

ITT EDUCATIONAL SERVICES INC  
Form 10-K/A  
October 20, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-K/A**  
**(Amendment No. 1)**

**(Mark One)**

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

**For the fiscal year ended December 31, 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**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**36-2061311**  
**(I.R.S. Employer**  
**Identification No.)**

**13000 North Meridian Street**

**Carmel, Indiana**  
**(Address of principal executive offices)**

**46032-1404**  
**(Zip Code)**

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

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of each class**  
**COMMON STOCK, \$.01 PAR VALUE**

**Name of each exchange on which registered**  
**NEW YORK STOCK EXCHANGE, INC.**

**Securities registered pursuant to Section 12(g) of the Act:**

**NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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.

Large accelerated filer

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

**\$566,443,560**

Aggregate market value of the voting stock held by nonaffiliates of the registrant based on the last sale price for such stock at June 28, 2013 (assuming solely for the purposes of this calculation that all Directors and executive officers of the registrant are affiliates).

**23,449,175**

Number of shares of Common Stock, \$.01 par value, outstanding at September 30, 2014.

**DOCUMENTS INCORPORATED BY REFERENCE**

None

**EXPLANATORY NOTE**

This Amendment No. 1 to Form 10-K (Form 10-K/A) (the Amended Filing ) is being filed solely for the purpose of modifying two paragraphs contained in Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations included in ITT Educational Services, Inc. s Annual Report on Form 10-K for the fiscal year ended December 31, 2013, originally filed with the U.S. Securities and Exchange Commission on October 16, 2014 (the Original Filing ). The two paragraphs that are being modified are the seventh and the tenth paragraphs of Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition, Liquidity and Capital Resources *Capital Resources*.

This Amended Filing does not modify or update any other disclosures set forth in the Original Filing and does not otherwise reflect events occurring after the date of the Original Filing.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*The following discussion should be read with the Selected Financial Data and the Consolidated Financial Statements and Notes to Consolidated Financial Statements included elsewhere in this report.*

This management's discussion and analysis of financial condition and results of operations is based on our 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.

**Revision of Prior Periods**

This management's discussion and analysis of financial condition and results of operations reflects the fact that we have revised our previously issued financial statements as of and for the years ended December 31, 2012 and 2011. We revised our Consolidated Statement of Income for the year ended December 31, 2012 to reflect immaterial corrections for:

the recognition of revenue with respect to students who withdrew from a program of study, which reduced revenue by \$20.4 million and student services and administrative expenses by \$21.5 million;

a contingent loss related to the 2009 RSA, which increased loss related to loan program guarantees by \$3.5 million; and

losses related to the 2009 RSA, which increased both revenue and loss related to loan program guarantees by \$19.8 million.

We also reclassified certain items in our Consolidated Statement of Income for the year ended December 31, 2012 to reflect adjustments for:

the settlement cost associated with the 2007 RSA, which decreased settlement cost and increased loss related to loan program guarantees by \$21.8 million;

the impairment of the Subordinated Note and Revolving Note, which decreased loss related to private student loan programs and increased asset impairment by \$15.2 million;

losses related to private education loan programs, which decreased loss related to private student loan programs and increased loss related to loan program guarantees by \$71.1 million; and

legal and other investigation costs, which decreased cost of educational services and increased legal and other investigation costs by \$0.9 million.

We revised our Consolidated Statement of Income for the year ended December 31, 2011 to reflect immaterial corrections for the recognition of revenue with respect to students who withdrew from a program of study, which reduced revenue by \$23.5 million and student services and administrative expenses by \$25.7 million. We also corrected the classification of losses related to the 2009 RSA and 2007 RSA in our Consolidated Statement of Income for the year ended December 31, 2011, which increased both revenue and loss related to loan program guarantees by \$23.5 million.

This management's discussion and analysis of financial condition and results of operations discusses our financial condition and results of operations as of and for the 12 months ended December 31, 2012 and 2011 as so revised and reclassified.

### **Consolidation and Core Operations**

In February 2014, we commenced a review of the accounting for a variable interest that we held in the PEAKS Trust, a VIE. We engaged significant internal and external resources to perform supplemental procedures to assist us in reviewing our financial statements and accounting practices (the Supplemental Procedures). As a result of the review and the Supplemental Procedures, on June 18, 2014, the Audit Committee of our Board of Directors determined that we should have consolidated the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013. February 28, 2013 was the first date that we had the substantive unilateral right to remove the servicer of the PEAKS Trust Student Loans, as described further below.

We had previously concluded that we were not required to consolidate the PEAKS Trust in our consolidated financial statements, because we believed we did not have the power to direct the activities of the PEAKS Trust that most significantly impact its economic performance and, therefore, believed we were not the primary beneficiary of the PEAKS Trust. We determined that the activities of the PEAKS Trust that most significantly impact its economic performance involve the servicing of the PEAKS Trust Student Loans. We determined that February 28, 2013 was the first date that we could exercise our right to terminate the servicing agreement that governs the servicing activities of the PEAKS Trust Student Loans (PEAKS Servicing Agreement), due to the failure of the entity that performs those servicing activities on behalf of the PEAKS Trust to meet certain performance criteria specified in the PEAKS Servicing Agreement. As a result of this analysis, we concluded that we became the primary beneficiary of the PEAKS Trust on February 28, 2013, which was the first date that we had the power to direct the activities of the

PEAKS Trust that most significantly impact the economic performance of the PEAKS Trust.

As a result of our determination that we should have consolidated the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013, we concluded that we needed to restate the unaudited condensed consolidated financial statements in our Quarterly Reports on Form 10-Q for each of the fiscal quarters ended March 31, 2013, June 30, 2013 and September 30, 2013, and that those previously-issued financial statements should no longer be relied upon. See Note 10 Variable Interest Entities of the Notes to Consolidated Financial Statements, for a further discussion of the Consolidation.

Our results of operations, financial condition and cash flows for periods after February 28, 2013 reflect the results of operations, financial condition and cash flows of the PEAKS Trust, because we were considered to have control over the PEAKS Trust under ASC 810, Consolidation ( ASC 810 ), as a result of our substantive unilateral right to terminate the PEAKS Servicing Agreement. We do not, however, actively manage the operations of the PEAKS Trust, and the assets of the consolidated PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust. Our obligations under the PEAKS Guarantee remain in effect, until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full, as discussed further under Private Education Loan Program Obligations and Note 16 Commitments and Contingencies of the Notes to Consolidated Financial Statements.

Unless otherwise noted, the information in this management's discussion and analysis of financial condition and results of operations is presented and discussed on a consolidated basis, including the PEAKS Trust. Certain information is also provided, however, regarding our results of operations, financial condition and cash flows on a basis that excludes the impact of the PEAKS Trust. We identify and describe our education programs and education-related services on this basis as our core operations ( Core Operations ). The presentation of the Core Operations financial measures differs from the presentation of our consolidated financial measures determined in accordance with generally accepted accounting principles in the United States ( GAAP ). We believe that the presentation of the Core Operations information assists investors in comparing current period information against prior periods during which the PEAKS Trust was not consolidated. In addition, our management believes that the Core Operations information provides useful information to investors, because it:

allows more meaningful information about our ongoing operating results, financial condition and cash flows;

helps in performing trend analyses and identifying trends that may otherwise be masked or distorted by items that are not part of the Core Operations; and

provides a higher degree of transparency of our core results of operations, financial condition and cash flows.

The following tables set forth selected data from our balance sheets, statements of income and statements of cash flows as of and for the years ended:

December 31, 2012 (which was prior to the Consolidation); and

December 31, 2013, regarding:

the Core Operations on a stand-alone basis;

the PEAKS Trust on a stand-alone basis;

the elimination of transactions between the PEAKS Trust and Core Operations, as a result of the Consolidation; and

the Core Operations and the PEAKS Trust consolidated in accordance with GAAP.

The information presented related to 2013 also constitutes the reconciliation of our non-GAAP Core Operations and PEAKS Trust data to the related GAAP consolidated financial measures. Following each table, we describe the effect of the Consolidation on the financial statement information presented, including the components attributable to the Core Operations and the PEAKS Trust.

	As of December 31, 2013				
	As of December 31, 2012	Core Operations	PEAKS Trust	Eliminations	GAAP Consolidated
(Dollar amounts in thousands)					
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 243,465	\$ 215,771	\$ 0	\$ 0	\$ 215,771
Restricted cash	3,478	3,043	2,593	0	5,636
Accounts receivable, net	78,928	99,530	0	0	99,530
PEAKS Trust student loans, net	0	0	7,730	0	7,730
Deferred income taxes	44,547	33,961	43,588	0	77,549
Prepaid expenses and other current assets	16,162	27,827	573	0	28,400
Total current assets	386,580	380,132	54,484	0	434,616



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Property and equipment, net	189,890	168,509	0	0	168,509
PEAKS Trust student loans, net	0	0	76,479	0	76,479
Deferred income taxes	57,471	113,398	(45,074)	0	68,324
Other assets	41,263	67,354	0	(8,431)	58,923
<b>Total assets</b>	<b>\$ 675,204</b>	<b>\$ 729,393</b>	<b>\$ 85,889</b>	<b>\$ (8,431)</b>	<b>\$ 806,851</b>
Current portion of long-term debt	\$ 0	\$ 50,000	\$ 0	\$ 0	\$ 50,000
Current portion of PEAKS Trust senior debt	0	0	157,883	0	157,883
Accounts payable	63,304	58,021	0	0	58,021
Accrued compensation and Benefits	21,023	18,107	0	0	18,107
Other current liabilities	106,796	33,366	11,830	(3,060)	42,136
Deferred revenue	135,900	147,630	0	0	147,630
<b>Total current liabilities</b>	<b>327,023</b>	<b>307,124</b>	<b>169,713</b>	<b>(3,060)</b>	<b>473,777</b>
Long-term debt	140,000	0	0	0	0
PEAKS Trust senior debt	0	0	71,341	0	71,341
Other liabilities	82,416	213,343	1,684	(68,940)	146,087
<b>Total liabilities</b>	<b>549,439</b>	<b>520,467</b>	<b>242,738</b>	<b>(72,000)</b>	<b>691,205</b>
<b>Total shareholders equity</b>	<b>125,765</b>	<b>208,926</b>	<b>(156,849)</b>	<b>63,569</b>	<b>115,646</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 675,204</b>	<b>\$ 729,393</b>	<b>\$ 85,889</b>	<b>\$ (8,431)</b>	<b>\$ 806,851</b>

In accordance with ASC 810, the assets and liabilities of the PEAKS Trust were treated as having been acquired by us at their fair values as of February 28, 2013. The carrying values of the assets and liabilities of the PEAKS Trust are included on our Consolidated Balance Sheet as of December 31, 2013. The assets of the PEAKS Trust consist of cash and the PEAKS Trust Student Loans. The liabilities of the PEAKS Trust consist primarily of the PEAKS Senior Debt. For further information about the terms of the PEAKS Senior Debt, see Financial Condition, Liquidity and Capital Resources *Financing*. The assets of the PEAKS Trust serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt. The carrying values of the assets and liabilities related to the PEAKS Program that had been included as balance sheet items related to our Core Operations and consisted of the Subordinated Note, a guarantee receivable and a contingent liability, were eliminated from our Consolidated Balance Sheet as of December 31, 2013.

Although the assets and liabilities of the PEAKS Trust are presented on our Consolidated Balance Sheets following the Consolidation, the assets of the PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust.

	<b>Year Ended December 31, 2013</b>				
	<b>Year Ended December 31, 2012</b>	<b>Core Operations</b>	<b>PEAKS Trust</b>	<b>Eliminations</b>	<b>GAAP Consolidated</b>
	<b>(Dollar amounts in thousands)</b>				
<b>Statement of Income Data:</b>					
Revenue	\$ 1,286,633	\$ 1,059,315	\$ 12,996	\$ 0	\$ 1,072,311
Cost and expenses:					
Cost of educational services	538,350	486,353	0	0	486,353
Student services and administrative expenses	400,856	392,253	5,288	0	397,541
Asset impairment	15,166	0	0	0	0
Legal and other investigation costs	873	6,923	0	0	6,923
Loss related to loan program guarantees	101,025	115,503	0	(24,539)	90,964
Provision for PEAKS Trust student loan losses	0	0	29,349	0	29,349
Total costs and expenses	1,056,270	1,001,032	34,637	(24,539)	1,011,130
Operating income (loss)	230,363	58,283	(21,641)	24,539	61,181
(Loss) on consolidation of PEAKS Trust	0	0	(112,748)	39,500	(73,248)
Interest income	1,348	578	0	(470)	108
Interest (expense)	(3,723)	(3,989)	(21,288)	0	(25,277)
Income (loss) before provision for income taxes	227,988	54,872	(155,677)	63,569	(37,236)
Provision for income taxes	89,018	(11,384)	1,172	0	(10,212)
Net income (loss)	\$ 138,970	\$ 66,256	\$ (156,849)	\$ 63,569	\$ (27,024)

The Consolidation impacts the presentation of our Statements of Income in a number of ways. Following the Consolidation, our revenue consists of:

revenue from the Core Operations, primarily from tuition, tool kit sales and student fees; and

student loan interest income on the PEAKS Trust Student Loans, which is the accretion of the accretable yield on the PEAKS Trust Student Loans.

Following the Consolidation, our student services and administrative expenses are comprised of:

expenses related to the Core Operations, including marketing expenses, an expense for uncollectible accounts and administrative expenses incurred primarily at our corporate headquarters; and

expenses incurred by the PEAKS Trust, primarily related to fees for servicing the PEAKS Trust Student Loans and various other administrative fees and expenses of the PEAKS Trust.

The loss related to loan program guarantees represents:

in 2012, the additional contingent liability accruals that we recorded related to the PEAKS Guarantee and the 2009 RSA; and

in 2013, the additional contingent liability accruals that we recorded related to the 2009 RSA, because the contingent liability related to the PEAKS Guarantee was eliminated from our consolidated financial statements as a result of the Consolidation (though our obligations under the PEAKS Guarantee remain in effect).

Following the Consolidation, our provision for PEAKS Trust student loan losses represents the increase in the allowance for loan losses that occurred during the period. The allowance for loan losses is the difference between the carrying value and the total present value of the expected principal and interest collections of each loan pool of the PEAKS Trust Student Loans, discounted by the loan pool's effective interest rate as of December 31, 2013.

We recognized a loss upon the Consolidation that represented the amount by which the fair value of the PEAKS Trust's liabilities exceeded the fair value of the PEAKS Trust's assets as of February 28, 2013, partially reduced by the net amount of the carrying value of the assets and liabilities related to the PEAKS Program that had been recorded in our consolidated financial statements as of February 28, 2013 and were eliminated upon the Consolidation. Following the Consolidation, our interest expense includes:

interest expense from matters related to the Core Operations, primarily the interest expense on the outstanding balance under the Amended Credit Agreement; and

interest expense on the PEAKS Senior Debt, which includes the contractual interest obligation and the accretion of the discount on the PEAKS Senior Debt.

Since the inception of the PEAKS Program, we have guaranteed, and continue to guarantee, the payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and the minimum required Asset/Liability Ratio, pursuant to the terms of the PEAKS Guarantee. Our obligations under the PEAKS Guarantee remain in effect until the PEAKS Senior Debt and the PEAKS Trust's fees and expenses are paid in full.

The revenue and expenses of the PEAKS Trust are presented in our Consolidated Statements of Income following the Consolidation. The cash received by the PEAKS Trust, which is derived from its revenue, however, is considered restricted and can only be used to satisfy the obligations of the PEAKS Trust.

	Year Ended December 31, 2013				
	Year Ended December 31, 2012	Core Operations	PEAKS Trust	Eliminations	GAAP Consolidated
	(Dollar amounts in thousands)				
<b>Statement of Cash Flows Data:</b>					
<b>Cash flows from operating activities:</b>					
Net income (loss)	\$ 138,970	\$ 66,256	\$ (156,849)	\$ 63,569	\$ (27,024)
Adjustments to reconcile net income to net cash flows from operating activities:					
Depreciation and amortization	29,350	27,252	0	0	27,252
Provision for doubtful accounts	56,818	67,640	0	0	67,640
Deferred income taxes	(59,999)	(47,318)	(7,107)	0	(54,425)
Excess tax benefit from stock option exercises	(1,382)	0	0	0	0
Stock-based compensation expense	16,658	11,638	0	0	11,638
Settlement cost	21,750	(46,000)	0	0	(46,000)
Asset impairment	15,166	0	0	0	0
Accretion of discount on PEAKS Trust student loans	0	0	(12,996)	0	(12,996)
Accretion of discount on PEAKS Trust senior debt	0	0	4,926	0	4,926
Provision for PEAKS Trust student loan losses	0	0	29,349	0	29,349
Loss on consolidation of PEAKS Trust	0	0	112,748	(39,500)	73,248
Other	6,992	315	0	0	315
<b>Changes in operating assets and liabilities:</b>					
Restricted cash	3,794				