ITT EDUCATIONAL SERVICES INC
Form 10-Q
October 29, 2013
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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 September 30, 2013

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

23,369,914

Number of shares of Common Stock, $.01 par value, outstanding at September 30, 2013

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ITT EDUCATIONAL SERVICES, INC.

Carmel, Indiana

Quarterly Report to Securities and Exchange Commission

September 30, 2013

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 September 30, 2013 (unaudited)	As of December 31, 2012	As of September 30, 2012 (unaudited)
Assets			
Current assets:			
Cash and cash equivalents	$ 168,721	$ 246,342	$ 174,458
Restricted cash	612	601	720
Accounts receivable, net	119,529	77,313	89,425
Deferred income taxes	25,687	44,547	19,284
Prepaid expenses and other current assets	18,952	16,162	18,331
Total current assets	333,501	384,965	302,218
Property and equipment, net	174,394	189,890	194,253
Deferred income taxes	54,657	56,112	39,499
Other assets	46,409	41,263	49,080
Total assets	$ 608,961	$ 672,230	$ 585,050
Liabilities and Shareholders Equity			
Current liabilities:			
Accounts payable	$ 61,468	$ 63,304	$ 76,358
Accrued compensation and benefits	20,113	21,023	19,729
Other current liabilities	51,285	86,722	19,910
Deferred revenue	132,246	135,900	119,089
Total current liabilities	265,112	306,949	235,086
Long-term debt	60,000	140,000	140,000
Other liabilities	82,852	98,327	78,189
Total liabilities	407,964	545,276	453,275
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	206,714	206,703	203,095
Retained earnings	1,030,002	959,072	968,545
Accumulated other comprehensive (loss)	(7,715)	(7,930)	(8,970)

Treasury stock, 13,698,990, 13,744,395 and 13,744,474 shares, at cost	(1,028,375)	(1,031,262)	(1,031,266)
Total shareholders equity	200,997	126,954	131,775
Total liabilities and shareholders equity	$ 608,961	$ 672,230	$ 585,050

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 September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Revenue	$ 259,416	$ 314,747	$ 807,063	$ 986,366
Costs and expenses:				
Cost of educational services	121,994	133,948	371,043	409,829
Student services and administrative expenses	99,130	110,046	306,315	327,779
Loss related to private student loan programs	6,213	0	9,677	0
Total costs and expenses	227,337	243,994	687,035	737,608
Operating income	32,079	70,753	120,028	248,758
Interest income	170	125	376	1,308
Interest (expense)	(915)	(1,021)	(3,180)	(2,822)
Income before provision for income taxes	31,334	69,857	117,224	247,244
Provision for income taxes	12,393	26,997	46,294	97,311
Net income	$ 18,941	$ 42,860	$ 70,930	$ 149,933
Earnings per share:				
Basic	$ 0.81	$ 1.83	$ 3.03	$ 6.23
Diluted	$ 0.80	$ 1.83	$ 3.01	$ 6.20
Weighted average shares outstanding:				
Basic	23,418	23,359	23,410	24,054
Diluted	23,634	23,443	23,556	24,200

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 September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Net Income	$ 18,941	$ 42,860	$ 70,930	$ 149,933
Other comprehensive income, net of tax:				
Net actuarial pension loss amortization, net of income tax of $196, $265, $589 and $796	310	414	929	1,241
Prior service (credit) amortization, net of income tax of $151, $152, $453 and $455	(238)	(237)	(714)	(711)
Unrealized gains (losses) on available-for-sale securities, net of income tax of $0, $0, $0 and $0	0	0	0	(21)
Other comprehensive income, net of tax	72	177	215	509
Comprehensive Income	$ 19,013	$ 43,037	$ 71,145	$ 150,442

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 September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Cash flows from operating activities:				
Net income	$ 18,941	$ 42,860	$ 70,930	$ 149,933
Adjustments to reconcile net income to net cash flows from operating activities:				
Depreciation and amortization	6,173	6,930	20,816	22,045
Provision for doubtful accounts	17,967	22,873	56,890	57,480
Deferred income taxes	280	(6,021)	16,614	(16,097)
Excess tax benefit from stock option exercises	0	(3)	0	(1,382)
Stock-based compensation expense	3,304	4,291	8,698	13,046
Settlement cost	0	0	(46,000)	0
Other	102	340	467	97
Changes in operating assets and liabilities, net of acquisition:				
Restricted cash	164	31	(11)	1,408
Accounts receivable	(13,326)	(38,623)	(98,012)	(98,799)
Accounts payable	(2,427)	(4,419)	(2,012)	(2,518)
Other operating assets and liabilities	2,370	(5,758)	(8,634)	1,008
Deferred revenue	17,769	(2,784)	(4,240)	(107,454)
Net cash flows from operating activities	51,317	19,717	15,506	18,767
Cash flows from investing activities:				
Facility expenditures	(81)	(108)	(541)	(493)
Capital expenditures, net	(904)	(3,185)	(4,277)	(14,820)
Acquisition of company, net of cash acquired	(6,953)	0	(6,953)	0
Proceeds from sales and maturities of investments and repayment of notes	91	553	413	216,724
Purchase of investments and note advances	(138)	0	(1,379)	(63,545)
Net cash flows from investing activities	(7,985)	(2,740)	(12,737)	137,866
Cash flows from financing activities:				
Excess tax benefit from stock option exercises	0	3	0	1,382
Proceeds from exercise of stock options	0	254	0	8,345
Debt issue costs	0	0	0	(1,525)
Proceeds from revolving borrowings	0	0	0	175,000

Repayment of revolving borrowings	(60,000)	(10,000)	(80,000)	(185,000)
Repurchase of common stock and shares tendered for taxes	(19)	(10)	(390)	(209,370)
Net cash flows from financing activities	(60,019)	(9,753)	(80,390)	(211,168)
Net change in cash and cash equivalents	(16,687)	7,224	(77,621)	(54,535)
Cash and cash equivalents at beginning of period	185,408	167,234	246,342	228,993
Cash and cash equivalents at end of period	$ 168,721	$ 174,458	$ 168,721	$ 174,458

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				Accumulated Other	Common Stock in Treasury		
	Shares	Amount	Capital Surplus	Retained Earnings	Comprehensive Income/(Loss)	Shares	Amount	Total
Balance as of December 31, 2011	37,069	$ 371	$ 189,573	$ 827,675	($9,479)	(10,969)	($839,341)	$ 168,799
For the nine months ended September 30, 2012 (unaudited):								
Net income				149,933				149,933
Other comprehensive income					509			509
Equity award vesting and exercises				(9,062)		272	17,407	8,345
Tax benefit from equity awards			922					922
Stock-based compensation			12,600					12,600
Common shares repurchased						(3,026)	(207,918)	(207,918)
Issuance of shares for Directors compensation				(1)		1	38	37
Shares tendered for taxes						(22)	(1,452)	(1,452)
Balance as of September 30, 2012	37,069	371	203,095	968,545	(8,970)	(13,744)	(1,031,266)	131,775
For the three months ended December 31, 2012 (unaudited):								
Net income				(9,468)				(9,468)
Other comprehensive income					1,040			1,040
				(5)			5	0

Equity award vesting and exercises								
Tax benefit from equity awards			(4)					(4)
Stock-based compensation			3,612					3,612
Shares tendered for taxes							(1)	(1)
Balance as of December 31, 2012	37,069	371	206,703	959,072	(7,930)	(13,744)	(1,031,262)	126,954
For the nine months ended September 30, 2013 (unaudited):								
Net income				70,930				70,930
Other comprehensive income					215			215
Equity award vesting and exercises			(3,277)			68	3,277	0
Tax benefit from equity awards			(5,410)					(5,410)
Stock-based compensation			8,698					8,698
Shares tendered for taxes						(23)	(390)	(390)
Balance as of September 30, 2013	37,069	$ 371	$ 206,714	$ 1,030,002	($7,715)	(13,699)	($1,028,375)	$ 200,997

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

September 30, 2013

(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 September 30, 2013, we were offering:

- master, bachelor and associate degree programs to approximately 61,000 students at ITT Technical Institute and Daniel Webster College locations; and
- short-term information technology and business learning solutions for individuals.

In addition, we offered one or more of our online degree programs to students who are located in 48 states. As of September 30, 2013, we had 149 college locations (including 147 campuses and two learning sites) in 39 states and one training facility. 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. In August 2013, we acquired all of the membership interests of Cable Holdings, LLC (Cable Holdings), an education company that offers short-term information technology and business learning solutions for individuals. See Note 3 Acquisition, for additional discussion of the acquisition of Cable Holdings. 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, 2012 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 9 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, 2012.

2. New Accounting Guidance

In February 2013, the FASB issued Accounting Standards Update (ASU) No. 2013-02, which is included in the Codification under ASC 220, Other Comprehensive Income (ASC 220). This update requires an entity to report the effect, by component, of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income. This guidance is effective for interim and annual reporting periods beginning January 1, 2013. The adoption of this guidance requires that we provide additional disclosures regarding the amounts reclassified out of accumulated other comprehensive income during the reporting period. We have included these disclosures in the footnotes to our condensed consolidated financial statements.

In October 2012, the FASB issued ASU No. 2012-04, which makes technical corrections, clarifications and limited-scope improvements to various topics throughout the Codification. The amendments in this ASU that do not have transition guidance are effective upon issuance and the amendments that are subject to transition guidance are effective for our interim and annual reporting periods beginning January 1, 2013. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

In July 2012, the FASB issued ASU No. 2012-02, which is included in the Codification under ASC 350, Intangibles Goodwill and Other (ASC 350). This update allows an entity to first assess qualitative factors to determine whether it must perform a quantitative impairment test. An entity would be required to calculate the fair value of an indefinite-lived intangible asset, if the entity determines, based on a qualitative assessment, that it is more likely than not that the indefinite-lived asset is impaired. This guidance is effective for impairment tests performed for our interim and annual reporting periods beginning January 1, 2013. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

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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. In January 2013, the FASB issued ASU No. 2013-01, which clarifies the scope of the disclosures required under ASU No. 2011-11. Both of these updates are effective for interim and annual reporting periods beginning January 1, 2013. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

3. Acquisition

On August 1, 2013, we acquired all of the membership interests of Cable Holdings for $6,953 in cash, net of cash acquired. Cable Holdings is an education company that operates under the name of Benchmark Learning and offers short-term information technology and business learning solutions for career advancers and other professionals. The acquisition of Cable Holdings allowed us to immediately begin operating in the short-term learning solutions market, which we hope to expand upon by leveraging our current employer relationships, alumni and facilities, and integrating Cable Holdings operations into the Center for Professional Development @ ITT Technical Institute.

Our condensed consolidated financial statements include the results of Cable Holdings from the acquisition date. The revenue and expenses of Cable Holdings included in our Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2013 were not material. Our revenue, net income and earnings per share would not have been materially affected, if the revenue and expenses of Cable Holdings were presented for the three and nine months ended September 30, 2013 and 2012 as if the transaction had occurred at the beginning of the earliest period presented. The costs incurred to acquire Cable Holdings were expensed and were not material.

We accounted for the acquisition of Cable Holdings in accordance with ASC 805, Business Combinations (ASC 805), which requires the use of the acquisition method of accounting for all business combinations. The purchase price has been preliminarily allocated to identifiable net assets. The excess of the consideration paid over the estimated fair values of the identifiable net assets acquired was recognized as goodwill. The fair value of the acquired identifiable intangible assets is preliminary, pending receipt of the final valuation. The identifiable intangible assets acquired consist of customer relationships, non-compete agreements, trade names and training materials, which will be amortized over their estimated useful lives.

The following table sets forth the estimated fair values allocated to the major classes of assets acquired and liabilities assumed in the Cable Holdings acquisition as of the acquisition date:

	Assets Acquired	Liabilities Assumed
Cash and other current assets	$ 1,423	
Furniture and equipment	480	
Identifiable intangible assets	2,990	
Goodwill	3,567	
Accounts payable and other liabilities		$ 1,265

The estimated fair values of the assets acquired and liabilities assumed in the Cable Holdings acquisition are preliminary and based on information that was available to us as of the acquisition date and as of September 30, 2013. We may revise the allocation of the purchase price when we complete the final review of the information. We expect to finalize the purchase price allocation by December 31, 2013.

4. 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 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 September 30, 2013:

		Fair Value Measurements at Reporting Date Using		
		(Level 1)	(Level 2)	(Level 3)
Description	**As of September 30, 2013**	**Quoted Prices in Active Markets for Identical Assets**	**Significant Other Observable Inputs**	**Significant Unobservable Inputs**
Cash equivalents:				
Money market fund	$ 167,121	$ 167,121	$ 0	$ 0
Other assets:				
Money market fund	8,625	8,625	0	0
	$ 175,746	$ 175,746	$ 0	$ 0

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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.

Each of the carrying value and the estimated fair value of the notes receivable and other receivables included in Prepaid expenses and other current assets or Other assets on our Condensed Consolidated Balance Sheet was approximately $10,200 as of September 30, 2013, $9,600 as of December 31, 2012 and $18,000 as of September 30, 2012. We estimated the fair value of the notes receivable and other receivables 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.

Each of the carrying value and estimated fair value of our long-term debt was approximately $60,000 as of September 30, 2013, $140,000 as of December 31, 2012 and $140,000 as of September 30, 2012. 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.

5. Equity Compensation

On May 7, 2013, our shareholders approved the ITT Educational Services, Inc. Amended and Restated 2006 Equity Compensation Plan (the Amended 2006 Plan). Prior to May 7, 2013, we adopted and our shareholders approved the 2006 ITT Educational Services, Inc. Equity Compensation Plan (the Original 2006 Plan). The Amended 2006 Plan increased the maximum number of shares of our common stock that may be issued pursuant to awards under the plan to 7,350,000, an increase of 3,350,000 over the 4,000,000 maximum under the Original 2006 Plan.

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 September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Stock-based compensation expense	$ 3,304	$ 4,291	$ 8,698	$ 13,046
Income tax (benefit)	($ 1,272)	($ 1,652)	($ 3,349)	($5,023)

We did not capitalize any stock-based compensation cost in the three or nine months ended September 30, 2013 or 2012.

As of September 30, 2013, we estimated that pre-tax compensation expense for unvested stock-based compensation grants in the amount of approximately $17,700, 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 2.1 years.

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

	Nine Months Ended September 30, 2013				
	# of Shares	Weighted Average Exercise Price	Aggregate Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (1)
Outstanding at beginning of period	1,574,604	$ 84.90	$ 133,691		
Granted	154,000	$ 19.31	2,974		
Forfeited	(16,668)	$ 75.11	(1,252)		
Exercised	0	$ 0.00	0		
Expired	(361,988)	$ 70.59	(25,554)		
Outstanding at end of period	1,349,948	$ 81.38	$ 109,858	2.7	$ 1,800
Exercisable at end of period	1,060,443	$ 91.47	$ 97,003	2.3	$ 0

(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 September 30, 2013 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.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Shares subject to stock options granted	0	0	154,000	156,500
Weighted average grant date fair value per share	$ 0	$ 0	$ 9.16	$ 31.36
Shares subject to stock options exercised	0	4,855	0	202,820
Intrinsic value of stock options exercised	$ 0	$ 14	$ 0	$ 4,802
Proceeds received from stock options exercised	$ 0	$ 254	$ 0	$ 8,345
Tax benefits realized from stock options exercised	$ 0	$ 5	$ 0	$ 1,602

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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Risk-free interest rates	Not applicable	Not applicable	0.7%	0.7%
Expected lives (in years)	Not applicable	Not applicable	4.6	4.5
Volatility	Not applicable	Not applicable	60%	51%
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:

	Nine Months Ended September 30, 2013	
	# of RSUs	Weighted Average Grant Date Fair Value
Unvested at beginning of period	413,645	$ 75.35
Granted	521,614	$ 19.96
Forfeited	(94,471)	$ 51.14
Vested	(68,066)	$ 88.70
Unvested at end of period	772,722	$ 39.74

The total fair market value of the RSUs that vested and were settled in shares of our common stock was $49 in the three months ended September 30, 2013 and $29 in the three months ended September 30, 2012. The total fair market value of the RSUs that vested and were settled in shares of our common stock was $1,226 in the nine months ended September 30, 2013 and $4,565 in the nine months ended September 30, 2012. In the nine months ended September 30, 2012, 48,935 RSUs vested and were settled in cash for $3,073.

6. Stock Repurchases

As of September 30, 2013, 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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Number of shares	0	0	0	3,025,700
Total cost	$ 0	$ 0	$ 0	$ 207,918
Average cost per share	$ 0	$ 0	$ 0	$ 68.72

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7. Debt

On March 21, 2012, we entered into a credit agreement (the Credit Agreement) that provides for a $325,000 senior revolving credit facility (the Revolver). The 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 Credit Agreement are not under any obligation to provide any such additional revolving commitments or term loan commitments. The 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 a prior credit agreement which was terminated on March 21, 2012. In addition to the prepayment of the outstanding indebtedness under the prior credit agreement, borrowings under the Credit Agreement are used for general corporate purposes.

Borrowings under the Credit Agreement bear 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 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 Credit Agreement and which primarily includes outstanding borrowings, recorded contingent liabilities related to our guarantee obligations, letters of credit and surety bonds) to EBITDA (as defined in the 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 Credit Agreement. The amount of the commitment fee is determined based on the Leverage Ratio as of the end of each fiscal quarter.

The Credit Agreement contains, among other things, covenants, representations and warranties and events of default customary for credit facilities. The 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 September 30, 2013.

As of September 30, 2013, the borrowings under the Credit Agreement totaled $60,000. The effective interest rate on our borrowings was approximately 4.10% per annum in the three months ended September 30, 2013 and approximately 2.70% per annum in the three months ended September 30, 2012. In the nine months ended September 30, 2013, the effective interest rate on our borrowings was approximately 3.40% per annum compared to approximately 2.30% per annum in the nine months ended September 30, 2012. The commitment fee under the Credit Agreement was 0.40% as of September 30, 2013.

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

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2013	**2012**	**2013**	**2012**
	$776	$879	$2,762	$2,541

8. Investments

We did not hold any available-for-sale investments as of September 30, 2013, December 31, 2012 or September 30, 2012.

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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Interest income on investments	$ 16	$ 36	$ 74	$ 252
Realized net gains on the sale of investments	0	0	0	40
Total investment income	$ 16	$ 36	$ 74	$ 292

9. 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. In the three and nine months ended September 30, 2012, the discount was amortized and recognized in Interest income on our Condensed Consolidated Statements of Income over the term of the Subordinated Note. We did not recognize any interest income related to the amortization of the Subordinated Note discount on our Condensed Consolidated Statements of Income in the three or nine months ended September 30, 2013. The maturity date of the Subordinated Note is in March 2026. The face value of the Subordinated Note was approximately $73,000 as of September 30, 2013 and December 31, 2012 and $73,400 as of September 30, 2012.

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 September 30, 2013, the value of the assets of the PEAKS Trust satisfied this requirement.

We guarantee payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and the required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt (PEAKS Guarantee). We did not explicitly or implicitly provide any financial or other support to the PEAKS Trust during the three or nine months ended September 30, 2013 or 2012 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. Nevertheless, during the three and nine months ended September 30, 2013, we made payments on behalf of certain student borrowers under the PEAKS Program to the organization that services the student loans on behalf of the PEAKS Trust to help those borrowers avoid defaulting on their PEAKS Program private education loans (Payments on Behalf of Borrowers), which defaults would have triggered contractually required payments by us under the PEAKS Program. Our guarantee 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 our guarantee (which do not include Payments on Behalf of Borrowers) and payment of the Subordinated Note, in each case only to the extent of available funds remaining in the PEAKS Trust.

In the nine months ended September 30, 2013, we made Payments on Behalf of Borrowers in connection with the PEAKS Program. We made those payments after assessing:

- the likelihood of us being contractually required to make payments under the PEAKS Guarantee in the near future;
- the effect on our liquidity that would result from making payments under the PEAKS Guarantee compared to making Payments on Behalf of Borrowers;
- the effect that Payments on Behalf of Borrowers may have on the funds available to the PEAKS Trust to repay the Subordinated Note to us following full payment of the PEAKS Trust s other obligations; and

the fact that we will not be able to recover Payments on Behalf of Borrowers directly from the student borrowers on whose behalf we made those payments.

Payments on Behalf of Borrowers assist in:

maintaining the ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt at the required level; and

satisfying the following month s required payment of interest on the PEAKS Senior Debt and administrative fees and expenses of the PEAKS Trust.

We will continue to assess whether it would be economically beneficial to us to make Payments on Behalf of Borrowers in future periods, and we may make Payments of Behalf of Borrowers in the future based on our assessment of the above factors. Making Payments on Behalf of Borrowers does not give us the power to direct the activities that most significantly impact the economic performance of the PEAKS Trust and, therefore, does not change our conclusion that we are not the primary beneficiary of the PEAKS Trust.

Making Payments on Behalf of Borrowers:

may result in us paying amounts to the PEAKS Trust in advance of when a guarantee payment would be due, which would negatively impact our liquidity in a particular period;

may result in us paying a lesser amount than we otherwise would have been required to pay in future periods under the PEAKS Guarantee, which would positively impact our liquidity in a particular period; and

may reduce the amount that we could receive following full payment of the PEAKS Senior Debt and fees and expenses of the PEAKS Trust, because that amount is limited to the amounts we paid under the PEAKS Guarantee (which do not include Payments on Behalf of Borrowers) and the amount due to us under the Subordinated Note.

The amount owed to us under the Subordinated Note was approximately $73,000 as of September 30, 2013. In determining the estimated default rate used in the assumptions to establish our liability for guarantee obligations, we considered the payment performance of the private education loans under the PEAKS Program. Any Payments on Behalf of Borrowers that we made with respect to those loans, however, were not considered to be payments on those loans for purposes of that determination.

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The following table sets forth the guarantee payments and Payments on Behalf of Borrowers that we made related to the PEAKS Program in the periods indicated:

Type of Payment	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Guarantee	$ 138	$ 243	$ 1,377	$ 502
Payments on Behalf of Borrowers	2,502	0	7,647	0
Total	$ 2,640	$ 243	$ 9,024	$ 502

See Note 12 Contingencies, for further discussion of the PEAKS Guarantee.

The PEAKS Trust is a variable interest entity as defined under ASC 810. We held variable interests in the PEAKS Trust as of September 30, 2013 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 reasonable 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 nine months ended September 30, 2013. 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 made 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 did 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 represented 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. The following table sets forth the payments that we made to the 2009 Entity related to our guarantee obligations under the 2009 RSA, net of recoveries, in the periods indicated:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	$458	$560	$738	$1,141

We asserted the right to offset amounts owed to us by the 2009 Entity under a revolving promissory note (the Revolving Note) related to the 2009 RSA, net of recoveries, of $47 in the three months ended September 30, 2013 and $8,023 in the nine months ended September 30, 2013. Approximately $6,800 of the amount that we claimed as an offset against the Revolving Note in the nine months ended September 30, 2013 related to our election under the 2009 RSA to discharge our guarantee obligations with respect to certain defaulted private education loans under the 2009 Loan Program. We recorded all of the amounts claimed as offsets in Other current liabilities on our Condensed Consolidated Balance Sheet as of September 30, 2013. See Note 12 Contingencies, for further discussion of the 2009 RSA. Claiming an offset against the Revolving Note related to our election under the 2009 RSA to discharge our guarantee obligations with respect to certain defaulted private education loans does not give us the power to direct the activities that most significantly impact the economic performance of the 2009 Entity and, therefore, does not change our conclusion that we are not the primary beneficiary of the 2009 Entity. If we believe that doing so would be economically beneficial to us, we may elect in future periods to accelerate the timing of certain guarantee payments to the 2009 Entity that we would otherwise be required to make at a later date, in order to discharge our guarantee obligations under the 2009 RSA related to certain 2009 Loan Program private education loans that default (Discharge Payments). Making Discharge Payments would not give us the power to direct the activities that most significantly impact the economic performance of the 2009 Entity and, therefore, would not change our conclusion that we are not the primary beneficiary of the 2009 Entity.

In addition, we have made advances to the 2009 Entity under the Revolving Note. We did not make any advances in the three or nine months ended September 30, 2013 or 2012 to the 2009 Entity under the Revolving Note that we were not contractually required to make. Certain 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 is currently due and payable in full. The amount owed to us under the Revolving Note, excluding the offsets described above, was approximately $8,200 as of September 30, 2013, $8,300 as of December 31, 2012 and $8,600 as of September 30, 2012.

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.

The 2009 Entity is a variable interest entity as defined under ASC 810. We held variable interests in the 2009 Entity as of September 30, 2013 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 reasonable 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 nine months ended September 30, 2013. 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.

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In the three months ended December 31, 2012, we determined that the Subordinated Note and the Revolving Note were impaired and recorded an impairment charge in the aggregate amount of $15,200. The aggregate carrying value of the Subordinated Note and the Revolving Note was approximately $2,500 as of September 30, 2013, $2,900 as of December 31, 2012 and $18,000 as of September 30, 2012 and was included on our Condensed Consolidated Balance Sheet in Prepaid expenses and other current assets as of September 30, 2013 and in Other assets as of December 31, 2012 and September 30, 2012. The accrual of interest (in the case of the Revolving Note) and the accretion of discount (in the case of the Subordinated Note) is discontinued when, in our opinion, the borrower may be unable to make payments owed under the note as they become due. We did not recognize any interest income related to the Subordinated Note or the Revolving Note in our Condensed Consolidated Statements of Income during the time that the Subordinated Note and Revolving Note were impaired, which included the three and nine months ended September 30, 2013.

10. 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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
Shares:				
Weighted average number of shares of common stock outstanding	23,418	23,359	23,410	24,054
Shares assumed issued (less shares assumed purchased for treasury)for stock-based compensation	216	84	146	146
Outstanding shares for diluted earnings per share calculation	23,634	23,443	23,556	24,200

A total of approximately 1.2 million shares in the three months ended September 30, 2013 and 1.5 million shares in the nine months ended September 30, 2013 were excluded from the calculation of our diluted earnings per common share, because the effect was anti-dilutive. We excluded from the calculation of our diluted earnings per common share approximately 1.8 million shares in the three months ended September 30, 2012 and 1.6 million shares in the nine months ended September 30, 2012, because the effect was anti-dilutive.

11. 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	Nine Months Ended September 30,

	Ended September 30, 2013	2012	2013	2012
Interest cost	$ 439	$ 516	$ 1,316	$ 1,548
Expected return on assets	(1,087)	(1,128)	(3,260)	(3,385)
Recognized net actuarial loss	506	679	1,518	2,037
Amortization of prior service (credit)	(389)	(389)	(1,167)	(1,166)
Net periodic pension (benefit)	($531)	($322)	($1,593)	($966)

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 nine months ended September 30, 2013 or 2012. We do not expect to make any material contributions to the ESI Pension Plan or the ESI Excess Pension Plan in 2013.

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The following table sets forth the changes in the components of Accumulated other comprehensive loss on our Condensed Consolidated Balance Sheet in the nine months ended September 30, 2013:

	Defined Benefit Pension Items		
	Accumulated Other Comprehensive Income (Loss)	**Income Tax Benefit (Expense)**	**Accumulated Other Comprehensive Income (Loss) Net of Income Tax**
Balance at January 1, 2013	($13,058)	$ 5,128	($7,930)
Amortization of:			
Actuarial (gains)/losses	1,518	(589)	929
Prior service costs (credits)	(1,167)	453	(714)
Balance at September 30, 2013	($12,707)	$ 4,992	($7,715)

The reclassification of prior service costs/credits and actuarial gains/losses from Accumulated other comprehensive loss are included in the computation of net periodic pension cost (benefit). Net periodic pension cost (benefit) was included in compensation expense in Cost of educational services and Student services and administrative expenses on our Condensed Consolidated Statements of Income in the nine months ended September 30, 2013.

12. 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 September 30, 2013, the total face amount of those surety bonds was approximately $20,000.

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 September 30, 2013, our recorded liability for these claims and contingencies was approximately $81,235, consisting of approximately:

$40,000 related to our guarantee obligations under the PEAKS Program;

$32,910 related to our guarantee obligations under the 2009 RSA; and

$8,325 related to other claims and contingencies not directly associated with the PEAKS Program or 2009 RSA.

The 2009 RSA and PEAKS Program are hereinafter collectively referred to as the RSAs. As of September 30, 2013, $43,314 of the recorded liability was included in Other current liabilities and $37,921 was included in Other liabilities on our Condensed Consolidated Balance Sheet. The $43,314 included in Other current liabilities as of September 30, 2013 included $8,023 that we claimed as an offset against amounts owed to us under the Revolving Note. See *Guarantees* below for further discussion of the amounts we claimed as offsets under the Revolving Note. The $37,921 included in Other liabilities as of September 30, 2013 represents our estimate of the loss that we believe we will realize over the next seven to ten years related to our estimated guarantee obligations under the RSAs.

The following table sets forth the activity with respect to our recorded liability related to our claims and contingencies in the periods indicated:

	Nine Months Ended September 30,	
	2013	**2012**
Balance as of January 1	$ 123,439	$ 36,028
Increases (decreases) from:		
Additional reserves:		
PEAKS Program	721	0
2009 RSA	8,957	9,600
Other	3,085	272
Payments, net	(55,770)	(1,653)
Estimated recovery	803	0
Balance as of September 30	$ 81,235	$ 44,247

We had guaranteed the repayment of private education loans made by a lender to our students in 2007 and early 2008 (the 2007 RSA) that the lender charged off above a certain percentage of the total dollar volume of private education loans made under the 2007 RSA. In January 2013, we paid $46,000 in a settlement to absolve us from any further obligations with respect to our guarantee obligations under the 2007 RSA. The liability for this settlement was included in Other current liabilities on our Condensed Consolidated Balance Sheet as of December 31, 2012.

In connection with estimating our recorded liability for claims and contingencies as of September 30, 2013, we 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. In order to estimate the possible range of losses under the RSAs, we made certain assumptions with respect to the performance of the private education loans made under the RSAs over the life of those loans. The life of a private education loan made under the RSAs may be in excess of ten years from the date of disbursement. Therefore, our estimate of the possible range of losses under the RSAs was based on assumptions for periods in excess of ten years, and those assumptions included, among other things, the following:

- the repayment performance of the private education loans under each of the RSAs;
- the timing and rate at which the private education loans will be paid;
- the changes in the variable interest rates due on the private education loans and PEAKS Senior Debt;
- the amounts that will be collected in the future on the private education loans that have defaulted; and
- the fees and expenses associated with servicing the private education loans.

We consulted with two third-party consumer credit consulting firms in arriving at our assumptions and estimates. The assumptions have changed, and may continue to change, significantly over time as actual results become known, which would affect our estimated range of possible losses related to the RSAs. With respect to our guarantee obligations under the RSAs, we believe that it is reasonably possible that we may incur losses in an estimated range of $9,000 less than to $41,000 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 December 22, 2008, we were served with a qui tam action that was filed on July 3, 2007 in the United States District Court for the Southern District of Indiana by a former employee (relator) on behalf of herself and the federal government under the following caption: *United States of America ex rel. Debra Leveski v. ITT Educational Services, Inc.* (the Leveski Litigation). We were served with the Leveski Litigation after the U.S. Department of Justice declined to intervene in the litigation. On June 3, 2008, the relator filed an amended complaint in the Leveski Litigation. On September 23, 2009, the court dismissed the Leveski Litigation without prejudice and gave the relator an opportunity to replead her complaint. On October 8, 2009, the relator filed a second amended complaint. In the second amended complaint, the relator alleges that we violated the False Claims Act, 31 U.S.C. § 3729, *et seq*., and the Higher Education Act of 1965, as amended (the HEA) by compensating our sales representatives and financial aid administrators with commissions, bonuses or other incentive payments based directly or indirectly on success in securing enrollments or federal financial aid. The relator alleges that all of our revenue derived from the federal student financial aid programs from July 3, 2001 through July 3, 2007 was generated as a result of our violating the HEA. The relator seeks various forms of recovery on behalf of herself and the federal government, including:

- treble the amount of unspecified funds paid to us for federal student grants;

- treble the amount of unspecified default payments, special allowance payments and interest received by lenders with respect to federal student loans received by our students;

- all civil penalties allowed by law; and

- attorney s fees and costs.

A qui tam action is a civil lawsuit brought by one or more individuals (a qui tam relator) on behalf of the federal or state government for an alleged submission to the government of a false claim for payment. A qui tam action is always filed under seal and remains under seal until the government decides whether to intervene in the litigation. Whenever a relator files a qui tam action, the government typically initiates an investigation in order to determine whether to intervene in the litigation. If the government intervenes, it has primary control over the litigation. If the government declines to intervene, the relator may pursue the litigation on behalf of the government. If the government or the relator is successful in the litigation, the relator receives a portion of the government s recovery.

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On August 8, 2011, the district court granted our motion to dismiss all of the relator s claims in the Leveski Litigation for lack of subject-matter jurisdiction and issued a judgment for us. On February 16, 2012, the relator in the Leveski Litigation filed a Notice of Appeal with the 7th Circuit Court of Appeals regarding the final judgment entered by the district court dismissing all claims against us. On March 26, 2012, the district court in the Leveski Litigation awarded us approximately $395 in sanctions against the relator s attorneys for filing a frivolous lawsuit. Relator s attorneys also appealed this award to the 7th Circuit Court of Appeals. On July 8, 2013, the 7th Circuit Court of Appeals reversed the district court s dismissal of the Leveski Litigation for lack of subject-matter jurisdiction and the award of sanctions against relator s attorneys. In addition, the 7th Circuit Court of Appeals remanded the Leveski Litigation back to the district court for further proceedings.

We have defended, and intend to continue to defend, ourselves vigorously against the allegations made in the complaint.

On March 11, 2013, 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: *William Koetsch, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc., et al.* (the Koetsch Litigation). On July 25, 2013, the court named the Plumbers and Pipefitters National Pension Fund and Metropolitan Water Reclamation District Retirement Fund as the lead plaintiffs and consolidated the Koetsch Litigation and the MLAF Litigation (defined below) under the following caption: *In re ITT Educational Services, Inc. Securities Litigation* (the Securities Litigation). On October 7, 2013, an amended complaint was filed in the Securities Litigation. The amended complaint alleges, among other things, that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder by:

- our failure to properly account for the 2007 RSA, 2009 RSA and PEAKS Program;
- employing devices, schemes and artifices to defraud;
- making untrue statements of material facts, or omitting material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;
- making the above statements intentionally or with reckless disregard for the truth;
- engaging in acts, practices, and a course of business that operated as a fraud or deceit upon lead plaintiffs and others similarly situated in connection with their purchases of our common stock;
- deceiving the investing public, including lead plaintiffs and the purported class, regarding, among other things, our artificially inflated statements of financial strength and understated liabilities; and
- causing our common stock to trade at artificially inflated prices and causing the plaintiff and other putative class members to purchase our common stock at inflated prices.

The putative class period in this action is from April 24, 2008 through February 25, 2013. The plaintiffs seek, among other things, the designation of this action as a class action, an award of unspecified compensatory damages, interest, costs and expenses, including counsel fees and expert fees, and such equitable/injunctive and other relief as the court deems appropriate. All of the defendants intend to defend themselves vigorously against the allegations made in the amended complaint.

On April 17, 2013, 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: *Massachusetts Laborers Annuity Fund, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc., et al.* (the MLAF Litigation). The complaint alleges, among other things, that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder by:

- our failure to properly account for the 2007 RSA, 2009 RSA and PEAKS Program;
- our failure to establish adequate reserves associated with our guarantee obligations under the 2007 RSA, 2009 RSA and PEAKS Program, which caused us to misrepresent our earnings, liabilities, net income and financial condition throughout the putative class period;
- making false and misleading statements;
- engaging in a scheme to deceive the market and a course of conduct that artificially inflated the price of our common stock;
- operating as a fraud or deceit on purchasers of our common stock by misrepresenting our liabilities related to the 2007 RSA, 2009 RSA and PEAKS Program, financial results and business prospects;
- artificially inflating the price of our common stock; and
- causing the putative class members to purchase our common stock at artificially inflated prices.

The putative class period in this action is from April 24, 2008 through February 25, 2013. The plaintiff seeks, among other things, the designation of this action as a class action, and an award of unspecified compensatory damages, interest, costs, attorney s fees and equitable/injunctive or other relief as the Court deems just and proper. All of the defendants intend to defend themselves vigorously against the allegations made in the complaint. On July 25, 2013, the MLAF Litigation was consolidated into the Securities Litigation.

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On May 8, 2013, a complaint in a shareholder derivative lawsuit was filed against two of our current executive officers and all of our current Directors in the United States District Court for the Southern District of New York under the following caption: *Sasha Wilfred, Derivatively on Behalf of Nominal Defendant ITT Educational Services, Inc. v. Kevin M. Modany, et al.* (the Wilfred Litigation). The complaint alleges, among other things, that from April 24, 2008 through February 25, 2013, the defendants violated state law, including breaching their fiduciary duties to us, grossly mismanaging us, wasting our corporate assets and being unjustly enriched, by:

- causing or allowing us to disseminate to our shareholders materially misleading and inaccurate information relating to a series of risk-sharing agreements through SEC filings, press releases, conference calls, and other public statements and disclosures;
- willfully ignoring obvious and pervasive problems with our internal controls and practices and procedures, and failing to make a good faith effort to correct these problems or prevent their recurrence;
- violating and breaching fiduciary duties of care, loyalty, reasonable inquiry, oversight, good faith and supervision;
- causing or allowing us to misrepresent material facts regarding our financial position and business prospects; and
- abandoning their responsibilities and duties with regard to prudently managing our businesses in a manner imposed upon them by law.

The complaint seeks:

- unspecified damages;
- restitution;
- disgorgement of all profits, benefits and other compensation obtained by the individual defendants;
- an order directing us to take all necessary actions to reform and improve our corporate governance and internal procedures; and
- costs and disbursements, including attorneys , accountants and experts fees, costs and expenses.

All of the individual defendants intend to defend themselves vigorously against the allegations in the complaint. On August 6, 2013, the parties agreed to stay the Wilfred Litigation until the Securities Litigation is dismissed with prejudice or the defendants file an answer in the Securities Litigation.

Although the derivative action is brought nominally on behalf of us, we expect to incur defense costs and other expenses in connection with the derivative lawsuit.

There can be no assurance that the ultimate outcome of the Leveski Litigation, Securities Litigation, Wilfred Litigation or other actions (including other actions under federal or state securities laws) will not have a material adverse effect on our financial condition, results of operations or cash flows.

The current officers named in the Securities Litigation and the Wilfred Litigation include Daniel M. Fitzpatrick and Kevin M. Modany.

Certain of our current and former officers and Directors are or may become a party in the actions described above. Our By-laws and Restated Certificate of Incorporation obligate us to indemnify our officers and Directors to the fullest extent permitted by Delaware law, provided that their conduct complied with certain requirements. We are obligated to advance defense costs to our officers and Directors, subject to the individual s obligation to repay such amount if it is ultimately determined that the individual was not entitled to indemnification. In addition, our indemnity obligation can, under certain circumstances, include indemnifiable judgments, penalties, fines and amounts paid in settlement in connection with those actions.

Guarantees. We entered into the PEAKS Guarantee in connection with the PEAKS Program. Under the PEAKS Guarantee, we guarantee payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and the required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt. 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 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 (which do not include Payments on Behalf of Borrowers) to the extent that funds are remaining in the PEAKS Trust. To the extent that any funds remain in the PEAKS Trust after repayment of the amounts that we paid under the PEAKS Guarantee, we will be entitled to repayment of the Subordinated Note. The amount owed to us under the Subordinated Note was approximately $73,000 as of September 30, 2013. Payments made under the PEAKS Guarantee that we expect to recover, net of accrued discount, were approximately $7,800 as of September 30, 2013 and $6,700 as of December 31, 2012 and are included in Other assets on our Condensed Consolidated Balance Sheet.

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

- up to $256,000 in principal of PEAKS Senior Debt, which was the approximate outstanding principal balance of the PEAKS Senior Debt as of September 30, 2013;

- accrued interest on the PEAKS Senior Debt;

- the fees and expenses of the PEAKS Trust; and

- amounts by which the ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt falls below the required level.

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 and the performance of which also affects the ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt;

- the fact that those loans will 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; 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.

In the nine months ended September 30, 2013, we made Payments on Behalf of Borrowers in connection with the PEAKS Program. We made those payments after assessing:

- the likelihood of us being contractually required to make payments under the PEAKS Guarantee in the near future;

- the effect on our liquidity that would result from making payments under the PEAKS Guarantee compared to making Payments on Behalf of Borrowers;

- the effect that Payments on Behalf of Borrowers may have on the funds available to the PEAKS Trust to repay the Subordinated Note to us following full payment of the PEAKS Trust s other obligations; and

- the fact that we will not be able to recover Payments on Behalf of Borrowers directly from the student borrowers on whose behalf we made those payments.

Payments on Behalf of Borrowers assist in:

- maintaining the ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt at the required level; and

- satisfying the following month s required payment of interest on the PEAKS Senior Debt and administrative fees and expenses of the PEAKS Trust.

We will continue to assess whether it would be economically beneficial to us to make Payments on Behalf of Borrowers in future periods, and we may make Payments of Behalf of Borrowers in the future based on our assessment of the above factors.

Making Payments on Behalf of Borrowers:

- may result in us paying amounts to the PEAKS Trust in advance of when a guarantee payment would be due, which would negatively impact our liquidity in a particular period;

- may result in us paying a lesser amount than we otherwise would have been required to pay in future periods under the PEAKS Guarantee, which would positively impact our liquidity in a particular period; and.

- may reduce the amount that we could receive following full payment of the PEAKS Senior Debt and fees and expenses of the PEAKS Trust, because that amount is limited to the amounts we paid under the PEAKS Guarantee (which do not include Payments on Behalf of Borrowers) and the amount due to us under the Subordinated Note.

The amount owed to us under the Subordinated Note was approximately $73,000 as of September 30, 2013. In determining the estimated default rate used in the assumptions to establish our liability for guarantee obligations, we considered the payment performance of the private education loans under the PEAKS Program. Any Payments on Behalf of Borrowers that we made with respect to those loans, however, were not considered to be payments on those loans for purposes of that determination.

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.

Under the 2009 RSA, we have the right to elect to make Discharge Payments with respect to private education loans that have defaulted. The effect of a making a Discharge Payment related to a private education loan is to reduce the aggregate amount that we may have to pay under our guarantee obligations with respect to that loan. To date, we have claimed as an offset against the Revolving Note amounts that would have the effect of discharging our obligations with respect to certain defaulted loans under

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the 2009 RSA. If we believe that doing so would be economically beneficial to us, we may make Discharge Payments in future periods. Making Discharge Payments may result in us paying amounts to the 2009 Entity in advance of when a guarantee payment would be due, which would negatively impact our liquidity in a particular period, but may result in us paying a lesser amount than we otherwise would have been required to pay under our guarantee obligation in future periods under the 2009 RSA.

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 September 30, 2013, 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 September 30, 2013. 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 September 30, 2013.

The following table sets forth the approximate aggregate amount of guarantee payments and Payments on Behalf of Borrowers that we made related to the RSAs, net of recoveries, in the periods indicated:

Type of Payment	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Guarantee:				
PEAKS Guarantee	$ 138	$ 243	$ 1,377	$ 502
2009 RSA	458	560	738	1,141
Payments on Behalf of Borrowers	2,502	0	7,647	0
Total	$ 3,098	$ 803	$ 9,762	$ 1,643

We asserted the right to offset amounts owed to us by the 2009 Entity under the Revolving Note related to the 2009 RSA, net of recoveries, of $47 in the three months ended September 30, 2013 and $8,023 in the nine months ended September 30, 2013. Approximately $6,800 of the amount that we claimed as an offset against the Revolving Note in the nine months ended September 30, 2013 related to our election under the 2009 RSA to discharge our guarantee obligations with respect to certain defaulted private education loans under the 2009 Loan Program. We recorded all of the amounts claimed as offsets in Other current liabilities on our Condensed Consolidated Balance Sheet as of September 30, 2013.

At the end of each reporting period, we assess whether we should recognize a contingent liability related to our guarantee obligations under the RSAs and, if so, in what amount. As with any assessment, as facts and circumstances change, the recorded liability could change, and has changed, significantly. In order to make this assessment, we made certain assumptions with respect to the performance of the private education loans made under each of the RSAs over the life of these loans. The life of a private education loan made under the RSAs may be in excess of ten years from the date of disbursement. Therefore, our assessment was based on assumptions for periods in excess of ten years, and those assumptions include among other things, the following:

- the repayment performance of the private education loans under each of the RSAs;

the timing and rate at which the private education loans will be paid;

the changes in the variable interest rates due on the private education loans and PEAKS Senior Debt;

the amounts that will be collected in the future on the private education loans that have defaulted; and

the fees and expenses associated with servicing the private education loans.

We consulted with two third-party consumer credit consulting firms in arriving at our assumptions. The assumptions have changed, and may continue to change, significantly over time as actual results become known. In determining the estimated default rate used in the assumptions to establish our liability for guarantee obligations, we considered the payment performance of the private education loans under the PEAKS Program. Any Payments on Behalf of Borrowers that we made with respect to those loans, however, were not considered to be payments on those loans for purposes of that determination. Our recorded liability for our guarantee obligations under the RSAs is included in Other current liabilities and Other liabilities on our Condensed Consolidated Balance Sheets.

As previously disclosed, on February 8, 2013, we received a subpoena from the SEC. In a letter accompanying the subpoena, the SEC states that it is conducting an investigation of us. The SEC s subpoena requests the production of documents and communications that, among other things, relate to our actions and accounting associated with: (a) agreements that we entered into with the 2009 Entity to create the 2009 Loan Program, including, without limitation, the 2009 RSA; and (b) agreements that we entered into to create the PEAKS Program. On May 9, 2013, we received a second subpoena from the SEC requesting the production of certain communications related to the same subject matter as the subpoena received on February 8, 2013. We are cooperating with the SEC in its investigation, and we have provided documentation, communications and other information, including testimony of one of our officers, to the SEC in response to both subpoenas. There can be no assurance, however, that the ultimate outcome of the SEC investigation will not have a material adverse effect on our financial condition or results of operations.

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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, 2012 filed with the SEC, in Part II, Item 1A. Risk Factors of our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2013 and June 30, 2013 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, 2012 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.

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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.

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 in the order of significance.

Background

We are a leading proprietary provider of postsecondary degree programs in the United States based on revenue and student enrollment. As of September 30, 2013, we were offering:

- master, bachelor and associate degree programs to approximately 61,000 students; and
- short-term information technology and business learning solutions for career advancers and other professionals.

As of September 30, 2013, we had 149 college locations (including 147 campuses and two learning sites) in 39 states and one training facility. 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 August 2013, we acquired all of the membership interests of Cable Holdings, an education company that offers short-term information technology and business learning solutions for career advancers and other professionals.

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;
- helping our graduates obtain entry-level employment involving their fields of study at higher starting annual salaries; and
- investing in other education-related opportunities.

As part of our efforts to maximize the efficiency and effectiveness of our campus locations, during the nine months ended September 30, 2013, we relocated four of our campuses into existing facilities of other ITT Technical Institute campuses. We also suspended the enrollment of new students at two other ITT Technical Institute campuses, until we determine whether to continue operations at those campuses.

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, 2012 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 February 2013, the FASB issued ASU No. 2013-02, which is included in the Codification under ASC 220. This update requires an entity to report the effect, by component, of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income. This guidance is effective for interim and annual reporting periods beginning January 1, 2013. The adoption of this guidance requires that we provide additional disclosures regarding the amounts reclassified out of accumulated other comprehensive income during the reporting period. We have included these disclosures in the footnotes to our condensed consolidated financial statements.

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In October 2012, the FASB issued ASU No. 2012-04, which makes technical corrections, clarifications and limited-scope improvements to various topics throughout the Codification. The amendments in this ASU that do not have transition guidance are effective upon issuance and the amendments that are subject to transition guidance are effective for our interim and annual reporting periods beginning January 1, 2013. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

In July 2012, the FASB issued ASU No. 2012-02, which is included in the Codification under ASC 350. This update allows an entity to first assess qualitative factors to determine whether it must perform a quantitative impairment test. An entity would be required to calculate the fair value of an indefinite-lived intangible asset, if the entity determines, based on a qualitative assessment, that it is more likely than not that the indefinite-lived asset is impaired. This guidance is effective for impairment tests performed for our interim and annual reporting periods beginning January 1, 2013. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

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. In January 2013, the FASB issued ASU No. 2013-01, which clarifies the scope of the disclosures required under ASU No. 2011-11. Both of these updates are effective for interim and annual reporting periods beginning January 1, 2013. 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 September 30,		Nine Months Ended September 30,	
	2013	**2012**	**2013**	**2012**
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of educational services	47.0%	42.6%	46.0%	41.5%
Student services and administrative expenses	38.2%	35.0%	38.0%	33.2%
Loss related to private student loan programs	2.4%	0.0%	1.2%	0.0%
Operating income	12.4%	22.5%	14.9%	25.2%
Interest (expense), net	(0.3%)	(0.3%)	(0.3%)	(0.2%)
Income before provision for income taxes	12.1%	22.2%	14.5%	25.1%

The following table sets forth our total student enrollment as of the dates indicated:

	2013		2012	
	Total	**(Decrease)**	**Total**	**(Decrease)**
Total Student	**Student**	**To**	**Student**	**To**

Enrollment as of:	Enrollment	Prior Year	Enrollment	Prior Year
March 31	61,039	(14.2%)	71,123	(15.4%)
June 30	58,617	(11.7%)	66,397	(15.7%)
September 30	60,997	(7.1%)	65,662	(17.1%)
December 31	Not applicable	Not applicable	61,059	(16.6%)

Total student enrollment includes all new and continuing students. A continuing student is any student who, in the academic term being measured, is enrolled in a program of study at one of our campuses and was enrolled in the same program at any of our campuses at the end of the immediately preceding academic term. A new student is any student who, in the academic term being measured, enrolls in and begins attending any program of study at one of our campuses:

- for the first time at that campus;
- after graduating in a prior academic term from a different program of study at that campus; or
- after having withdrawn or been terminated from a program of study at that campus.

The following table sets forth our new student enrollment in the periods indicated:

	2013		2012	
New Student Enrollment in the Three Months Ended:	**New Student Enrollment**	**Increase (Decrease) To Prior Year**	**New Student Enrollment**	**(Decrease) To Prior Year**
March 31	17,412	(3.6%)	18,067	(17.0%)
June 30	16,883	7.5%	15,698	(9.5%)
September 30	20,307	5.2%	19,298	(15.8%)
December 31	Not applicable	Not applicable	13,398	(11.4%)
Total for the year	Not applicable	Not applicable	66,461	(13.9%)

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We believe that the 5.2% increase in new student enrollment in the three months ended September 30, 2013 compared to the three months ended September 30, 2012 and the 7.5% increase in new student enrollment in the three months ended June 30, 2013 compared to the three months ended June 30, 2012 was primarily due to:

- an increase in the number of prospective students who inquired about our programs of study in the three months ended June 30, 2013;
- an increase in the rate at which prospective students who applied for enrollment actually began attending classes in their programs of study; and
- increased availability to and use by our students of institutional scholarships and awards, which have the effect of reducing the students cost of our programs of study.

We believe that the 3.6% decrease in new student enrollment in the three months ended March 31, 2013 compared to the three months ended March 31, 2012 was primarily due to:

- changes that we made to program offerings at select campuses which resulted in a more significant decline in new student enrollment in the criminal justice programs of study compared to our other curricula; and
- a decrease in new student enrollment in our bachelor degree programs.

We believe that the decrease in new student enrollment in the three months ended March 31, 2013 compared to the three months ended March 31, 2012 was also due to our prospective students :

- greater sensitivity to the cost of postsecondary education; and
- uncertainty about the value of a postsecondary education due to the prolonged economic and labor market disruptions.

A continued decline in total student enrollment, and declines in new student enrollment similar to those that we experienced prior to the three months ended June 30, 2013, could have a material adverse effect on our business, financial condition, revenue and other results of operations and cash flows. We have taken a number of steps in an attempt to reverse the declines in total and new student enrollment, including, without limitation:

- introducing an institutional scholarship program, called the Opportunity Scholarship, which is intended to help reduce the cost of an ITT Technical Institute education and increase student access to our programs of study; and refining our marketing, advertising and communications to focus more on the student value proposition and outcomes of an ITT Technical Institute education.

At the vast majority of our campuses, we generally organize the academic schedule for programs of study offered on the basis of four 12-week academic quarters in a calendar year. The academic quarters typically begin in early March, mid-June, early September and late November or early December. To measure the persistence of our students, the number of continuing students in any academic term is divided by the total student enrollment in the immediately preceding academic term.

The following table sets forth the rates of our students persistence as of the dates indicated:

	Student Persistence as of:			
Year	**March 31**	**June 30**	**September 30**	**December 31**
2011	73.5%	73.1%	71.5%	73.4%
2012	72.4%	71.3%	69.8%	72.6%
2013	71.5%	68.4%	69.4%	Not applicable

We believe that the decrease in student persistence as of September 30, 2013 compared to September 30, 2012 was primarily due to a decrease in student retention in the three months ended September 30, 2013 compared to the same prior year period, primarily attributed to:

lower student retention in a few courses that are delivered in the early portions of certain associate degree programs of study; and

an increase in the number of students who were enrolled in hybrid courses, in which a portion of the course is delivered in residence and a portion is delivered online, and which generally have a lower student retention rate.

We believe that the decrease in student persistence as of June 30, 2013 compared to June 30, 2012 was primarily due to:

an increase in the number of graduates at the end of the academic quarter that began in March 2013 compared to the end of the same academic quarter in the prior year; and

a slight decrease in student retention in the three months ended June 30, 2013 compared to the same prior year period, primarily attributed to lower student retention in a few courses that are delivered in the early portions of certain associate degree programs of study.

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The increase in the number of graduates at the end of the academic quarter that began in March 2013 was primarily due to two, instead of one, graduating classes of students comprised of:

- the first graduation class of the associate degree programs of study that we introduced in 2011, which reduce from eight to seven the number of academic quarters required for a full-time student to graduate; and
- the last graduation class of full-time students of the associate degree programs of study that required eight academic quarters for a full-time student to graduate.

We believe that the decrease in student persistence as of March 31, 2013 compared to March 31, 2012 was primarily due to the number of graduates in the three months ended March 31, 2013 compared to the three months ended March 31, 2012 decreasing at a lesser rate than the decline in total student enrollment as of December 31, 2012 compared to December 31, 2011.

Three Months Ended September 30, 2013 Compared with Three Months Ended September 30, 2012. Revenue decreased $55.3 million, or 17.6%, to $259.4 million in the three months ended September 30, 2013 compared to $314.7 million in the three months ended September 30, 2012. The primary factors that contributed to this decrease included:

- an increase in institutional scholarships and awards provided to our students, which reduced revenue by $34.2 million in the three months ended September 30, 2013 compared to the same prior year period;
- an 11.7% decrease in total student enrollment as of June 30, 2013 compared to June 30, 2012; and
- a 7.1% decrease in total student enrollment as of September 30, 2013 compared to September 30, 2012.

The increase in institutional scholarships and awards was primarily due to the introduction of the Opportunity Scholarship at the vast majority of the ITT Technical Institute campuses in the academic quarter that began in March 2013.

Cost of educational services decreased $12.0 million, or 8.9%, to $122.0 million in the three months ended September 30, 2013 compared to $133.9 million in the three months ended September 30, 2012. The primary factor that contributed to this decrease was a decrease in compensation and benefit costs resulting from fewer employees, which was partially offset by an increase in legal costs and $3.3 million of expense that was recorded in the three months ended September 30, 2013 related to the relocation of three of our ITT Technical Institutes.

Cost of educational services as a percentage of revenue increased 440 basis points to 47.0% in the three months ended September 30, 2013 compared to 42.6% in the three months ended September 30, 2012. The primary factors that contributed to this increase were a decline in revenue and an increase in legal costs, which were partially offset by decreases in compensation and benefit costs.

Student services and administrative expenses decreased $10.9 million, or 9.9%, to $99.1 million in the three months ended September 30, 2013 compared to $110.0 million in the three months ended September 30, 2012. The principal causes of this decrease were decreases in compensation and benefit costs and bad debt expense.

Student services and administrative expenses increased to 38.2% of revenue in the three months ended September 30, 2013 compared to 35.0% of revenue in the three months ended September 30, 2012. The principal cause of this increase was a decline in revenue, which was partially offset by decreases in compensation and benefit costs and bad debt expense. Bad debt expense as a percentage of revenue decreased to 6.9% in the three months ended September 30, 2013 compared to 7.3% in the three months ended September 30, 2012, primarily as a result of the increased use by our students of institutional scholarships and awards.

In the three months ended September 30, 2013, we recorded a loss of $6.2 million for additional accruals related to our guarantee obligations under the RSAs.

Operating income decreased $38.7 million, or 54.7%, to $32.1 million in the three months ended September 30, 2013 compared to $70.8 million in the three months ended September 30, 2012, primarily as a result of the impact of the factors discussed above in connection with revenue, cost of educational services, and student services and administrative expenses. Our operating margin decreased to 12.4% in the three months ended September 30, 2013 compared to 22.5% in the three months ended September 30, 2012, primarily as a result of the impact of the factors discussed above.

Interest income increased $0.1 million, or 36.0%, to $0.2 million in the three months ended September 30, 2013 compared to $0.1 million in the three months ended September 30, 2012, primarily due to the amortization of the discount on the receivable from the PEAKS Trust for amounts paid under the PEAKS Guarantee. See Note 12 of the Notes to Condensed Consolidated Financial Statements for a discussion of this right of repayment. Interest expense decreased $0.1 million, or 10.4%, to $0.9 million in the three months ended September 30, 2013 compared to $1.0 million in the three months ended September 30, 2012, primarily due to a decrease in our weighted average outstanding borrowings under the Credit Agreement, which was partially offset by an increase in the effective interest rate on the Revolver.

Our combined federal and state effective income tax rate was 39.6% in the three months ended September 30, 2013 compared to 38.7% in the three months ended September 30, 2012. The effective income tax rate was lower in the three months ended September 30, 2012 primarily due to the reversal of an unrecognized benefit accrual related to items with respect to which the statute of limitations had lapsed.

Nine Months Ended September 30, 2013 Compared with Nine Months Ended September 30, 2012. Revenue decreased $179.3 million, or 18.2%, to $807.1 million in the nine months ended September 30, 2013 compared to $986.4 million in the nine months ended September 30, 2012. The primary factors that contributed to this decrease included:

- an increase in institutional scholarships and awards provided to our students, which reduced revenue by $65.2 million in the nine months ended September 30, 2013 compared to the same prior year period;
- a 14.2% decrease in total student enrollment as of March 31, 2013 compared to March 31, 2012;
- a 16.6% decrease in total student enrollment as of December 31, 2012 compared to December 31, 2011;
- an 11.7% decrease in total student enrollment as of June 30, 2013 compared to June 30, 2012; and
- a 7.1% decrease in total student enrollment as of September 30, 2013 compared to September 30, 2012.

The increase in institutional scholarships and awards was primarily due to the introduction of the Opportunity Scholarship at the vast majority of the ITT Technical Institute campuses in the academic quarter that began in March 2013.

Cost of educational services decreased $38.8 million, or 9.5%, to $371.0 million in the nine months ended September 30, 2013 compared to $409.8 million in the nine months ended September 30, 2012. The primary factors that contributed to this decrease included:

- a decrease in compensation and benefit costs, resulting from fewer employees; and
- a decrease in course supply expenses, due to lower student enrollments.

Cost of educational services as a percentage of revenue increased 450 basis points to 46.0% in the nine months ended September 30, 2013 compared to 41.5% in the nine months ended September 30, 2012. The primary factor that contributed to this increase was a decline in revenue, which was partially offset by decreases in compensation and benefit costs and course supply expenses.

Student services and administrative expenses decreased $21.5 million, or 6.5%, to $306.3 million in the nine months ended September 30, 2013 compared to $327.8 million in the nine months ended September 30, 2012. The principal causes of this decrease were decreases in compensation and benefit costs and expenses related to student scholarships.

Student services and administrative expenses increased to 38.0% of revenue in the nine months ended September 30, 2013 compared to 33.2% of revenue in the nine months ended September 30, 2012. The principal cause of this increase was a decline in revenue, which was partially offset by decreases in compensation and benefit costs and expenses related to student scholarships. Bad debt expense as a percentage of revenue increased to 7.0% in the nine months ended September 30, 2013 compared to 5.8% in the nine months ended September 30, 2012, primarily as a result of an increase in student account balances that were determined to be uncollectible.

In the nine months ended September 30, 2013, we recorded a loss of $9.7 million for additional accruals related to our guarantee obligations under the RSAs.

Operating income decreased $128.7 million, or 51.7%, to $120.0 million in the nine months ended September 30, 2013 compared to $248.8 million in the nine months ended September 30, 2012, primarily as a result of the impact of the factors discussed above in connection with revenue, cost of educational services, and student services and administrative expenses. Our operating margin decreased to 14.9% in the nine months ended September 30, 2013 compared to 25.2% in the nine months ended September 30, 2012, primarily as a result of the impact of the factors discussed above.

Interest income decreased $0.9 million, or 71.3%, to $0.4 million in the nine months ended September 30, 2013 compared to $1.3 million in the nine months ended September 30, 2012, primarily due to discontinuing the amortization of the discount on the Subordinated Note that we issued in connection with the PEAKS Program. See Note 9 of the Notes to Condensed Consolidated Financial Statements for a discussion of the Subordinated Note. Interest expense increased $0.4 million, or 12.7%, to $3.2 million in the nine months ended September 30, 2013 compared to $2.8 million in the nine months ended September 30, 2012, primarily due to an increase in the effective interest rate on the Revolver, which was partially offset by a decrease in our weighted average outstanding borrowings under the Credit Agreement.

Our combined federal and state effective income tax rate was 39.5% in the nine months ended September 30, 2013 compared to 39.4% in the nine months ended September 30, 2012.

Financial Condition, Liquidity and Capital Resources

Cash and cash equivalents were $168.7 million as of September 30, 2013 compared to $246.3 million as of December 31, 2012 and $174.5 million as of September 30, 2012. Cash and cash equivalents as of September 30, 2013 decreased $77.6 million compared to December 31, 2012, primarily due to:

- a payment of $46.0 million made in January 2013 in a settlement to absolve us from any further obligations with respect to our guarantee obligations under the 2007 RSA;
- a net repayment of $80.0 million in outstanding borrowings under the Revolver in the nine months ended September 30, 2013; and
- the purchase of Cable Holdings for approximately $7.0 million.

These decreases were partially offset by cash generated from operating activities. Cash and cash equivalents as of September 30, 2013 decreased $5.7 million compared to September 30, 2012, primarily due to a net repayment of $80.0 million in outstanding borrowings under the Revolver and the $46.0 million settlement payment related to the 2007 RSA, which were partially offset by cash generated from operating activities.

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We are required to recognize the funded status of our defined benefit postretirement plans on our balance sheet. We recorded an asset of $9.4 million for the ESI Pension Plan, a non-contributory defined benefit pension plan commonly referred to as a cash balance plan, and a liability of $0.3 million for the ESI Excess Pension Plan, a nonqualified, unfunded retirement plan, on our Condensed Consolidated Balance Sheet as of September 30, 2013.

We do not expect to make any material contributions to the ESI Pension Plan or the ESI Excess Pension Plan in 2013. In 2012, we did not make any contributions to either the ESI Pension Plan or the ESI Excess Pension Plan.

Payments that we are required to make in the future pursuant to our guarantee obligations under the RSAs could have a material adverse effect on our cash flows and liquidity. If we elect to make Payments on Behalf of Borrowers or Discharge Payments in future periods, those payments could impact our liquidity in particular periods. See *Off-Balance Sheet Arrangements* below for a further discussion of our guarantee obligations under the RSAs, Payments on Behalf of Borrowers and Discharge Payments.

Operations. Net cash generated from operating activities was $51.3 million in the three months ended September 30, 2013 compared to net cash generated from operating activities of $19.7 million in the three months ended September 30, 2012. The $31.6 million increase in net cash flows from operating activities was primarily due to lower income tax and compensation-related payments, which were partially offset by a decrease in funds received as a result of lower student enrollments.

Net cash generated from operating activities was $15.5 million in the nine months ended September 30, 2013 compared to net cash generated from operating activities of $18.8 million in the nine months ended September 30, 2012. The $3.3 million decrease in net cash flows from operating activities was primarily due to a decrease in funds received as a result of lower student enrollments and the settlement payment to absolve us from any further obligations with respect to our guarantee obligations under the 2007 RSA, which were partially offset by lower income tax and compensation-related payments.

Accounts receivable less allowance for doubtful accounts was $119.5 million as of September 30, 2013 compared to $89.4 million as of September 30, 2012. Days sales outstanding increased 16.3 days to 42.4 days at September 30, 2013 compared to 26.1 days at September 30, 2012. Our accounts receivable balance and days sales outstanding increased as of September 30, 2013, primarily due to:

- an increase in internal student financing as a result of a decrease in the amount of funds received from private education loans made to our students by third-party lenders and less than full utilization of the Opportunity Scholarship by our students (see *Student Financing Update*); and
- to a lesser extent, changes implemented to the Federal Pell Grant Program that eliminated multiple awards in a twelve-month period and adjusted the lifetime limits, both of which began to impact our students in 2012.

Investing. In each of the three months ended September 30, 2013 and 2012, we spent $0.1 million to renovate, expand and construct buildings. In each of the nine months ended September 30, 2013 and 2012, we spent $0.5 million to renovate, expand or construct buildings.

Capital expenditures, excluding facility construction, totaled:

$0.9 million in the three months ended September 30, 2013 compared to $3.2 million in the three months ended September 30, 2012; and

$4.3 million in the nine months ended September 30, 2013 compared to $14.8 million in the nine months ended September 30, 2012.

These expenditures consisted primarily of classroom and laboratory equipment (such as computers and electronic equipment), classroom and office furniture, software and leasehold improvements. We also spent approximately $7.0 million, net of cash acquired, in the three and nine months ended September 30, 2013 to acquire Cable Holdings.

We plan to continue to upgrade our current facilities and equipment in 2013. Cash generated from operating activities is expected to be sufficient to fund our capital expenditure requirements.

Financing. On March 21, 2012, we entered into the Credit Agreement that provides for a Revolver in the amount of $325.0 million. The Credit Agreement also provides that we may seek additional revolving commitments or term loan commitments in an aggregate principal amount not to exceed $125.0 million. The lenders under the Credit Agreement are not under any obligation to provide any such additional revolving commitments or term loan commitments. The 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 a prior credit agreement which was terminated on March 21, 2012. In addition to the prepayment of the outstanding indebtedness under the prior credit agreement, borrowings under the Credit Agreement are used for general corporate purposes.

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Borrowings under the Credit Agreement bear interest, at our option, at LIBOR plus an applicable margin or at an alternative base rate, as defined under the Credit Agreement, plus an applicable margin. The applicable margin for borrowings under the Revolver is determined based on 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 Credit Agreement. The amount of the commitment fee is determined based on the Leverage Ratio as of the end of each fiscal quarter.

The Credit Agreement contains, among other things, covenants, representations and warranties and events of default customary for credit facilities. The 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 September 30, 2013.

As of September 30, 2013, the borrowings under the Credit Agreement totaled $60.0 million. The effective interest rate on our borrowings was approximately 4.10% per annum in the three months ended September 30, 2013 compared to approximately 2.70% per annum in the three months ended September 30, 2012. In the nine months ended September 30, 2013, the effective interest rate on our borrowings was approximately 3.40% per annum compared to approximately 2.30% per annum in the nine months ended September 30, 2012. The commitment fee under the Credit Agreement was 0.40% as of September 30, 2013.

Our Board of Directors has authorized us to repurchase shares of our common stock in the open market or through privately negotiated transactions in accordance with Rule 10b-18 of the Exchange Act under the Repurchase Program. The following table sets forth information regarding our share repurchase activity in the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Number of shares repurchased	0	0	0	3,025,700
Total cost of shares repurchased (in millions)	$ 0	$ 0	$ 0	$ 207.9
Average cost per share	$ 0	$ 0	$ 0	$ 68.72

Approximately 7.8 million shares remained available for repurchase under the Repurchase Program as of September 30, 2013. Pursuant to the Board s stock repurchase authorization, we may repurchase additional shares of our common stock from time to time in the future depending on market conditions and other considerations.

We believe that cash generated from operations will be adequate to satisfy our working capital, guarantee, loan repayment and capital expenditure requirements for the foreseeable future. We also believe that any reduction in cash and cash equivalents that may result from their use to make guarantee payments, make Payments on Behalf of Borrowers, make Discharge Payments, purchase facilities, construct facilities, repay loans or repurchase shares of our common stock will not have a material adverse effect on our expansion plans, planned capital expenditures, ability to meet any applicable regulatory financial responsibility standards or ability to conduct normal operations.

Student Financing Update. During the fourth quarter of 2012, we introduced an institutional scholarship program, called the Opportunity Scholarship, which is intended to help reduce the cost of an ITT Technical Institute education and increase student access to our programs of study. Beginning with the June 2013 academic quarter, the Opportunity Scholarship was being offered to students at all of the ITT Technical Institute campuses. We believe that the Opportunity Scholarship has and will continue to reduce our students need and use of private education loans, as well as decrease the internal student financing that we provide to our students. As an institutional scholarship, our revenue is reduced by the amount of the Opportunity Scholarship awarded. In addition, no cash payments are received and students will not be obligated to make payments to us of the amounts awarded under the Opportunity Scholarship. Therefore, we believe that our revenue should decrease in 2013, if the Opportunity Scholarship is utilized by the majority of our students, as expected. In addition, we believe that the amounts receivable from students to us will decrease in future periods as more students utilize the Opportunity Scholarship, instead of internal student financing.

Our revenue decreased in the three months and nine months ended September 30, 2013 compared to the same periods in the prior year, partially as a result of the increase in institutional scholarships and awards provided to our students. As a result of the increase in institutional scholarships and awards, our revenue decreased:

- $34.2 million in the three months ended September 30, 2013 compared to the three months ended September 30, 2012; and

- $65.2 million in the nine months ended September 30, 2013 compared to the nine months ended September 30, 2012.

The increase in institutional scholarships and awards in the three and nine months ended September 30, 2013 was primarily due to the introduction of the Opportunity Scholarship at the vast majority of the ITT Technical Institute campuses in the academic quarter than began in March 2013.

Based on the amount of Opportunity Scholarships that we estimate may be awarded in 2013, we believe that the Opportunity Scholarships, as well as, to a lesser extent, other factors, will have the effect of reducing our revenue per student by approximately 4.0 to 6.0 percent in the full year 2013 compared to 2012, and could result in our bad debt expense as a percentage of revenue being approximately 7% for the full year 2013.

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As previously discussed, the two private education loan programs that provided the vast majority of the private education loans to our students in 2011 and 2010 expired in 2011. As a result, in 2012 and in the nine months ended September 30, 2013, we increased the amount of internal student financing that we provided to our students. The internal student financing that we provide to our students consists of non-interest bearing, unsecured credit extended to our students and is included in Accounts receivable, net on our Condensed Consolidated Balance Sheets. As of September 30, 2013, our accounts receivable less allowance for doubtful accounts increased $30.1 million, or 33.7%, to $119.5 million compared to $89.4 million as of September 30, 2012, primarily due to:

- the increase in the amount of internal financing that we provided to our students since the private education loan programs expired in 2011; and
- less than full utilization of the Opportunity Scholarship by our students.

The internal student financing provided to a student is generally due and payable by the student at the end of the student s academic year (which is generally nine months) or enrollment, whichever occurs first. In contrast, we typically received the proceeds of a student s private education loan at the beginning of the student s academic year. Both the delay in our receipt of internal student financing payments compared to our receipt of private education loan proceeds and the increased amount of internal student financing that we provide to our students as a result of the expiration of the two primary private education loan programs utilized by our students have negatively impacted our liquidity and cash flows from operating activities. The increased amount of internal student financing that we provided to our students as a result of the expiration of the two primary private education loan programs utilized by our students has also exposed us to greater credit risk. In addition, we have the risk of collection with respect to our internal student financing which resulted in an increase in our bad debt expense as a percentage of revenue in the nine months ended September 30, 2013 to 7.0% compared to 5.8% in the nine months ended September 30, 2012. The 16.3-day increase in our days sales outstanding to 42.4 days at September 30, 2013 compared to 26.1 days at September 30, 2012 was primarily attributable to:

- the increase in internal student financing caused by a decrease in the amount of funds received from private education loans made to our students by third-party lenders and less than full utilization of the Opportunity Scholarship by our students; and
- to a lesser extent, changes implemented to the Federal Pell Grant Program that eliminated multiple awards in a twelve-month period and adjusted the lifetime limits, both of which began to impact our students in 2012.

We plan to continue the roll-out of the Opportunity Scholarship which we believe will reduce the amount of internal student financing that we provide to our students. The increased use of institutional scholarships and awards by our students and any additional internal student financing provided to our students could result in a continuation of the adverse factors that are described above, including a material adverse effect on our financial condition and cash flows.

Contractual Obligations

The following table sets forth our specified contractual obligations as of September 30, 2013:

		Payments Due by Period			
Contractual Obligations	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(In thousands)		
Operating lease obligations	$ 159,234	$ 46,738	$ 70,305	$ 31,146	$ 11,045
Long-term debt, including scheduled interest payments (a)	$ 64,249	$ 2,707	$ 61,542	$ 0	$ 0
Claims and contingencies (b)	$ 35,292	$ 35,292	$ 0	$ 0	$ 0
Total	$ 258,775	$ 84,737	$ 131,847	$ 31,146	$ 11,045

(a) The long-term debt represents the Revolver under the Credit Agreement and assumes that the $60.0 million outstanding balance under the Revolver as of September 30, 2013 will be outstanding at all times through the date of maturity. The amounts shown include the principal payments that will be due upon maturity as well as interest payments and commitment fees. Interest payments and commitment fees have been calculated based on their scheduled payment dates using the interest rate charged on our borrowings and the rate charged on unutilized commitments as of September 30, 2013.

(b) The $35.3 million in the Claims and contingencies line item consists of the $43.3 million recorded liability for claims and contingencies that was included in Other current liabilities on our Condensed Consolidated Balance Sheet as of September 30, 2013, less approximately $8.0 million that we claimed as an offset against amounts owed to use under the Revolving Note. This is an estimate of the amount of claims and contingencies that we believe we will pay during the next 12 months, the substantial majority of which relate to our guarantee obligations under the RSAs. The recorded liability for claims and contingencies of $37.9 million, which was included in Other liabilities on our Condensed Consolidated Balance Sheet as of September 30, 2013, is not included in the table above, because we cannot reasonably predict the timing of possible payments that we believe we will make after September 30, 2014 related to our claims and contingencies, the substantial majority of which relate to our guarantee obligations under the RSAs. See Note 12 of the Notes to Condensed Consolidated Financial Statements for additional information on our claims and contingencies as of September 30, 2013.

The table above does not reflect unrecognized tax benefits of $21.0 million and accrued interest related to unrecognized tax benefits of $6.3 million, because we cannot reasonably predict the timing of the resolution of the related tax positions.

Off-Balance Sheet Arrangements

As of September 30, 2013, we leased our non-owned facilities under operating lease agreements. A majority of the operating leases contain renewal options that can be exercised after the initial lease term. Renewal options are generally for periods of one to five years. All operating leases will expire over the next 11 years and management believes that:

- those leases will be renewed or replaced by other leases in the normal course of business;
- we may purchase the facilities represented by those leases; or
- we may purchase or build other replacement facilities.

There are no material restrictions imposed by the lease agreements, and we have not entered into any significant guarantees related to the leases. We are required to make additional payments under the terms of certain operating leases for taxes, insurance and other operating expenses incurred during the operating lease period.

As part of our normal course of 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 September 30, 2013, the total face amount of those surety bonds was approximately $20.0 million.

On January 20, 2010, we entered into the PEAKS Program. Under the PEAKS Program, an unaffiliated lender originated private education loans to our eligible students and, subsequently, sold those loans to the PEAKS Trust. The PEAKS Trust issued the PEAKS Senior Debt to investors. The assets of the PEAKS Trust (which include, among other assets, the student loans held by the PEAKS Trust) serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt. The PEAKS Trust is required to maintain assets having an aggregate value that exceeds the outstanding balance of the PEAKS Senior Debt, which requirement we guarantee. As of September 30, 2013, the value of the assets of the PEAKS Trust satisfied this requirement. The PEAKS Senior Debt bears interest at a variable rate based on the LIBOR plus a margin and matures in January 2020. As of September 30, 2013, the outstanding principal balance of the PEAKS Senior Debt was approximately $256.0 million.

In connection with the PEAKS Program, 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 to the PEAKS Trust a portion of the amount of each private student loan disbursed to us under the PEAKS Program, in exchange for the Subordinated Note. The Subordinated Note does not bear interest, and principal is due on the Subordinated Note following:

- the repayment of the PEAKS Senior Debt;

- the payment of fees and expenses of the PEAKS Trust; and
- the reimbursement of the amount of any payments made by us under the PEAKS Guarantee, other than Payments on Behalf of Borrowers.

The PEAKS Trust utilized the proceeds from the issuance of the PEAKS Senior Debt and the Subordinated Note to purchase the student loans from the lender.

Under the PEAKS Guarantee, we guarantee payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and the required ratio of assets of the PEAKS Trust to outstanding Senior Debt. The PEAKS Guarantee 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 Title IV Programs. 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 our guarantee (which do not include Payments on Behalf of Borrowers) and payment of the Subordinated Note, in each case only to the extent of available funds remaining in the PEAKS Trust.

In the nine months ended September 30, 2013, we made Payments on Behalf of Borrowers in connection with the PEAKS Program. We made those payments after assessing:

- the likelihood of us being contractually required to make payments under the PEAKS Guarantee in the near future;
- the effect on our liquidity that would result from making payments under the PEAKS Guarantee compared to making Payments on Behalf of Borrowers;
- the effect that Payments on Behalf of Borrowers may have on the funds available to the PEAKS Trust to repay the Subordinated Note to us following full payment of the PEAKS Trust s other obligations; and
- the fact that we will not be able to recover Payments on Behalf of Borrowers directly from the student borrowers on whose behalf we made those payments.

Payments on Behalf of Borrowers assist in:

- maintaining the ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt at the required level; and
- satisfying the following month s required payment of interest on the PEAKS Senior Debt and administrative fees and expenses of the PEAKS Trust.

We will continue to assess whether it would be economically beneficial to us to make Payments on Behalf of Borrowers in future periods, and we may make Payments of Behalf of Borrowers in the future based on our assessment of the above factors.

Making Payments on Behalf of Borrowers:

- may result in us paying amounts to the PEAKS Trust in advance of when a guarantee payment would be due, which would negatively impact our liquidity in a particular period;
- may result in us paying a lesser amount than we otherwise would have been required to pay in future periods under the PEAKS Guarantee, which would positively impact our liquidity in a particular period; and
- may reduce the amount that we could receive following full payment of the PEAKS Senior Debt and fees and expenses of the PEAKS Trust, because that amount is limited to the amounts we paid under the PEAKS Guarantee (which do not include Payments on Behalf of Borrowers) and the amount due to us under the Subordinated Note.

The amount owed to us under the Subordinated Note was approximately $73.0 million as of September 30, 2013. In determining the estimated default rate used in the assumptions to establish our liability for guarantee obligations, we considered the payment performance of the private education loans under the PEAKS Program. Any Payments on Behalf of Borrowers that we made with respect to those loans, however, were not considered to be payments on those loans for purposes of that determination.

We entered into the PEAKS Program to offer our students another source of private education loans that they could use to help pay their education costs owed to us and to supplement the limited amount of private education loans available to our students under other private education loans programs, including the 2009 Loan Program. Under the PEAKS Program, our students had access to a greater amount of private education loans, which resulted in a reduction in the amount of internal financing that we provided to our students in 2010 and 2011. 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.

On February 20, 2009, we entered into the 2009 Loan Program. In connection with the 2009 Loan Program, we entered into the 2009 RSA. 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 $141.0 million. No new private education loans were or will be made 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 September 30, 2013, the total collateral maintained in a restricted bank account was not material. 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 September 30, 2013.

In addition, beginning in the second quarter of 2009, we have made advances to the 2009 Entity under the Revolving Note. We made the advances, which bear interest, so that the 2009 Entity could use those funds primarily to provide additional funding for the private education loans, instead of retaining the funds ourselves and providing internal student financing, which is non-interest bearing. In the future, we may also make Discharge payments to the 2009 Entity. The Revolving Note bears interest at a rate based on the prime rate plus an applicable margin. Certain of the assets of the 2009 Entity serve as collateral for the Revolving Note. The Revolving Note is subject to customary terms and conditions and is currently due and payable in full.

Under the 2009 RSA, we have the right to elect to make Discharge Payments with respect to private education loans that have defaulted. The effect of a making a Discharge Payment related to a private education loan is to reduce the aggregate amount that we may have to pay under our guarantee obligations with respect to that loan. To date, we have claimed as an offset against the Revolving Note amounts that would have the effect of discharging our obligations with respect to certain defaulted loans under the 2009 RSA. If we believe that doing so would be economically beneficial to us, we may make Discharge Payments in future periods. Making Discharge Payments may result in us paying amounts to the 2009 Entity in advance of when a guarantee payment would be due, which would negatively impact our liquidity in a particular period, but may result in us paying a lesser amount than we otherwise would have been required to pay under our guarantee obligations in future periods under the 2009 RSA.

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The following table sets forth the guarantee payments and Payments on Behalf of Borrowers that we made related to the RSAs in the approximate aggregate amount, net of recoveries, in the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	(In thousands)			
Type of Payment	**2013**	**2012**	**2013**	**2012**
Guarantee:				
PEAKS Guarantee	$ 138	$ 243	$ 1,377	$ 502
2009 RSA	458	560	738	1,141
Payments on Behalf of Borrowers	2,502	0	7,647	0
Total	$ 3,098	$ 803	$ 9,762	$ 1,643

We also asserted the right to offset approximately $8.0 million, net of recoveries, of the amount owed to us by the 2009 Entity under the Revolving Note in the nine months ended September 30, 2013. Approximately $6.8 million of the amount that we claimed as an offset against the Revolving Note related to our election under the 2009 RSA to discharge our guarantee obligations with respect to certain defaulted private education loans under the 2009 Loan Program. We recorded all of the amounts claimed as offsets in Other current liabilities on our Condensed Consolidated Balance Sheet as of September 30, 2013. See Notes 9 and 12 of the Notes to Condensed Consolidated Financial Statements for further discussion of the RSAs.

At the end of each reporting period, we assess whether we should recognize a contingent liability related to the various claims and contingencies that we are subject to, 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 with any assessment, as facts and circumstances change, the recorded liability could change, and has changed, significantly. The following table sets forth our recorded liability for these claims and contingencies as of the date indicated:

Type of Claim and Contingency	**As of September 30,2013 (In thousands)**
Guarantee Obligations under the RSAs:	
PEAKS Program	$ 40,000
2009 RSA	32,910
Other Claims and Contingencies	8,325
Total	$ 81,235

Approximately $43.3 million of the recorded liability was included in Other current liabilities and approximately $37.9 million was included in Other liabilities on our Condensed Consolidated Balance Sheet as of September 30, 2013. We believe that the $37.9 million loss included in Other liabilities as of September 30, 2013 will be realized over the next seven to ten years related to our estimated guarantee obligations under the RSAs.

We review various factors and make certain assumptions when determining the amount to recognize as a contingent liability with respect to the guarantee arrangements under the RSAs at the end of each reporting period. In order to make this assessment, we made certain assumptions with respect to the performance of the private education loans made under each of the RSAs over the life of these loans. The life of a private education loan made under the RSAs may be in excess of ten years from the date of disbursement. Therefore, our assessment was based on assumptions for periods in excess of ten years, and those assumptions include among other things, the following:

- the repayment performance of the private education loans under each of the RSAs;
- the timing and rate at which the private education loans will be paid;
- the changes in the variable interest rates due on the private education loans and PEAKS Senior Debt;
- the amounts that will be collected in the future on the private education loans that have defaulted; and
- the fees and expenses associated with servicing the private education loans.

We consulted with two third-party consumer credit consulting firms in arriving at our assumptions. The assumptions have changed, and may continue to change, significantly over time as actual results become known. The principal factor that we review is the repayment performance of the private education loans under each of the RSAs. In determining the estimated default rate used in the assumptions to establish our liability for guarantee obligations, we considered the payment performance of the private education loans under the PEAKS Program. Any Payments on Behalf of Borrowers that we made with respect to those loans, however, were not considered to be payments on those loans for purposes of that determination. As each portfolio of private education loans matures, additional data related to the performance of the loans and other information regarding the loans becomes available to us that we utilize to estimate the related contingent liability. In certain prior reporting periods, there have been disruptions in the servicing of a portion of the private education loans under the RSAs, which we believe had a negative impact on the repayment performance of those private education loans. We cannot predict with any certainty whether other servicing disruptions will occur in the future. If additional servicing disruptions occur or other factors negatively impact the repayment performance of the private education loans under the RSAs in the future, the contingent liability associated with those guarantees would increase and we could be required to pay additional material amounts under our guarantee obligations which could have a material adverse effect on our financial condition, results of operations and cash flows.

In determining the contingent liability amount to be recorded related to the RSAs at the end of each reporting period, we, with the assistance of our third-party consumer credit consultants, evaluate a variety of data related to the repayment performance of the private education loans under the RSAs, including, but not limited to:

- the payment and default trends by the month in which the private education loan entered repayment;
- the payment and default trends based on the education completion status achieved by the borrower (i.e., whether the borrower graduated or withdrew from his or her program of study);
- the payment status of the loans in repayment (i.e., whether the loans are current or delinquent);
- the status of the loans that are not in repayment (i.e., whether repayment is deferred, because the borrower is in school or for some other reason, or whether the loan is in the grace period after the borrower leaves school or is in forbearance); and
- the current academic standing of borrowers who have not yet entered repayment.

During the three months ended September 30, 2013, certain data that we evaluate were trending unfavorably compared to our immediately preceding evaluation, which caused us to increase the estimated default rates used in our analysis of the contingent liability from an average of approximately 57% to an average of approximately 59%. Primarily as a result of the revised estimated default rates, we recorded an additional expense of $6.2 million related to the RSAs in the three months ended September 30, 2013.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

In the normal course of our business, we are subject to fluctuations in interest rates that could impact the cost of our financing activities. Our primary interest rate risk exposure results from changes in short-term interest rates and the LIBOR.

Changes in the LIBOR would affect the borrowing costs associated with our revolving credit facilities. We estimate that the market risk can best be measured by a hypothetical 100 basis point increase in the LIBOR. If such a hypothetical increase in the LIBOR were to occur, the effect on our results from operations and cash flow would not have been material for the three and nine months ended September 30, 2013.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures.
We are responsible for establishing and maintaining disclosure controls and procedures (DCP) that are designed to ensure that information required to be disclosed by us in the reports filed by us under the Exchange Act is:
(a) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms; and
(b) accumulated and communicated to our management, including our principal executive and principal financial officers, to allow timely decisions regarding required disclosures.

In designing and evaluating our DCP, we recognize that any controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving the desired control objectives, and that our management s duties require it to make its best judgment regarding the design of our DCP. As of the end of our third fiscal quarter of 2013, we conducted an evaluation, under the supervision (and with the participation) of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our DCP pursuant to Rule 13a-15 of the Exchange Act. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our DCP were effective at the reasonable assurance level as of September 30, 2013.

(b) Changes in Internal Control Over Financial Reporting.

There were no changes in our internal control over financial reporting that occurred during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.
We are subject to various claims and contingencies in the ordinary course of our business, including those related to litigation, business transactions, employee-related matters and taxes, among others. We cannot assure you of the ultimate outcome of any litigation involving us. 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.

On December 22, 2008, we were served with a qui tam action in the Leveski Litigation that was filed on July 3, 2007 in the United States District Court for the Southern District of Indiana by a former employee (relator) on behalf of herself and the federal government under the following caption: *United States of America ex rel. Debra Leveski v. ITT Educational Services, Inc.* We were served with the Leveski Litigation after the U.S. Department of Justice declined to intervene in the litigation. On June 3, 2008, the relator filed an amended complaint in the Leveski Litigation. On September 23, 2009, the court dismissed the Leveski Litigation without prejudice and gave the relator an opportunity to replead her complaint. On October 8, 2009, the relator filed a second amended complaint. In the second amended complaint, the relator alleges that we violated the False Claims Act, 31 U.S.C. § 3729, *et seq*., and the HEA by compensating our sales representatives and financial aid administrators with commissions, bonuses or other incentive payments based directly or indirectly on success in securing enrollments or federal financial aid. The relator alleges that all of our revenue derived from the federal student financial aid programs from July 3, 2001 through July 3, 2007 was generated as a result of our violating the HEA. The relator seeks various forms of recovery on behalf of herself and the federal government, including:

- treble the amount of unspecified funds paid to us for federal student grants;
- treble the amount of unspecified default payments, special allowance payments and interest received by lenders with respect to federal student loans received by our students;
- all civil penalties allowed by law; and
- attorney s fees and costs.

A qui tam action is a civil lawsuit brought by a qui tam relator on behalf of the federal or state government for an alleged submission to the government of a false claim for payment. A qui tam action is always filed under seal and remains under seal until the government decides whether to intervene in the litigation. Whenever a relator files a qui tam action, the government typically initiates an investigation in order to determine whether to intervene in the litigation. If the government intervenes, it has primary control over the litigation. If the government declines to intervene, the relator may pursue the litigation on behalf of the government. If the government or the relator is successful in the litigation, the relator receives a portion of the government s recovery.

On August 8, 2011, the district court granted our motion to dismiss all of the relator s claims in the Leveski Litigation for lack of subject-matter jurisdiction and issued a judgment for us. On February 16, 2012, the relator in the Leveski Litigation filed a Notice of Appeal with the 7th Circuit Court of Appeals regarding the final judgment entered by the district court dismissing all claims against us. On March 26, 2012, the district court in the Leveski Litigation awarded us approximately $0.4 million in sanctions against the relator s attorneys for filing a frivolous lawsuit. Relator s attorneys also appealed this award to the 7th Circuit Court of Appeals. On July 8, 2013, the 7th Circuit Court of Appeals reversed the district court s dismissal of the Leveski Litigation for lack of subject-matter jurisdiction and the award of sanctions against relator s attorneys. In addition, the 7th Circuit Court of Appeals remanded the Leveski Litigation back to the district court for further proceedings.

We have defended, and intend to continue to defend, ourselves vigorously against the allegations made in the complaint.

On March 11, 2013, a complaint in the Koetsch Litigation 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: *William Koetsch, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc., et al.* On July 25, 2013, the court named the Plumbers and Pipefitters National Pension Fund and Metropolitan Water Reclamation District Retirement Fund as the lead plaintiffs and consolidated the Koetsch Litigation and the MLAF Litigation under the following caption: *In re ITT Educational Services, Inc. Securities Litigation* (the Securities Litigation). On October 7, 2013, an amended complaint was filed in the Securities Litigation. The amended complaint alleges, among other things, that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder by:

- our failure to properly account for the 2007 RSA, 2009 RSA and PEAKS Program;
- employing devices, schemes and artifices to defraud;
- making untrue statements of material facts, or omitting material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;
- making the above statements intentionally or with reckless disregard for the truth;
- engaging in acts, practices, and a course of business that operated as a fraud or deceit upon lead plaintiffs and others similarly situated in connection with their purchases of our common stock;
- deceiving the investing public, including lead plaintiffs and the purported class, regarding, among other things, our artificially inflated statements of financial strength and understated liabilities; and
- causing our common stock to trade at artificially inflated prices and causing the plaintiff and other putative class members to purchase our common stock at inflated prices.

The putative class period in this action is from April 24, 2008 through February 25, 2013. The plaintiffs seek, among other things, the designation of this action as a class action, an award of unspecified compensatory damages, interest, costs and expenses, including counsel fees and expert fees, and such equitable/injunctive and other relief as the court deems appropriate. All of the defendants intend to defend themselves vigorously against the allegations made in the amended complaint.

On April 17, 2013, a complaint in the MLAF Litigation 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: *Massachusetts Laborers Annuity Fund, Individually and on Behalf of All Others Similarly Situated v. ITT Educational Services, Inc., et al.* The complaint alleges, among other things, that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder by:

- our failure to properly account for the 2007 RSA, 2009 RSA and PEAKS Program;
- our failure to establish adequate reserves associated with our guarantee obligations under the 2007 RSA, 2009 RSA and PEAKS Program, which caused us to misrepresent our earnings, liabilities, net income and financial condition throughout the putative class period;
- making false and misleading statements;
- engaging in a scheme to deceive the market and a course of conduct that artificially inflated the price of our common stock;
- operating as a fraud or deceit on purchasers of our common stock by misrepresenting our liabilities related to the 2007 RSA, 2009 RSA and PEAKS Program, financial results and business prospects;
- artificially inflating the price of our common stock; and
- causing the putative class members to purchase our common stock at artificially inflated prices.

The putative class period in this action is from April 24, 2008 through February 25, 2013. The plaintiff seeks, among other things, the designation of this action as a class action, and an award of unspecified compensatory damages, interest, costs, attorney s fees and equitable/injunctive or other relief as the Court deems just and proper. All of the defendants intend to defend themselves vigorously against the allegations made in the complaint. On July 25, 2013, the MLAF Litigation was consolidated into the Securities Litigation.

On May 8, 2013, a complaint in the Wilfred Litigation was filed against two of our current executive officers and all of our current Directors in the United States District Court for the Southern District of New York under the following caption: *Sasha Wilfred, Derivatively on Behalf of Nominal Defendant ITT Educational Services, Inc. v. Kevin M. Modany, et al.* The complaint alleges, among other things, that from April 24, 2008 through February 25, 2013, the defendants violated state law, including breaching their fiduciary duties to us, grossly mismanaging us, wasting our corporate assets and being unjustly enriched, by:

- causing or allowing us to disseminate to our shareholders materially misleading and inaccurate information relating to a series of risk-sharing agreements through SEC filings, press releases, conference calls, and other

- public statements and disclosures;

- willfully ignoring obvious and pervasive problems with our internal controls and practices and procedures, and failing to make a good faith effort to correct these problems or prevent their recurrence;

- violating and breaching fiduciary duties of care, loyalty, reasonable inquiry, oversight, good faith and supervision;

- causing or allowing us to misrepresent material facts regarding our financial position and business prospects; and

- abandoning their responsibilities and duties with regard to prudently managing our businesses in a manner imposed upon them by law.

The complaint seeks:

- unspecified damages;

- restitution;

- disgorgement of all profits, benefits and other compensation obtained by the individual defendants;

- an order directing us to take all necessary actions to reform and improve our corporate governance and internal procedures; and

- costs and disbursements, including attorneys , accountants and experts fees, costs and expenses.

All of the individual defendants intend to defend themselves vigorously against the allegations in the complaint. On August 6, 2013, the parties agreed to stay the Wilfred Litigation until the Securities Litigation is dismissed with prejudice or the defendants file an answer in the Securities Litigation.

Although the derivative action is brought nominally on behalf of us, we expect to incur defense costs and other expenses in connection with the derivative lawsuit.

There can be no assurance that the ultimate outcome of the Leveski Litigation, Securities Litigation, Wilfred Litigation or other actions (including other actions under federal or state securities laws) will not have a material adverse effect on our financial condition, results of operations or cash flows.

The current officers named in the Securities Litigation and the Wilfred Litigation include Daniel M. Fitzpatrick and Kevin M. Modany.

Certain of our current and former officers and Directors are or may become a party in the actions described above. Our By-laws and Restated Certificate of Incorporation obligate us to indemnify our officers and Directors to the fullest extent permitted by Delaware law, provided that their conduct complied with certain requirements. We are obligated to advance defense costs to our officers and Directors, subject to the individual s obligation to repay such amount if it is ultimately determined that the individual was not entitled to indemnification. In addition, our indemnity obligation can, under certain circumstances, include indemnifiable judgments, penalties, fines and amounts paid in settlement in connection with those actions.

On May 18, 2012, we received a Civil Investigative Demand (the Original CID) from the U.S. Consumer Financial Protection Bureau (CFPB). The CFPB s Original CID provided that the purpose of the investigation was, in part, to determine whether for-profit post-secondary companies, student loan origination and servicing providers, or other unnamed persons have engaged or are engaging in unlawful acts or practices relating to the advertising, marketing, or origination of private student loans. The CFPB s Original CID contained broad requests for production of documents, answers to interrogatories and written reports related to private education loans made to our students and many other aspects of our business. We provided documentation and other information to the CFPB, while preserving our rights to object to its inquiry. In August 2012, we filed a petition with the CFPB to set aside or modify the CFPB s Original CID.

In September 2013, the CFPB withdrew the Original CID and we received a new Civil Investigative Demand (the New CID) from the CFPB. The purpose of the CFPB s investigation as provided in the New CID is the same as the purpose stated in the Original CID. While the scope of the information requested in the New CID is somewhat narrower than in the Original CID, the New CID contains broad requests for oral testimony, production of documents and written reports related to private education loans made to our students, internal financing provided to our students and certain other aspects of our business. In connection with the CFPB s withdrawal of the Original CID and issuance of the New CID, we withdrew our petition to set aside or modify the CFPB s Original CID, while preserving our rights to object to the New CID. We have begun assembling documentation and other information to provide to the CFPB, while preserving our rights to object to its inquiry. We believe that our acts and practices relating to private education loans are lawful.

On October 30, 2012, we received a CID from the Massachusetts Office of the Attorney General (MAG). The MAG s CID provides that the MAG is investigating allegations that we may have violated Massachusetts General Laws, Chapter 93A, Section 2(a) by engaging in unfair or deceptive practices in connection with marketing and advertising job placement and student outcomes, the recruitment of students, and the financing of education. The MAG s CID contains broad requests for production of documents related to our students in Massachusetts, including the financial aid available to those students, our recruitment of those students, the career services that we offer to those students, our marketing and advertising, the retention and graduation rates of those students and many other aspects of our business. We are cooperating with the MAG in its investigation, and we have provided documentation, communications and other information to the MAG in response to the CID. We believe that our acts and practices relating to our students in Massachusetts are lawful.

On February 8, 2013, we received a subpoena from the SEC. In a letter accompanying the subpoena, the SEC states that it is conducting an investigation of us. The SEC s subpoena requests the production of documents and communications that, among other things, relate to our actions and accounting associated with: (a) agreements that we entered into with the 2009 Entity to create the 2009 Loan Program, including, without limitation, the 2009 RSA; and (b) agreements that we entered into to create the PEAKS Program. On May 9, 2013, we received a second subpoena from the SEC requesting the production of certain communications related to the same subject matter as the subpoena received on February 8, 2013. We are cooperating with the SEC in its investigation, and we have provided documentation, communications and other information, including testimony of one of our officers, to the SEC in response to both subpoenas. There can be no assurance, however, that the ultimate outcome of the SEC investigation will not have a material adverse effect on our financial condition or results of operations.

Item 1A. Risk Factors.

You should carefully consider the risks and uncertainties we describe in this Report, our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2013 and June 30, 2013 before deciding to invest in, or retain, shares of our common stock. These are not the only risks and uncertainties that we face. Additional risks and uncertainties that we do not currently know about, we currently believe are immaterial or we have not predicted may also harm our business operations or adversely affect us. If any of these risks or uncertainties actually occurs, our business, financial condition, results of operations, cash flows or stock price could be materially adversely affected. Except as set forth below and in Part II, Item 1A. of our Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2013 and June 30, 2013, there have been no material changes from the risk factors discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Government and regulatory agencies and third parties may bring investigations, claims or actions against us based on alleged violations of the extensive regulatory requirements applicable to our campuses, which could require us to pay monetary damages, receive other sanctions and expend significant resources to defend those claims or actions. Due to the highly regulated nature of the postsecondary education industry, we are subject to investigations and claims of non-compliance with regulatory standards and other actions brought by regulatory agencies, students, shareholders and other parties. If the results of any of those investigations and claims are unfavorable to us, we may be required to pay money damages or be subject to fines, penalties, injunctions, operational limitations, loss of eligibility to participate in federal or state financial aid programs, debarments, additional oversight and reporting, or other civil and criminal sanctions. Those sanctions could have a material adverse effect on our financial condition, results of operations and cash flows. Even if we satisfactorily resolve the issues raised by those types of investigations and claims, we may have to divert significant financial and management resources from our ongoing business operations to address and defend those investigations and claims, which could have a material adverse effect on our financial condition, results of operations and cash flows. Adverse publicity regarding any of those investigations and claims could also negatively affect our business and the market price of our common stock. See Business Highly Regulated Industry in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

On May 18, 2012, we received the Original CID from the CFPB. The CFPB s Original CID provided that the purpose of the investigation was, in part, to determine whether for-profit post-secondary companies, student loan origination and servicing providers, or other unnamed persons have engaged or are engaging in unlawful acts or practices relating to the advertising, marketing, or origination of private student loans. The CFPB s Original CID contained broad requests for production of documents, answers to interrogatories and written reports related to private education loans made to our students and many other aspects of our business. We provided documentation and other information to the CFPB, while preserving our rights to object to its inquiry. In August 2012, we filed a petition with the CFPB to set aside or modify the CFPB s Original CID.

In September 2013, the CFPB withdrew the Original CID and we received the New CID from the CFPB. The purpose of the CFPB s investigation as provided in the New CID is the same as the purpose stated in the Original CID. While the scope of the information requested in the New CID is somewhat narrower than in the Original CID, the New CID contains broad requests for oral testimony, production of documents and written reports related to private education loans made to our students, internal financing provided to our students and certain other aspects of our business. In connection with the CFPB s withdrawal of the Original CID and issuance of the New CID, we withdrew our petition to set aside or modify the CFPB s Original CID, while preserving our rights to object to the New CID. We have begun assembling documentation and other information to provide to the CFPB, while preserving our rights to object to its inquiry. We believe that our acts and practices relating to private education loans are lawful.

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On February 8, 2013, we received a subpoena from the SEC. In a letter accompanying the subpoena, the SEC states that it is conducting an investigation of us. The SEC s subpoena requests the production of documents and communications that, among other things, relate to our actions and accounting associated with: (a) agreements that we entered into with the 2009 Entity to create the 2009 Loan Program, including, without limitation, the 2009 RSA; and (b) agreements that we entered into to create the PEAKS Program. On May 9, 2013, we received a second subpoena from the SEC requesting the production of certain communications related to the same subject matter as the subpoena received on February 8, 2013. We are cooperating with the SEC in its investigation, and we have provided documentation, communications and other information, including testimony of one of our officers, to the SEC in response to both subpoenas. There can be no assurance, however, that the ultimate outcome of the SEC investigation will not have a material adverse effect on our financial condition or results of operations.

One or more of our institutions may lose its eligibility to participate in Title IV Programs, if its federal student loan cohort default rates are too high. Under the HEA, an institution may lose its eligibility to participate in some or all Title IV Programs, if the rates at which the institution s students default on their federal student loans exceed specified percentages. The ED calculates these rates for each institution on an annual basis, based on the number of students who have defaulted, not the dollar amount of such defaults. Each institution that participated in the Federal Family Education Loan (FFEL) program and/or William D. Ford Federal Direct Loan (FDL) program receives a FFEL/FDL cohort default rate for each federal fiscal year (FFY) based on defaulted FFEL and FDL program loans. A FFY is October 1 through September 30. The ED calculates an institution s annual cohort default rate as the rate at which borrowers scheduled to begin repayment on their loans in one FFY default on those loans by the end of:

- the next FFY (Two-Year CDR); and
- the second succeeding FFY (Three-Year CDR).

The ED began calculating a Three-Year CDR for each institution for FFY 2009.

If an institution s Two-Year CDR is:

- 25% or greater for three consecutive FFYs, the institution loses eligibility to participate in the FDL program and the Federal Pell Grant (Pell) program for the remainder of the FFY in which the ED determines that the institution has lost its eligibility and for the two subsequent FFYs; or greater than 40% for one FFY, the institution loses eligibility to participate in the FDL programs for the remainder of the FFY in which the ED determines that the institution has lost its eligibility and for the two subsequent FFYs.

None of our institutions had a Two-Year CDR of 25% or greater for any of the FFYs 2008, 2009, 2010 or 2011, which are the four most recent FFYs for which official Two-Year CDRs have been issued by the ED. The following table sets forth the average of our institutions Two-Year CDRs for the FFYs indicated:

FFY	Two-Year CDR Average
2011 (a)	14.4%
2010	16.4%
2009	18.0%
2008	12.2%

(a) The most recent FFY for which the ED has published official Two-Year CDRs.

We believe that the increase in the Two-Year CDR average for FFYs 2011, 2010 and 2009 compared to the Two-Year CDR average for FFYs 2008 was primarily due to the servicing on the FFEL program loans that were purchased by the ED from the lenders (the Purchased Loans). The Purchased Loans were initially serviced by the FFEL program lenders that made those loans, until the Purchased Loans were sold to the ED. Upon receipt of the Purchased Loans, the ED transferred the servicing of those loans to the servicer of the FDL program loans. Shortly thereafter, the ED replaced the servicer of the FDL program loans with four different servicers, and servicing of the Purchased Loans was distributed among the new servicers of the FDL program loans. We believe that the changes in the servicers of the Purchased Loans had a negative impact on the servicing of those loans, which could have resulted in a higher Two-Year CDR average with respect to those loans. Our institutions Two-Year CDR average for FFYs 2011, 2010 and 2009 with respect to the FFEL program loans that were not sold by the FFEL program lenders to the ED (the Retained Loans) was approximately the same as our institutions Two-Year CDR average for FFY 2008. We believe that this is primarily due to the absence of any disruption in the servicing of the Retained Loans.

We have appealed the ITT Technical Institute institutions official Two-Year CDRs for FFYs 2010 and 2009 on the basis that the Purchased Loans were improperly serviced.

Beginning with the official Three-Year CDRs for FFY 2009, the cohort default rate for three consecutive FFYs that triggers loss of eligibility to participate in FDL and Pell programs increases from 25% to 30%. We believe that our institutions Three-Year CDRs have been, and will likely continue to be, higher than our institutions Two-Year CDRs because of longer repayment and default histories, among other factors. None of our institutions had a Three-Year CDR of 30% or greater for the 2010 FFY, which is the most recent FFY for which Three-Year CDRs have been issued by the ED. We believe that the ITT Technical Institute institutions official Three-Year CDRs will be less than 30% for FFY 2011. The following table sets forth the average of our institutions Three-Year CDRs for the FFYs indicated:

FFY	Three-Year CDR Average
2010 (a)	29.0%
2009	32.9% (b)

(a) The most recent FFY for which the ED has published official Three-Year CDRs.
(b) Reduced by the ED from 34.2% as a result of an uncorrected data adjustment.

Since the same Purchased Loans are included in both the Two- and Three-Year CDRs for FFY 2009, we appealed the ITT Technical Institute institutions official Three-Year CDRs for FFY 2009 on the basis that those Purchased Loans were improperly serviced.

The ED may place an institution on provisional certification status, if the institution s official:

- Two-Year CDR is 25% or greater in any of the three most recent FFYs; or
- beginning in 2014, Three-Year CDR is 30% or greater for at least two of the three most recent FFYs.

The ED may more closely review an institution that is provisionally certified, if it applies for approval to open a new location or offer a new program of study that requires approval, or makes some other significant change affecting its eligibility. Provisional certification does not otherwise limit an institution s participation in Title IV Programs.

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An institution can appeal its loss of eligibility due to high Three-Year CDRs. During the pendency of any such appeal, the institution remains eligible to participate in the FDL and Pell programs. If an institution continues its participation in the FDL programs during the pendency of any such appeal and the appeal is unsuccessful, the institution must pay the ED the amount of interest, special allowance, reinsurance and any related payments paid by the ED (or which the ED is obligated to pay) with respect to the FDL program loans made to the institution s students or their parents that would not have been made if the institution had not continued its participation (the Direct Costs). If a substantial number of our campuses were subject to losing their eligibility to participate in the FDL and Pell programs because of our institutions Three-Year CDRs, the potential amount of the Direct Costs for which we would be liable if our appeals were unsuccessful would prevent us from continuing some or all of the affected campuses participation in the FDL program during the pendency of those appeals, which would have a material adverse effect on our financial condition, results of operations and cash flows.

Current and future economic conditions in the United States could also adversely affect our institutions Two-Year CDRs and Three-Year CDRs. Increases in interest rates, declines in individuals incomes, and job losses for our students and graduates or their parents have contributed to, and could continue to contribute to, higher default rates on student loans.

The servicing and collection efforts of student loan servicers help to lower our institutions Two-Year CDRs and Three-Year CDRs. We supplement their efforts by attempting to contact students to advise them of their responsibilities and any deferment, forbearance or alternative repayment plans for which they may qualify.

If any of our institutions lost its eligibility to participate in FDL and Pell programs and we could not arrange for alternative financing sources for the students attending the campuses in that institution, we would probably have to close those campuses, which could have a material adverse effect on our financial condition, results of operations and cash flows.

If the charge-off rate on private education loans under programs where we have a guarantee obligation continues at the current rate, or is higher than the current rate, our guarantee obligations related to those loans could have a material adverse effect on us. We have entered into risk sharing and guarantee agreements with unaffiliated entities related to private education loans provided to our students to help pay the students cost of education that student financial aid from federal, state and other sources does not cover. We have settled all of our guarantee obligations under a risk sharing agreement that we entered into in 2007 (the 2007 RSA) through a payment of $46.0 million in January 2013. 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 RSA, based on dollar volume. Under the PEAKS Program, we guarantee:

- the payment of principal (i.e., approximately $256.0 million as of September 30, 2013), interest and, prior to February 2013, certain call premiums on the outstanding senior debt obligations of the PEAKS Trust that holds the private education loans made under the PEAKS Program;
- the payment of administrative fees and expenses to that trust; and
- that the required ratio of assets to outstanding senior debt obligations of that trust will be maintained.

Our obligations under the 2009 RSA and the PEAKS Program (collectively, the RSAs) will remain in effect until all private education loans made under that RSA or the senior debt obligation, as applicable, are paid in full or charged off. The following table sets forth the guarantee payments and payments on behalf of student borrowers under the PEAKS Program to help those borrowers avoid defaulting on their PEAKS Program private education loans (Payments on Behalf of Borrowers) that we made related to the RSAs in the approximate aggregate amount, net of recoveries, in the period indicated:

Type of Payment	**Nine Months Ended September 30, 2013 (In millions)**
Guarantee:	
PEAKS Guarantee	$ 1.4
2009 RSA	0.7
Payments on Behalf of Borrowers	7.7
Total	$ 9.8

In the nine months ended September 30, 2013, we made Payments on Behalf of Borrowers in connection with the PEAKS Program. We made those payments after assessing:

- the likelihood of us being contractually required to make payments under the PEAKS Guarantee in the near future;
- the effect on our liquidity that would result from making payments under the PEAKS Guarantee compared to making Payments on Behalf of Borrowers;
- the effect that Payments on Behalf of Borrowers may have on the funds available to the PEAKS Trust to repay the Subordinated Note to us following full payment of the PEAKS Trust s other obligations; and
- the fact that we will not be able to recover Payments on Behalf of Borrowers directly from the student borrowers on whose behalf we made those payments.

Payments on Behalf of Borrowers assist in:

- maintaining the ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt at the required level; and

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satisfying the following month s required payment of interest on the PEAKS Senior Debt and administrative fees and expenses of the PEAKS Trust.

We will continue to assess whether it would be economically beneficial to us to make Payments on Behalf of Borrowers in future periods, and we may make Payments of Behalf of Borrowers in the future based on our assessment of the above factors.

Making Payments on Behalf of Borrowers:

- may result in us paying amounts to the PEAKS Trust in advance of when a guarantee payment would be due, which would negatively impact our liquidity in a particular period;
- may result in us paying a lesser amount than we otherwise would have been required to pay in future periods under the PEAKS Guarantee, which would positively impact our liquidity in a particular period; and
- may reduce the amount that we could receive following full payment of the PEAKS Senior Debt and fees and expenses of the PEAKS Trust, because that amount is limited to the amounts we paid under the PEAKS Guarantee (which do not include Payments on Behalf of Borrowers) and the amount due to us under the Subordinated Note.

The amount owed to us under the Subordinated Note was approximately $73.0 million as of September 30, 2013.

In addition, under the 2009 RSA, we have the right to elect to make payments to the 2009 Entity to discharge our guarantee obligations under the 2009 RSA related to certain 2009 Loan Program private education loans that default (Discharge Payments). Making Discharge Payments may result in us paying amounts to the 2009 Entity in advance of when a guarantee payment would be due, which would negatively impact our liquidity in a particular period, but may result in us paying a lesser amount than we otherwise would have been required to pay under our guarantee obligations in future periods under the 2009 RSA.

We are not able to estimate the maximum potential future payments that we could be required to make under the RSAs. The maximum potential future payments that we could be required to make pursuant to our guarantee obligations under the RSAs are affected by various factors. See Notes 9 and 12 of the Notes to Condensed Consolidated Financial Statements.

We review various factors and make certain assumptions when assessing the amount to recognize as a contingent liability with respect to the guarantee arrangements under the RSAs at the end of each reporting period. As with any assessment, as facts and circumstances change, the recorded liability could change, and has changed, significantly. In order to make this assessment, we made certain assumptions with respect to the performance of the private education loans made under each of the RSAs over the life of these loans. The life of a private education loan made under the RSAs may be in excess of ten years from the date of disbursement. Therefore, our assessment was based on assumptions for periods in excess of ten years, and those assumptions include among other things, the following:

- the repayment performance of the private education loans under each of the RSAs;

- the timing and rate at which the private education loans will be paid;
- the changes in the variable interest rates due on the private education loans and the PEAKS Senior Debt;
- the amounts that will be collected in the future on the private education loans that have defaulted; and
- the fees and expenses associated with servicing the private education loans.

We consulted with two third-party consumer credit consulting firms in arriving at our assumptions. The assumptions have changed, and may continue to change, significantly over time as actual results become known. The principal factor that we review is the repayment performance of the private education loans under each of the RSAs. We, with the assistance of our third-party consumer credit consultants, evaluate a variety of data related to the repayment performance of the private education loans under the RSAs, including, but not limited to:

- the payment and default trends by the month in which the private education loan entered repayment;
- the payment and default trends based on the education completion status achieved by the borrower (i.e., whether the borrower graduated or withdrew from his or her program of study);
- the payment status of the loans in repayment (i.e., whether the loans are current or delinquent);
- the status of the loans that are not in repayment (i.e., whether repayment is deferred, because the borrower is in school or for some other reason, or whether the loan is in the grace period after the borrower leaves school or is in forbearance); and
- the current academic standing of borrowers who have not yet entered repayment.

In determining the estimated default rate used in the assumptions to establish our liability for guarantee obligations, we considered the payment performance of the private education loans under the PEAKS Program. Any Payments on Behalf of Borrowers that we made with respect to those loans, however, were not considered to be payments on those loans for purposes of that determination. To date, the charge-off rate on the private education loans has been higher, and the timing of charge-offs has been earlier, than we originally projected.

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In certain prior reporting periods, there have been disruptions in the servicing of a portion of the private education loans under the RSAs, which we believe negatively impacted the repayment performance of those private education loans. We cannot predict with any certainty whether servicing disruptions will occur in the future. If the charge-off rate on the private education loans under the RSAs continues at the current rate, or is higher than the current rate, due to a broader change in borrower repayment behavior, additional servicing disruptions and/or any other reason, we could be required to pay additional material amounts under our guarantee obligations, including amounts to reduce the outstanding balance of the PEAKS Senior Debt to an amount sufficient to satisfy the required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt, which could have a material adverse effect on our financial condition, results of operations and cash flows.

At the end of each reporting period, we assess whether we should recognize a contingent liability related to the various claims and contingencies that we are subject to, including those related to litigation, business transactions, guarantee arrangements and employee-related matters, among others. The following table sets forth our recorded liability for these claims and contingencies as of the date indicated:

Type of Claim and Contingency	**As of September 30, 2013 (in millions)**	
Guarantee Obligations under the RSAs:		
PEAKS Program	$	40.0
2009 RSA		32.9
Other Claims and Contingencies		8.3
Total	$	81.2

We believe that it is reasonably possible that we may incur losses in an estimated range of $9.0 million less than to $41.0 million greater than the recorded liability for the RSAs.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

In the three months ended September 30, 2013, we did not repurchase any shares of our common stock. Our Board of Directors has authorized us to repurchase shares of our common stock in the open market or through privately negotiated transactions in accordance with Rule 10b-18 of the Exchange Act under the Repurchase Program. The shares that remained available for repurchase under the Repurchase Program were 7,771,025 as of September 30, 2013. Unless earlier terminated by our Board of Directors, the Repurchase Program will expire when we repurchase all shares authorized for repurchase thereunder.

Item 6. Exhibits.

A list of exhibits required to be filed as part of this report is set forth in the Index to Exhibits, which immediately precedes the exhibits, and is incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ITT Educational Services, Inc.

Date: October 29, 2013

By: /s/ Daniel M. Fitzpatrick
Daniel M. Fitzpatrick
Executive Vice President, Chief Financial Officer
(Duly Authorized Officer, Principal Financial Officer
and Principal Accounting Officer)

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INDEX TO EXHIBITS

Exhibit No.	Description
3.1	Restated Certificate of Incorporation, as Amended to Date (incorporated herein by reference from the same exhibit number to ITT/ESI s 2005 second fiscal quarter report on Form 10-Q)
3.2	Restated By-Laws, as Amended to Date (incorporated herein by reference from the same exhibit number to ITT/ESI s Current Report on Form 8-K filed on July 22, 2011)
31.1	Chief Executive Officer s Certification Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
31.2	Chief Financial Officer s Certification Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
32.1	Chief Executive Officer s Certification Pursuant to 18 U.S.C. Section 1350
32.2	Chief Financial Officer s Certification Pursuant to 18 U.S.C. Section 1350
101	The following materials from ITT Educational Services, Inc. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in XBRL (eXtensible Business Reporting language):
	(i) Condensed Consolidated Balance Sheets; (ii) Condensed Consolidated Statements of Income; (iii) Condensed Consolidated Statements of Comprehensive Income; (iv) Condensed Consolidated Statements of Cash Flows; (v) Condensed Consolidated Statements of Shareholders Equity; and (vi) Notes to Condensed Consolidated Financial Statements