private education loans were or will be originated under the 2009 Loan Program after December 31, 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through June 2012. Our obligations under the 2009 RSA will remain in effect until all private education loans made under the 2009 Loan Program are paid in full or charged off. The standard repayment term for a private education loan made under the 2009 Loan Program is ten years, with repayment generally beginning six months after a student graduates or three months after a student withdraws or is terminated from his or her program of study.

Pursuant to the 2009 RSA, we are required to maintain collateral to secure our guarantee obligation in an amount equal to a percentage of the outstanding balance of private education loans disbursed to our students under the 2009 Loan Program. As of June 30, 2012, the total collateral maintained in a restricted bank account was not material. This amount is included in Other assets on our Condensed Consolidated Balance Sheet as of June 30, 2012. The 2009 RSA also requires that we comply with certain covenants, including that we maintain certain financial ratios which are measured on a quarterly basis. We were in compliance with these covenants as of June 30, 2012.

We entered into the 2007 RSA with a different lender for certain private education loans that were made to our students in 2007 and early 2008. We guarantee the repayment of any private education loans that the lender charges off above a certain percentage of the total dollar volume of private education loans made under the 2007 RSA. We will have the right to pursue repayment from the borrowers for those charged off private education loans under the 2007 RSA that we pay to the lender pursuant to our guarantee obligation. The 2007 RSA was terminated effective February 22, 2008, such that no private education loans have been or will be made under the 2007 RSA after that date. Based on information that we have received to date from the lender, we believe that the total original principal amount of private education loans made under the 2007 RSA, net of amounts refunded under those loans, was approximately $180,000. Our obligations under the 2007 RSA will remain in effect until all private education loans under the agreement are paid in full or charged off by the lender. The standard repayment term for a private education loan made under the 2007 RSA is ten years, with repayment generally beginning six months after a student graduates, withdraws or is terminated from his or her program of study.

As of June 30, 2012, we had made guarantee payments that were not material under the RSAs. At the end of each reporting period, we assess whether we should recognize a contingent liability related to our guarantees under the RSAs and, if so, in what amount. Our recorded liability for the obligations related to the guarantee arrangements under the RSAs is included in Other liabilities on our Condensed Consolidated Balance Sheets.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Forward-Looking Statements

All statements, trend analyses and other information contained in this report that are not historical facts are forward-looking statements within the meaning of the safe harbor provision of the Private Securities Litigation Reform Act of 1995 and as defined in Section 27A of the Securities Act of 1933 (the Securities Act) and Section 21E of the Exchange Act. Forward-looking statements are made based on our management s current expectations and beliefs concerning future developments and their potential effects on us. You can identify those statements by the use of words such as could, should, would, may, will, project, believe, anticipate, expect, plan, estimate, forecast, potential, intend, continue and contemplate, as well as similar words and expressions. Forward-looking statements involve risks and uncertainties and do not guarantee future performance. We cannot assure you that future developments affecting us will be those anticipated by our management. Among the factors that could cause actual results to differ materially from those expressed in our forward-looking statements are the following:

- *changes in federal and state governmental laws and regulations with respect to education and accreditation standards, or the interpretation or enforcement of those laws and regulations, including, but not limited to, the level of government funding for, and our eligibility to participate in, student financial aid programs utilized by our students;*
- *business conditions and growth in the postsecondary education industry and in the general economy;*
- *our failure to comply with the extensive education laws and regulations and accreditation standards that we are subject to;*
- *effects of any change in our ownership resulting in a change in control, including, but not limited to, the consequences of such changes on the accreditation and federal and state regulation of our campuses;*
- *our ability to implement our growth strategies;*
- *our failure to maintain or renew required federal or state authorizations or accreditations of our campuses or programs of study;*
- *receptivity of students and employers to our existing program offerings and new curricula;*
- *loss of access by our students to lenders for education loans;*
- *our ability to collect internally funded financing from our students;*
- *our exposure under our guarantees related to private student loan programs; and*
- *our ability to successfully defend litigation and other claims brought against us.*

Readers are also directed to other risks and uncertainties discussed in other documents we file with the SEC, including, without limitation, those discussed in Item 1A. Risk Factors. of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC, in Part II, Item 1A. Risk Factors of our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2012 and in Part II, Item 1A.

Risk Factors of this Quarterly Report on Form 10-Q. We undertake no obligation to update or revise any forward-looking information, whether as a result of new information, future developments or otherwise.

Overview

You should keep in mind the following points as you read this report:

- References in this document to we, us, our and ITT/ESI refer to ITT Educational Services, Inc. and its subsidiaries.

- The terms ITT Technical Institute or Daniel Webster College (in singular or plural form) refer to an individual school or campus owned and operated by ITT/ESI, including its learning sites, if any. The term institution (in singular or plural form) means a main campus and its additional locations, branch campuses and/or learning sites, if any.

This management s discussion and analysis of financial condition and results of operations should be read in conjunction with the same titled section contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC for discussion of, among other matters, the following items:

- cash receipts from financial aid programs;
- nature of capital additions;
- seasonality of revenue;
- components of income statement captions;
- federal regulations regarding:
  - timing of receipt of funds from the Title IV Programs;
  - percentage of applicable revenue that may be derived from the Title IV Programs;
  - return of Title IV Program funds for withdrawn students; and
  - default rates;
- private loan programs;
- investments; and
- repurchase of shares of our common stock.

This management s discussion and analysis of financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in conformity with generally accepted accounting principles in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenue, expenses, and contingent assets and liabilities. Actual results may differ from those estimates and judgments under different assumptions or conditions.

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In this management s discussion and analysis of financial condition and results of operations, when we discuss factors that contributed to a change in our financial condition or results of operations, we disclose the primary factors that materially contributed to that change.

Background

We are a leading proprietary provider of postsecondary degree programs in the United States based on revenue and student enrollment. As of June 30, 2012, we were offering master, bachelor and associate degree programs to approximately 66,000 students. As of June 30, 2012, we had 149 college locations (including 146 campuses and three learning sites) in 39 states. In addition, we offered one or more of our online programs to students who are located in 48 states. All of our college locations are authorized by the applicable education authorities of the states in which they operate, and are accredited by an accrediting commission recognized by the ED. We design our education programs, after consultation with employers and other constituents, to help graduates prepare for careers in various fields involving their areas of study. We have provided career-oriented education programs since 1969 under the ITT Technical Institute name and since June 2009 under the Daniel Webster College name.

In the second quarter of 2012, we began operations at one new ITT Technical Institute campus. We plan to begin operations at one new location during the remainder of 2012. Our strategy is to pursue multiple opportunities for growth. We are implementing a growth strategy designed to:

- improve the academic outcomes of our students;
- increase the value proposition of our education programs for our students; and
- increase access to high-quality, career-based education.

We intend to pursue this strategy by:

- increasing student enrollment in existing programs at existing campuses;
- increasing the number and types of program and other educational offerings that are delivered in residence and/or online;
- increasing our students engagement in their programs of study;
- enhancing the relevancy of our educational offerings;
- assessing student achievement and learning;
- improving the flexibility and convenience of how our institutions deliver their educational offerings;
- increasing our students access to financial aid;
- helping our graduates obtain entry-level employment involving their fields of study at higher starting annual salaries;

operating new campuses across the United States and new institutions in international markets;

adding learning sites to existing campuses; and

investing in other education-related opportunities.

Critical Accounting Policies and Estimates

The preparation of our condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenue, expenses, and contingent assets and liabilities. Actual results may differ from those estimates and judgments under different assumptions or conditions. We have discussed the critical accounting policies that we believe affect our more significant estimates and judgments used in the preparation of our consolidated financial statements in the Management s Discussion and Analysis of Financial Condition and Results of the Operations Critical Accounting Policies and Estimates section of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC. There have been no material changes to those critical accounting policies or the underlying accounting estimates or judgments.

New Accounting Guidance

In December 2011, the FASB issued ASU No. 2011-12, which is included in the Codification under ASC 220. This update defers the effective date of ASU No. 2011-05 for changes that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. None of the other requirements in ASU 2011-05 are affected by this update. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

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Also in December 2011, the FASB issued ASU No. 2011-11, which is included in the Codification under ASC 210. This update provides for enhanced disclosures to help users of financial statements evaluate the effect or potential effect of netting arrangements on an entity s financial position. This guidance is effective for interim and annual reporting periods beginning January 1, 2013. We have not yet determined the effect that the adoption of this guidance will have on our condensed consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, which is included in the Codification under ASC 350. This update allows an entity to assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, which is included in the Codification under ASC 220. This update requires total comprehensive income, the components of net income and the components of other comprehensive income to be presented either in a single continuous statement or in two separate but consecutive statements. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. Prior to January 1, 2012, we presented total Comprehensive income and the components of Other comprehensive income in our Condensed Consolidated Statement of Shareholders Equity. After December 31, 2011, we present total Comprehensive income and the components of Other comprehensive income in our Condensed Consolidated Statements of Comprehensive Income.

In May 2011, the FASB issued ASU 2011-04, which is included in the Codification under ASC 820. This update provides guidance and clarification about the application of existing fair value measurements and disclosure requirements. This guidance became effective for our interim and annual reporting periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

Results of Operations

The following table sets forth the percentage relationship of certain statement of income data to revenue for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,
	2012	2011	