

ITT EDUCATIONAL SERVICES INC

Form 10-K

February 22, 2013

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT

(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, 2012

OR

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

For the transition period from _____ to _____

Commission file number 1-13144

ITT EDUCATIONAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: ITT EDUCATIONAL SERVICES INC - Form 10-K

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	Name of each exchange on which registered
COMMON STOCK, \$.01 PAR VALUE	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

\$1,408,596,156

Aggregate market value of the voting stock held by nonaffiliates of the registrant based on the last sale price for such stock at June 29, 2012 (assuming solely for the purposes of this calculation that all Directors and executive officers of the registrant are affiliates).

Edgar Filing: ITT EDUCATIONAL SERVICES INC - Form 10-K

23,348,995

Number of shares of Common Stock, \$.01 par value, outstanding at January 31, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents have been incorporated by reference into this Annual Report on Form 10-K:

IDENTITY OF DOCUMENT	PARTS OF FORM 10-K INTO WHICH DOCUMENT IS INCORPORATED
Definitive Proxy Statement for the Annual Meeting of Shareholders to be held May 7, 2013	PART III

Table of Contents

ITT EDUCATIONAL SERVICES, INC.

Carmel, Indiana

Annual Report to Securities and Exchange Commission

December 31, 2012

Table of Contents

<u>PART I</u>		1
Item 1.	<u>Business.</u>	1
Item 1A.	<u>Risk Factors.</u>	11
Item 1B.	<u>Unresolved Staff Comments.</u>	27
Item 2.	<u>Properties.</u>	27
Item 3.	<u>Legal Proceedings.</u>	28
Item 4.	<u>Mine Safety Disclosures.</u>	28
<u>PART II</u>		28
Item 5.	<u>Market For Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.</u>	28
Item 6.	<u>Selected Financial Data.</u>	31
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	32
Item 7A.	<u>Quantitative and Qualitative Disclosures About Market Risk.</u>	47
Item 8.	<u>Financial Statements and Supplementary Data.</u>	47
Item 9.	<u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.</u>	47
Item 9A.	<u>Controls and Procedures</u>	47
Item 9B.	<u>Other Information.</u>	48
<u>PART III</u>		48
Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	48
Item 11.	<u>Executive Compensation.</u>	49
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.</u>	49
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence.</u>	49
Item 14.	<u>Principal Accountant Fees and Services.</u>	49
<u>PART IV</u>		50
Item 15.	<u>Exhibits and Financial Statement Schedules.</u>	50

Table of Contents

PART I

Item 1. Business.

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 Securities Exchange Act of 1934 (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 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 student loans;

our ability to collect internal student financing from our students;

our exposure under our guarantees related to private education 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 Risk Factors and elsewhere in this Annual Report and those detailed from time to time in other documents we file with the U.S. Securities and Exchange Commission (SEC). We undertake no obligation to update or revise any forward-looking information, whether as a result of new information, future developments or otherwise.

Edgar Filing: ITT EDUCATIONAL SERVICES INC - Form 10-K

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.

Background

We are a Delaware corporation incorporated in 1946. Our principal executive offices are located at 13000 North Meridian Street, Carmel, Indiana 46032-1404, and our telephone number is (317) 706-9200. From 1966 until our initial public offering on December 27, 1994, we were wholly owned by ITT Corporation, an Indiana corporation, formerly a Delaware corporation and formerly known as ITT Industries, Inc. (Old ITT). On September 29, 1995, ITT Corporation, a Nevada corporation (ITT), succeeded to the interests of Old ITT in the beneficial ownership of 83.3% of our common stock. ITT 's beneficial ownership of our common stock ended in February 1999.

Overview

We are a leading proprietary provider of postsecondary degree programs in the United States based on revenue and student enrollment. As of December 31, 2012, we were offering master, bachelor and associate degree programs to approximately 61,000 students. As of December 31, 2012, we had 149 locations (including 147 campuses and two learning sites) in 39 states. In addition, we offered one or more of our online programs to students who are located in 48 states. 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 (DWC) name.

Table of Contents

In 2012, we began operations at six new ITT Technical Institute campuses and discontinued operations at one learning site. We also continued our efforts to diversify our program offerings by developing programs at different levels in technology and non-technology fields of study that we intend to offer at our campuses and deliver entirely in residence, entirely online over the Internet or partially in residence and partially online.

Business Strategy

Our strategy is to pursue multiple opportunities for growth. We are implementing a growth strategy designed to:

improve the academic outcomes of our students;

increase the value proposition of our education programs for our students; and

increase access to high-quality, career-based education.

We intend to pursue this strategy by:

increasing student enrollment in existing programs at existing campuses;

increasing the number and types of program and other educational offerings that are delivered in residence and/or online;

increasing our students' engagement in their programs of study;

enhancing the relevancy of our educational offerings;

assessing student achievement and learning;

improving the flexibility and convenience of how our institutions deliver their educational offerings;

increasing our students' access to financial aid;

helping our graduates obtain entry-level employment involving their fields of study at higher starting annual salaries;

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

adding learning sites to existing campuses; and

Edgar Filing: ITT EDUCATIONAL SERVICES INC - Form 10-K

investing in other education-related opportunities.
The principal elements of this strategy include the following:

Enhance Results at Each Institution.

Increase Enrollments at Existing Campuses. We intend to increase recruiting efforts that are primarily aimed at delivering high-quality, career-based education to multiple adult-learner audiences.

Develop and Deliver Different Educational Offerings. We intend to develop and deliver different educational offerings that we believe offer graduates attractive returns on their educational investments.

As part of this strategy, we intend to further diversify our educational offerings by developing new programs of study in both technology and non-technology fields, but primarily in technology and healthcare-related disciplines. We believe that those programs of study will be at different education levels and delivered in a variety of formats, including entirely in residence, entirely online or partially in residence and partially online. In 2012, we began offering two new programs of study and increased the number of our campuses that offer bachelor degree programs from 128 to 133.

We also believe that we should increase the number of programs of study that we offer to our students across our campuses. In 2012, we added a total of 272 programs among 62 campuses.

We believe that developing new programs of study, delivering programs in different formats and increasing the number of programs from which prospective students may choose, can:

attract more, and a broader base of, students to our institutions;

motivate current students to extend their studies;

help improve student outcomes;

increase the value proposition of our programs of study to our students;

increase access to high-quality, career-based education; and

improve the utilization of our facilities.

Improve Student Outcomes. We strive to improve the graduation and graduate employment rates of our students by:

providing academic and career services;

dedicating administrative resources to those services;

increasing our students' engagement in their programs of study;

enhancing the relevancy of our educational offerings;

Edgar Filing: ITT EDUCATIONAL SERVICES INC - Form 10-K

assessing student achievement and learning; and

increasing our students' access to financial aid.

-2-

Table of Contents

Geographically Expand the Delivery of Our Educational Offerings. We plan to add new campuses and learning sites of our existing institutions at locations throughout the United States and new institutions in international markets. Using our proprietary methodology, we determine locations for new campuses and learning sites in the United States based on a number of factors, including demographics and population and employment growth. The following table sets forth the number of new campuses that began operations in the years indicated:

	2012	2011	2010
New campuses	6	11	9

Provide Education-Related Services. We plan to develop and provide education-related services to students and other constituencies. These services may involve a variety of activities, primarily at the postsecondary level.

Programs of Study

As of December 31, 2012, the ITT Technical Institutes were offering 52 degree programs in various fields of study across the following schools of study:

Information Technology (IT);

Electronics Technology;

Drafting and Design;

Business;

Criminal Justice; and

Breckinridge School of Nursing and Health Sciences.

We design our programs to help graduates prepare for careers in various fields involving their education by offering students a broad-based foundation in a variety of skills used in those fields. The following table sets forth examples of various fields involving the subject matter of programs within a particular school of study in which graduates have obtained entry-level positions:

School of Study	Fields
Business	accounting
	business administration
	financial services
	manufacturing
	marketing and advertising
	sales

Edgar Filing: ITT EDUCATIONAL SERVICES INC - Form 10-K

Drafting and Design

architectural and construction drafting

civil drafting

computer-aided drafting

electrical and electronics drafting

interior design

landscape architecture

mechanical drafting

multimedia communications

Electronics Technology

communications

computer technology

electronics product design and fabrication

industrial electronics

instrumentation

telecommunications

Criminal Justice

corrections

cyber security

investigations

security and policing

IT

communications

network administration

network technology

software development

systems technology

technical support

Breckinridge School of Nursing and Health Sciences

health information technology

nursing

At the vast majority of our campuses, we generally organize the academic schedule for programs of study on the basis of four 12-week academic quarters in a calendar year, with new students beginning at the start of each academic quarter. At these campuses, students taking a full-time course load can complete our associate degree programs in seven or eight academic

Table of Contents

quarters, bachelor degree programs in 14 or 15 academic quarters and a master degree program in six or seven academic quarters. We typically offer classes in most residence programs in:

3.5- to 5.5-hour sessions three days a week, Monday through Saturday, with all program courses taught entirely or partially in residence; or

sessions that are scheduled two to three days a week, Monday through Saturday, with certain program courses taught entirely or partially online over the Internet most academic quarters.

Depending on student enrollment, class sessions at the vast majority of our campuses are generally available in the morning, afternoon and evening. The courses that are taught online over the Internet are delivered through an asynchronous learning network and have a prescribed schedule for completion of the coursework. At the vast majority of our campuses, the class schedule for our residence courses and the coursework completion schedule for our online courses generally provide students with the flexibility to maintain employment concurrently with their studies. Based on student surveys, we believe that a majority of our students work at least part-time during their programs of study.

Most of our programs of study blend traditional academic content with applied learning concepts and have the objective of helping graduates prepare for a changing economic and/or technological environment. A significant portion of most programs offered at our campuses involves practical study in a lab environment.

The learning objectives of most courses in each program of study are substantially the same among the vast majority of our campuses to provide greater uniformity and to better enable students to transfer, if necessary, to other campuses offering the same programs with less disruption to their education. We regularly review each curriculum to respond to changes in technology and industry needs. Each of the ITT Technical Institutes establishes an advisory committee for each field of study taught at that campus, which is comprised of representatives of local employers and other constituents. These advisory committees assist the ITT Technical Institutes in assessing curricula, equipment and laboratory design, and updating the curricula. In addition to courses directly related to a student's program of study, our programs also include general education courses in the humanities, composition, mathematics, the sciences and the social sciences.

Gross tuition for a student entering an undergraduate residence program at an ITT Technical Institute in December 2012 for 36 quarter credit hours (the minimum course load for a full-time student for an academic year consisting of three academic quarters) was \$17,748 for all ITT Technical Institute undergraduate residence programs, except as adjusted in one state to reflect applicable taxes and fees. Gross tuition for a student entering an undergraduate residence program at DWC in September 2012 for 24 semester credit hours (the minimum course load for a full-time student for an academic year consisting of two academic semesters) was \$15,090 for all DWC undergraduate residence programs. The gross tuition amounts discussed above do not reflect institutional scholarships and grants which reduce the amount of gross tuition that students pay to attend our institutions. We have not increased gross tuition rates for our ITT Technical Institute programs of study since 2010, and we do not intend to increase gross tuition rates for our ITT Technical Institute programs of study in 2013. The majority of students attending residence programs at our campuses lived in that campus metropolitan area prior to enrollment. The only student housing that we provide is at the Nashua, New Hampshire campus of DWC.

Student Recruitment

We strive to attract students with the motivation and ability to complete the career-oriented educational programs offered by our campuses. To generate interest among potential students, we engage in a broad range of activities to inform potential students and their parents about our campuses and the programs they offer. These activities include television, Internet and other media advertising, social media, direct mailings and high school presentations. As of December 31, 2012, we employed approximately 1,300 full and part-time recruiting representatives to assist in recruiting efforts.

Local recruiting representatives of a campus pursue expressions of interest from potential students for our residence programs of study by contacting prospective students and arranging for interviews at the campus or any learning site of that campus. Occasionally, we also pursue expressions of interest from students for our residence programs of study by contacting them and arranging for their attendance at a seminar providing information about the campus and its programs. We pursue expressions of interest from potential students for our online programs of study by providing program and resource information on our websites and through telephone calls, electronic mail, social media and postal delivery.

Edgar Filing: ITT EDUCATIONAL SERVICES INC - Form 10-K

Student recruitment activities are subject to substantial regulation at both the state and federal level and by our accrediting commissions. Most states have bonding and licensing requirements that apply to many of our representatives and other employees involved in student recruitment. Our National Director of Recruitment and Regional Directors of Recruitment oversee the implementation of recruitment policies and procedures. In addition, our compliance department reviews student recruiting practices at each of our campuses on at least an annual basis.

Student Admission and Retention

We require all applicants for admission to any of our campus programs of study to have a high school diploma or a recognized equivalent. Depending on the program of study and the campus, applicants may also be required to:

pass an admission examination;

Table of Contents

possess a designated number of credit hours or degree with a specified overall cumulative grade point average from an accredited postsecondary educational institution;

complete the Scholastic Assessment Test or American College Testing examination; and

tour the campus.

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

Student Demographics	Approximate Percent of Student Census	
	December 31, 2012	December 31, 2011
Age		
19 or less	4%	4%
20 through 24	27%	30%
25 through 30	29%	29%
31 or over	40%	37%
Gender		
Male	72%	72%
Female	28%	28%
Race		
Caucasian	45%	48%
Other (1)	55%	52%

(1) Based on applicable federal classifications.

The faculty and staff at each of our campuses strive to help students overcome obstacles to the completion of their programs of study. As is the case in other postsecondary institutions, however, students often fail to complete their programs for a variety of personal, financial or academic reasons. Student withdrawals prior to program completion not only affect the students, they also have a negative regulatory and financial effect on the campus and the entire institution. To minimize student withdrawals, each of our campuses devotes staff resources to assist and advise students regarding academic and financial matters. We encourage academic advising and tutoring in the case of students experiencing academic difficulties. We also offer assistance and advice to students in our residence programs who are looking for part-time employment and housing.

Graduate Employment

We believe that the success of our graduates who begin their careers in fields involving their programs of study is critical to the ability of our campuses to continue to recruit students. We try to obtain data on the number of students employed following graduation. The reliability of such data depends largely on information that students and employers report to us. Based on this information, we believe that:

approximately 70% of the Employable Graduates (as defined below) in 2011 had obtained employment by April 30, 2012 in positions that required the direct or indirect use of skills taught in their programs of study; and

the percentage of Employable Graduates in 2012 who had obtained employment by February 15, 2013 in positions that required the direct or indirect use of skills taught in their programs of study was approximately 263 basis points lower than the percentage of Employable Graduates in 2011 who had obtained employment by February 15, 2012 in positions that required the direct or indirect use of skills taught in their programs of study.

Employable Graduates are defined in accordance with the graduate employment metrics that we are required to report by one of the accrediting commissions that accredits our institutions and include all of the graduates from the ITT Technical Institutes programs of study in the applicable year, except for those graduates who:

were pregnant, died or suffered other health-related conditions that prevented them from working;

continued their education;

were engaged in active U.S. military service;

moved out of the United States with a spouse or parent who was engaged in active U.S. military service;

were incarcerated in a correctional institution (other than a half-way house) for more than 30 consecutive days; or

possessed visas that did not permit them to work in the United States following graduation.

Each of our campuses employs personnel to offer its students and graduates career services. These persons assist in job searches, solicit employment opportunities from employers and provide information on job search techniques, where to access employer information, writing resumes and how to prepare for, appear at and conduct oneself during job interviews.

Based on information from graduates and employers who responded to our inquiries, the reported annualized salaries initially following graduation averaged approximately:

\$32,061 for the Employable Graduates in 2011 who, as of April 30, 2012, had obtained employment in positions that required the direct or indirect use of skills taught in their programs of study; and

Table of Contents

2.3% higher for the Employable Graduates in 2012 who, as of February 15, 2013, had obtained employment in positions that required the direct or indirect use of skills taught in their programs of study than the average annualized salaries reported by the Employable Graduates in 2011 who, as of February 15, 2012, had obtained employment in positions that required the direct or indirect use of skills taught in their programs of study.

The average annual salary initially following graduation for our Employable Graduates may vary significantly among the ITT Technical Institutes depending on local employment conditions and each Employable Graduate's particular program of study, background, prior work experience and willingness to relocate. Initial employers of Employable Graduates from programs of study at the ITT Technical Institutes include small, medium and large companies and governmental agencies.

Faculty

We hire faculty members in accordance with criteria established by us, the accrediting commissions that accredit our campuses and the state education authorities that regulate our campuses. We hire faculty with relevant work experience and/or academic credentials to teach most technical subjects. Faculty members at each campus typically include the chairperson for each school or program of study and various categories of instructors, including full-time and adjunct.

Administration and Employees

Each of our campuses is managed by a person who has overall responsibility for the operation of the campus. The administrative staff of each campus also includes managers in the major functional areas of that campus, including recruitment, finance, registration, academics and career services. As of December 31, 2012, we had approximately 4,900 full-time and 4,900 part-time employees. None of our employees are represented by labor unions.

Our headquarters provides centralized services to all of our campuses in the following areas:

- | | |
|--------------------------------|---------------------------|
| accounting | legal |
| marketing | regulatory |
| public relations | legislative affairs |
| curricula development | real estate |
| management information systems | human resources |
| purchasing | compliance/internal audit |

In addition, national managers of each of the following major campus functions reside at our headquarters and develop policies and procedures to guide these functions at our ITT Technical Institute campuses:

- | | |
|---------------|--------------------|
| recruiting | career services |
| financial aid | learning resources |

academic affairs registration
Managers located at our headquarters monitor the operating results of each of our campuses and regularly conduct on-site reviews.

Competition

The postsecondary education market in the United States is highly fragmented and competitive, with no single private or public institution enjoying a significant market share. Our campuses compete for students with associate, bachelor and graduate degree-granting institutions, which include public and nonprofit private colleges and proprietary institutions, as well as with alternatives to higher education such as military service or immediate employment. We believe competition among educational institutions is based on:

the quality and reliability of the institution's programs and student services;

the reputation of the institution and its programs and student services;

the type and cost of the institution's programs;

the employability of the institution's graduates;

the ability to provide easy and convenient access to the institution's programs and courses;

the quality and experience of the institution's faculty; and

the time required to complete the institution's programs.

Certain public and private colleges may offer programs similar to those offered by our campuses at a lower tuition cost due in part to government subsidies, foundation grants, tax deductible contributions, tax-exempt status or other financial resources not available to proprietary institutions. Other proprietary institutions offer programs that compete with those offered by our campuses. Certain of our competitors in both the public and private sectors have greater financial and other resources than we do.

Table of Contents

Federal and Other Financial Aid Programs