ITT EDUCATIONAL SERVICES INC
Form 10-Q
April 23, 2009

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 **March 31, 2009**

OR

o **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 **o**

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 **o** No **o**

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 **o**
Non-accelerated filer **o** (Do not check if a smaller reporting company)	Smaller reporting company **o**

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

Yes **o** No **x**

38,325,652
Number of shares of Common Stock, $.01 par value, outstanding at March 31, 2009

ITT EDUCATIONAL SERVICES, INC.

Carmel, Indiana

Quarterly Report to Securities and Exchange Commission

March 31, 2009

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

Index

Condensed Consolidated Balance Sheets as of March 31, 2009 and 2008 (unaudited) and

December 31, 2008

Condensed Consolidated Statements of Income (unaudited) for the three months ended

March 31, 2009 and 2008

Condensed Consolidated Statements of Cash Flows (unaudited) for the three months ended

March 31, 2009 and 2008

Condensed Consolidated Statements of Shareholders’ Equity for the three months ended

March 31, 2009 and 2008 (unaudited) and the year ended December 31, 2008

Notes to Condensed Consolidated Financial Statements

ITT EDUCATIONAL SERVICES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

		As of	
	March 31, 2009	**December 31, 2008**	**March 31, 2008**
	(unaudited)		**(unaudited)**
Assets			
Current assets:			
Cash and cash equivalents	$219,642	$226,255	$97,013
Short-term investments	146,062	138,709	212,085
Restricted cash	11	10,405	53
Accounts receivable, net	51,513	29,779	15,072
Deferred income taxes	12,143	12,104	8,314
Prepaid expenses and other current assets	15,960	13,793	13,594
Total current assets	445,331	431,045	346,131
Property and equipment, net	166,582	166,671	156,568
Direct marketing costs, net	24,631	22,973	21,304
Other assets	3,682	3,170	17,906
Total assets	$640,226	$623,859	$541,909
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable	$63,658	$54,815	$56,804
Accrued compensation and benefits	23,670	21,133	23,319
Accrued income taxes	36,959	14,976	24,135
Other accrued liabilities	11,896	11,423	11,123
Deferred revenue	133,137	162,206	203,648
Total current liabilities	269,320	264,553	319,029
Long-term debt	150,000	150,000	150,000
Deferred income taxes	726	1,504	11,013
Other liabilities	20,810	19,951	18,171
Total liabilities	440,856	436,008	498,213
Shareholders' equity:			
Preferred stock, $.01 par value,			
5,000,000 shares authorized, none issued	--	--	--
Common stock, $.01 par value, 300,000,000			
shares authorized, 54,068,904 issued	541	541	541
Capital surplus	144,004	135,655	129,225
Retained earnings	786,684	732,107	573,876
Accumulated other comprehensive (loss)	(13,293)	(13,384)	(3,417)
Treasury stock, 15,743,252, 15,352,376			

and 15,238,960 shares, at cost	(718,566)	(667,068)	(656,529)
Total shareholders' equity	199,370	187,851	43,696
Total liabilities and shareholders' equity	$640,226	$623,859	$541,909

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

ITT EDUCATIONAL SERVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Amounts in thousands, except per share data)
(unaudited)

	Three Months Ended March 31,	
	2009	**2008**
Revenue	$288,033	$234,850
Costs and expenses:		
Cost of educational services	101,087	92,025
Student services and administrative expenses	86,801	74,126
Total costs and expenses	187,888	166,151
Operating income	100,145	68,699
Interest income	1,233	2,033
Interest (expense)	(194)	(1,519)
Income before provision for income taxes	101,184	69,213
Provision for income taxes	39,255	26,581
Net income	$61,929	$42,632
Earnings per share:		
Basic	$1.61	$1.09
Diluted	$1.59	$1.08
Weighted average shares outstanding:		
Basic	38,558	39,201
Diluted	39,062	39,513

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

ITT EDUCATIONAL SERVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(unaudited)

	Three Months Ended March 31,	
	2009	**2008**
Cash flows from operating activities:		
Net income	$61,929	$42,632
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	5,772	5,494
Provision for doubtful accounts	14,209	6,933
Deferred income taxes	(1,042)	(1,637)
Excess tax benefit from stock option exercises	(3,793)	(33)
Stock-based compensation expense	4,183	2,175
Other	135	--
Changes in operating assets and liabilities:		
Restricted cash	10,132	6,017
Accounts receivable	(35,943)	(6,873)
Direct marketing costs, net	(1,658)	(737)
Accounts payable	8,843	11,681
Accrued income taxes	26,149	18,141
Other operating assets and liabilities	1,481	4,722
Deferred revenue	(29,069)	(9,479)
Net cash flows from operating activities	61,328	79,036
Cash flows from investing activities:		
Facility expenditures and land purchases	(1,074)	(6,293)
Capital expenditures, net	(4,608)	(2,504)
Proceeds from sales and maturities of investments	48,598	291,375
Purchase of investments	(55,770)	(200,100)
Net cash flows from investing activities	(12,854)	82,478
Cash flows from financing activities:		
Excess tax benefit from stock option exercises	3,793	33
Proceeds from exercise of stock options	5,823	41
Repurchase of common stock and shares tendered for taxes	(64,703)	(71,803)
Net cash flows from financing activities	(55,087)	(71,729)
Net change in cash and cash equivalents	(6,613)	89,785
Cash and cash equivalents at beginning of period	226,255	7,228

Cash and cash equivalents at end of period	$219,642	$97,013

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

ITT EDUCATIONAL SERVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollars and shares in thousands)

	Common Stock		Capital	Retained	Accumulated Other Comprehensive	Common Stock in Treasury		
	Shares	Amount	Surplus	Earnings	Income/(Loss)	Shares	Amount	Total
Balance as of December 31, 2007	54,069	$541	$127,017	$531,363	($3,417)	(14,375)	($584,946)	$70,558
For the three months ended March 31, 2008 (unaudited):								
Net income				42,632				42,632
Other comprehensive income								--
Comprehensive income								42,632
Exercise of stock options				(94)		2	135	41
Tax benefit from exercise of stock options			33					33
Stock-based compensation			2,175					2,175
Common shares repurchased						(865)	(71,803)	(71,803)
Issuance of shares for Directors’ compensation				(25)		1	85	60
Balance as of March 31, 2008	54,069	541	129,225	573,876	(3,417)	(15,237)	(656,529)	43,696
For the nine months ended December 31, 2008 (unaudited):								
Net income				160,340				160,340
Other comprehensive income:								
Amortization of prior service cost, net of income tax					17			17
Net actuarial pension loss, net of income tax					(11,212)			(11,212)
Pension settlement loss, net of income tax					928			928
Unrealized gain					428			428
Comprehensive income								150,501
Prior service costs, net of income tax					(128)			(128)
Adoption of SFAS No. 158 change in pension measurement date, net of income tax				325				325
Exercise of stock options				(2,434)		73	5,634	3,200
Tax benefit from exercise of stock options			1,168					1,168
Stock-based compensation			5,060					5,060
Common shares repurchased						(185)	(15,971)	(15,971)
Restricted stock cancellations			202			(3)	(202)	--
Balance as of December 31, 2008	54,069	541	135,655	732,107	(13,384)	(15,352)	(667,068)	187,851
For the three months ended March 31, 2009 (unaudited):								
Net income				61,929				61,929
Other comprehensive income:								
Amortization of prior service cost, net of income tax					4			4
Amortization of net actuarial pension loss, net of income tax					344			344
Unrealized (loss)					(257)			(257)
Comprehensive income								62,020
Exercise of stock options				(7,354)		139	13,177	5,823
Tax benefit from exercise of stock options and restricted stock vesting			4,166					4,166
Stock-based compensation			4,183					4,183

Common shares repurchased						(528)	(64,360)	(64,360)
Issuance of shares for Directors’ compensation				2		1	28	30
Restricted stock shares withheld for taxes						(3)	(343)	(343)
Balance as of March 31, 2009	54,069	$541	$144,004	$786,684	($13,293)	(15,743)	($718,566)	$199,370

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

ITT EDUCATIONAL SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

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

1. The Company and Basis of Presentation

We are a leading provider of technology-oriented postsecondary education in the United States based on revenue and student enrollment. As of March 31, 2009, we were offering master, bachelor and associate degree programs to more than 65,000 students. As of March 31, 2009, we had 106 institutes and nine learning sites located in 37 states. All of our institutes 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. 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, 2008 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. 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, 2008.

2. New Accounting Pronouncements

The following new accounting pronouncements became effective for us commencing with our first fiscal quarter of 2009:

- Statement of Financial Accounting Standards (“SFAS”) No. 163, “Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60” (“SFAS No. 163”), which clarifies how Financial Accounting Standards Board (“FASB”) Statement No. 60 applies to financial guarantee insurance contracts, including the recognition and measurement of premium revenue and claim liabilities. The adoption of this pronouncement did not have a material impact on our condensed consolidated financial statements.
- SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133” (“SFAS No. 161”), which expands the disclosure requirements for derivative instruments and hedging activities. The adoption of this pronouncement did not have a material impact on our condensed consolidated financial statements.
- SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51” (“SFAS No. 160”), which establishes accounting and reporting standards for the noncontrolling interest of a subsidiary and for the deconsolidation of a subsidiary. The adoption of this pronouncement did not have a material impact on our condensed consolidated financial statements.
- SFAS No. 141(R), “Business Combinations” (“SFAS No. 141(R)”), which establishes principles and requirements for how a company recognizes and measures assets, liabilities and noncontrolling interests acquired or assumed in a business combination. The adoption of

this pronouncement did not have a material impact on our condensed consolidated financial statements.

- Emerging Issues Task Force 07-01, “Accounting for Collaborative Arrangements” (“EITF 07-01”), which defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position (“FSP”) No. FAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments” (“FSP No. 107-1 and APB 28-1”), which requires disclosures about fair value of financial instruments for interim reporting periods. This guidance is effective for interim reporting periods ending after June 15, 2009 and will apply to our disclosures beginning with our second fiscal quarter of 2009. We have not determined the effect that the adoption of this guidance will have on our condensed consolidated financial statements and disclosures.

In April 2009, the FASB also issued FSP No. FAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (“FSP No. 157-4”), which provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This guidance is effective for interim reporting periods ending after June 15, 2009 and will apply to our disclosures beginning with our second fiscal quarter of 2009. We have not determined the effect that the adoption of this guidance will have on our condensed consolidated financial statements and disclosures.

Also in April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments” (“FSP No. 115-2 and FAS 124-2”), which amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This guidance is effective for interim reporting periods ending after June 15, 2009 and will apply to our disclosures beginning with our second fiscal quarter of 2009. We have not determined the effect that the adoption of this guidance will have on our condensed consolidated financial statements and disclosures.

In December 2008, the FASB issued FSP No. FAS 132(R)-1, “Employers’ Disclosures about Postretirement Benefit Plan Assets” (“FSP No. 132(R)-1”), which requires enhanced disclosures about plan assets in an employer’s defined benefit pension or other postretirement plan. These disclosures are intended to provide users of financial statements with a greater understanding of how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets and significant concentrations of risk within plan assets. FSP No. 132(R)-1 will apply to our plan asset disclosures beginning with our fiscal year ending December 31, 2009.

3. Fair Value

In February 2008, the FASB issued FSP No. 157-2, “Effective Date of FASB Statement No. 157” (“FSP No. 157-2”), which delayed the effective date of SFAS No. 157, “Fair Value Measurements” (“SFAS No. 157”) for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. This provision of SFAS No. 157 was effective for us beginning on January 1, 2009. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements, because we do not have any nonfinancial assets or nonfinancial liabilities recognized or disclosed at fair value.

SFAS No. 157 defines fair value for financial reporting 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 utilized assumptions categorized as observable inputs under SFAS No. 157. 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 March 31, 2009:

		Fair Value Measurements at Reporting Date Using		
		(Level 1)	**(Level 2)**	**(Level 3)**
Description	**As of March 31, 2009**	**Quoted Prices in Active Markets for Identical Assets**	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**
Cash equivalents	$220,170	$220,170	$--	$--
Short-term investments	146,062	66,134	79,928	--
	$366,232	$286,304	$79,928	$--

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. For assets that were categorized as Level 2, we used:

- quoted prices for similar assets in active markets;
- quoted prices for identical or similar assets in markets that were not active or in which little public information had been released;
- inputs other than quoted prices that were observable for the assets; or
- inputs that were principally derived from or corroborated by observable market data by correlation or other means.

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 March 31,	
	2009	**2008**
Stock-based compensation expense	$4,183	$2,175
Income tax (benefit)	($1,611)	($837)

We did not capitalize any stock-based compensation cost in the three months ended March 31, 2009 or 2008.

As of March 31, 2009, we estimated that pre-tax compensation expense for unvested stock-based compensation grants in the amount of approximately $22,502, 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.

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

	Three Months Ended March 31, 2009				
	# of Shares	Weighted Average Exercise Price	Aggregate Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (1)
Outstanding at beginning of period	1,561,517	$54.89	$85,710		
Granted	258,000	$121.56	31,362		
Forfeited	--	$--	--		
Exercised	(139,444)	$41.76	(5,823)		
Expired	--	$--	--		
Outstanding at end of period	1,680,073	$66.22	$111,249	5.2 years	$92,745
Exercisable at end of period	1,191,197	$50.59	$60,262	4.2 years	$84,373

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(1) The aggregate intrinsic value of the stock options was calculated by multiplying the number of shares subject to the options outstanding or exercisable, as applicable, by the closing market price of our common stock on March 31, 2009, and subtracting the applicable aggregate exercise price.

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

	Three Months Ended March 31,	
	2009	2008
Shares subject to stock options granted	258,000	162,543
Weighted average grant date fair value	$54.05	$37.49
Shares subject to stock options exercised	139,444	1,700
Intrinsic value of stock options exercised	$10,710	$86
Proceeds received from stock options exercised	$5,823	$41
Tax benefits realized from stock options exercised	$3,970	$33

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 March 31,	
	2009	2008
Risk-free interest rates	1.6%	2.7%
Expected lives (in years)	4.5	4.0
Volatility	54%	53%
Dividend yield	None	None

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

	Three Months Ended March 31, 2009			
	# of Shares of Restricted Stock	Weighted Average Grant Date Fair Value	# of RSUs	Weighted Average Grant Date Fair Value
Unvested at beginning of period	19,440	$61.05	95,079	$82.95
Granted	--	--	28,191	121.47
Forfeited	--	--	(1,323)	94.43
Vested	(8,130)	58.33	--	--
Unvested at end of period	11,310	$63.01	121,947	$91.73

The total fair market value of the shares vested during the three months ended March 31, 2009 was $995.

5. Stock Repurchases

As of March 31, 2009, 3,444,267 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 March 31,	
	2009	**2008**
Number of shares	527,833	865,000
Total cost	$64,360	$71,803
Average cost per share		