

ITT EDUCATIONAL SERVICES INC
Form 10-Q
October 23, 2008
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended **September 30, 2008**

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**

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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 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

Accelerated filer

Non-accelerated filer (Do not check if

Smaller reporting company

a 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

38,692,185

Number of shares of Common Stock, \$.01 par value, outstanding at September 30, 2008

ITT EDUCATIONAL SERVICES, INC.

Carmel, Indiana

Quarterly Report to Securities and Exchange Commission

September 30, 2008

PART I

FINANCIAL INFORMATION

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September 30, 2008 and 2007

Condensed Consolidated Statements of Shareholders' Equity for the nine months ended
September 30, 2008 and 2007 (unaudited) and the year ended December 31, 2007

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

| | September 30, 2008 (unaudited) | As of December 31, 2007 | September 30, 2007 (unaudited) |
|--|-----------------------------------|----------------------------|-----------------------------------|
| Assets | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$136,698 | \$7,228 | \$10,322 |
| Short-term investments | 150,000 | 303,360 | 261,760 |
| Accounts receivable, net | 33,309 | 15,132 | 16,351 |
| Deferred income taxes | 13,012 | 7,418 | 10,216 |
| Prepaid expenses and other current assets | 12,997 | 16,685 | 11,825 |
| Total current assets | 346,016 | 349,823 | 310,474 |
| Property and equipment, net | 166,140 | 153,265 | 153,394 |
| Direct marketing costs, net | 22,694 | 20,567 | 21,195 |
| Other assets | 19,481 | 17,298 | 12,285 |
| Total assets | \$554,331 | \$540,953 | \$497,348 |
| Liabilities and Shareholders' Equity | | | |
| Current liabilities: | | | |
| Current portion of long-term debt | \$-- | \$-- | \$42,857 |
| Accounts payable | 58,781 | 45,120 | 57,658 |
| Accrued compensation and benefits | 28,574 | 16,137 | 16,515 |
| Accrued income taxes | 1,753 | 6,028 | 313 |
| Other accrued liabilities | 12,274 | 11,512 | 12,634 |
| Deferred revenue | 142,044 | 213,127 | 192,673 |
| Total current liabilities | 243,426 | 291,924 | 322,650 |
| Long-term debt | 150,000 | 150,000 | 107,143 |
| Deferred income taxes | 10,108 | 11,754 | 11,768 |
| Other liabilities | 19,207 | 16,717 | 15,766 |
| Total liabilities | 422,741 | 470,395 | 457,327 |
| Shareholders' equity: | | | |
| Preferred stock, \$.01 par value, 5,000,000 shares authorized, none issued | -- | -- | -- |
| Common stock, \$.01 par value, 300,000,000 shares authorized, 54,068,904 issued | 541 | 541 | 541 |
| Capital surplus | 133,723 | 127,017 | 117,407 |
| Retained earnings | 670,073 | 531,363 | 502,870 |
| Accumulated other comprehensive (loss) | (3,417) | (3,417) | (6,280) |
| Treasury stock, 15,376,719, 14,375,582 and 14,316,212 shares, at cost | (669,330) | (584,946) | (574,517) |
| Total shareholders' equity | 131,590 | 70,558 | 40,021 |
| Total liabilities and shareholders' equity | \$554,331 | \$540,953 | \$497,348 |

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

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

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Revenue | \$254,273 | \$217,932 | \$735,533 | \$639,084 |
| Costs and expenses: | | | | |
| Cost of educational services | 95,011 | 88,822 | 282,219 | 270,173 |
| Student services and administrative expenses | 78,500 | 66,192 | 227,535 | 204,210 |
| Total costs and expenses | 173,511 | 155,014 | 509,754 | 474,383 |
| Operating income | 80,762 | 62,918 | 225,779 | 164,701 |
| Interest income | 1,565 | 2,433 | 4,774 | 8,180 |
| Interest (expense) | (1,012) | (2,120) | (3,588) | (6,303) |
| Income before provision for income taxes | 81,315 | 63,231 | 226,965 | 166,578 |
| Provision for income taxes | 31,129 | 23,563 | 87,017 | 63,455 |
| Net income | \$50,186 | \$39,668 | \$139,948 | \$103,123 |
| Earnings per share: | | | | |
| Basic | \$1.29 | \$0.99 | \$3.59 | \$2.55 |
| Diluted | \$1.28 | \$0.98 | \$3.56 | \$2.51 |
| Weighted average shares outstanding: | | | | |
| Basic | 38,777 | 39,958 | 38,938 | 40,437 |
| Diluted | 39,195 | 40,572 | 39,291 | 41,087 |

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

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

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-----------------|--------------------------|-----------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Cash flows from operating activities: | | | | |
| Net income | \$50,186 | \$39,668 | \$139,948 | \$103,123 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | | | |
| Depreciation and amortization | 5,077 | 5,030 | 16,335 | 17,770 |
| Provision for doubtful accounts | 12,839 | 3,845 | 29,457 | 13,835 |
| Deferred income taxes | (1,948) | (839) | (7,251) | (7,390) |
| Excess tax benefit from stock option exercises | (686) | (6,280) | (773) | (29,554) |
| Stock-based compensation expense | 1,628 | 896 | 5,731 | 4,067 |
| Changes in operating assets and liabilities: | | | | |
| Restricted cash | 181 | (642) | 6,039 | (655) |
| Accounts receivable | (16,950) | (10,266) | (47,634) | (20,819) |
| Direct marketing costs, net | (731) | 12 | (2,127) | 433 |
| Accounts payable | 4,375 | (2,459) | 13,661 | 9,710 |
| Accrued income taxes | (2,982) | 16,381 | (3,467) | 23,620 |
| Other operating assets and liabilities | 4,331 | 7,311 | 11,214 | 7,325 |
| Deferred revenue | 3,706 | 281 | (71,083) | (9,489) |
| Net cash flows from operating activities | 59,026 | 52,938 | 90,050 | 111,976 |
| Cash flows from investing activities: | | | | |
| Facility expenditures and land purchases | (3,944) | (2,764) | (17,107) | (11,460) |
| Capital expenditures, net | (4,286) | (4,351) | (12,103) | (11,293) |
| Proceeds from sales and maturities of investments | 492,760 | 440,766 | 964,565 | 1,625,072 |
| Purchase of investments | (472,260) | (412,241) | (811,205) | (1,691,825) |
| Net cash flows from investing activities | 12,270 | 21,410 | 124,150 | (89,506) |
| Cash flows from financing activities: | | | | |
| Excess tax benefit from stock option exercises | 686 | 6,280 | 773 | 29,554 |
| Proceeds from exercise of stock options | 1,996 | 6,931 | 2,271 | 24,472 |
| Repurchase of common stock | (15,971) | (87,316) | (87,774) | (228,079) |
| Net cash flows from financing activities | (13,289) | (74,105) | (84,730) | (174,053) |
| Net change in cash and cash equivalents | 58,007 | 243 | 129,470 | (151,583) |
| Cash and cash equivalents at beginning of period | 78,691 | 10,079 | 7,228 | 161,905 |
| Cash and cash equivalents at end of period | \$136,698 | \$10,322 | \$136,698 | \$10,322 |

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

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

| | Common Stock | | Capital Surplus | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Common Stock in Treasury | | |
|--|--------------|--------|--------------------|----------------------|--|-----------------------------|-------------|-----------|
| | Shares | Amount | | | | Shares | Amount | Total |
| Balance as of December 31, 2006 | 54,069 | \$541 | \$83,329 | \$471,848 | (\$6,533) | (13,029) | (\$445,240) | \$103,945 |
| Effect of adoption of FIN No. 48 | | | | 2,169 | | | | 2,169 |
| Balance as of January 1, 2007 | 54,069 | 541 | 83,329 | 474,017 | (6,533) | (13,029) | (445,240) | 106,114 |
| For the nine months ended September 30, 2007 (unaudited): | | | | | | | | |
| Net income | | | | 103,123 | | | | 103,123 |
| Other comprehensive income: | | | | | | | | |
| Amortization of pension loss, net of income tax | | | | | 253 | | | 253 |
| Comprehensive income | | | | | | | | 103,376 |
| Exercise of stock options | | | | (74,270) | | 1,071 | 98,742 | 24,472 |
| Tax benefit from exercise of stock options | | | 30,011 | | | | | 30,011 |
| Stock-based compensation | | | 4,067 | | | | | 4,067 |
| Common shares repurchased | | | | | | (2,359) | (228,079) | (228,079) |
| Issuance of shares for Directors' compensation | | | | | | 1 | 60 | 60 |
| Balance as of September 30, 2007 | 54,069 | 541 | 117,407 | 502,870 | (6,280) | (14,316) | (574,517) | 40,021 |
| For the three months ended December 31, 2007 (unaudited): | | | | | | | | |
| Net income | | | | 48,469 | | | | 48,469 |
| Other comprehensive income: | | | | | | | | |
| Amortization of pension loss, net of tax | | | | | 98 | | | 98 |
| Net actuarial pension gain | | | | | 2,765 | | | 2,765 |
| Comprehensive income | | | | | | | | 51,332 |
| Exercise of stock options | | | (77) | (19,976) | | 243 | 26,583 | 6,530 |
| Tax benefit from exercise of stock options | | | 8,577 | | | | | 8,577 |
| Stock-based compensation | | | 1,033 | | | | | 1,033 |
| Common shares repurchased | | | | | | (300) | (36,915) | (36,915) |
| Restricted stock cancellations and shares tendered for taxes | | | 77 | | | (2) | (97) | (20) |
| Balance as of December 31, 2007 | 54,069 | 541 | 127,017 | 531,363 | (3,417) | (14,375) | (584,946) | 70,558 |
| For the nine months ended September 30, 2008 (unaudited): | | | | | | | | |
| Net income | | | | 139,948 | | | | 139,948 |
| Other comprehensive income | | | | | | | | -- |
| Comprehensive income | | | | | | | | 139,948 |
| Exercise of stock options | | | | (1,213) | | 51 | 3,484 | 2,271 |
| Tax benefit from exercise of stock options | | | 796 | | | | | 796 |
| Stock-based compensation | | | 5,731 | | | | | 5,731 |
| Common shares repurchased | | | | | | (1,050) | (87,774) | (87,774) |
| Issuance of shares for Directors' compensation | | | | (25) | | 1 | 85 | 60 |
| Restricted stock cancellations | | | 179 | | | (3) | (179) | -- |
| Balance as of September 30, 2008 | 54,069 | \$541 | \$133,723 | \$670,073 | (\$3,417) | (15,376) | (\$669,330) | \$131,590 |

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

ITT EDUCATIONAL SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008

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

1. The Company and Basis of Presentation

We are a leading provider of technology-oriented postsecondary education in the United States based on revenue and student enrollment. As of September 30, 2008, we were offering master, bachelor and associate degree programs to more than 61,000 students. As of September 30, 2008, we had 103 institutes and nine learning sites located in 36 states. All of our institutes are authorized by the applicable education authorities of the states in which they operate and are accredited by an accrediting commission recognized by the U.S. Department of Education ("ED"). We have provided career-oriented education programs since 1969 under the "ITT Technical Institute" name. Our corporate headquarters are located in Carmel, Indiana.

The accompanying unaudited condensed consolidated financial statements include our wholly-owned subsidiaries' accounts and have been prepared in accordance with generally accepted accounting principles in the United States of America for interim periods and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures, including significant accounting policies, normally included in a complete presentation of financial statements prepared in accordance with those principles, rules and regulations have been omitted. The Condensed Consolidated Balance Sheet as of December 31, 2007 was derived from audited financial statements but, as presented in this report, may not include all disclosures required by accounting principles generally accepted in the United States. In the opinion of our management, the financial statements contain all adjustments necessary to fairly state our financial condition and results of operations. The interim financial information should be read in conjunction with the audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K as filed with the SEC for the year ended December 31, 2007.

As disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, we revised the classification for losses from the sale of treasury stock. Our September 30, 2007 retained earnings balance decreased and capital surplus balance increased by \$110,617 from those balances reported in our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2007 to conform to this revised classification. The revised classification did not have an effect on our total shareholders' equity, results of operations or cash flows.

2. Summary of Certain Accounting Policies

Accounts Receivable and Allowance for Doubtful Accounts. We extend unsecured credit to our students for tuition and fees and we record a receivable for the tuition and fees earned in excess of the payment received from or on behalf of a student. The individual student balances of these receivables are insignificant. We record an allowance for doubtful accounts with respect to accounts receivable on an institute-by-institute basis. We review the historical collection experience for each institute, consider other facts and circumstances related to an institute and record an allowance for doubtful accounts based on that review and consideration.

Beginning in the second quarter of 2008, we have extended larger amounts of unsecured credit to our students due to a decrease in private education loans made to our students by third-party lenders. We categorized these receivables based on the credit profiles of our students and recorded an allowance for doubtful accounts based on our historical collection experience related to amounts owed by students with similar credit profiles.

If our collection trends were to differ significantly from our historical collection experience, we would make a corresponding adjustment to our allowance for doubtful accounts. We write off the accounts receivable due from former students when we conclude that collection is not probable.

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Fair Value. In February 2007, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS No. 159”), which permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 was effective for us on January 1, 2008. This pronouncement did not have any effect on our condensed consolidated financial statements, because we did not elect the fair value methodology under SFAS No. 159 for any of our financial instruments or other items that are not currently required to be measured at fair value.

Effective January 1, 2008, we adopted SFAS No. 157, “Fair Value Measurements” (“SFAS No. 157”), for financial assets and financial liabilities measured on a recurring basis. This statement defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures regarding fair value measurements. SFAS No. 157 applies whenever other accounting pronouncements require or permit fair value measurements for assets and liabilities.

In February 2008, the FASB issued FASB Staff Position No. 157-2 (“FSP No. 157-2”), which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We will apply this provision of SFAS No. 157 beginning on January 1, 2009. We do not expect it to have a material effect on our consolidated financial statements, because we do not have any nonfinancial assets or nonfinancial liabilities recognized or disclosed at fair value.

SFAS No. 157 defines fair value for financial reporting as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants at the measurement date. The fair value measurement of our financial assets utilized assumptions categorized as observable inputs under SFAS No. 157. Observable inputs are assumptions based on independent market data sources.

The following table sets forth information regarding the fair value measurement of our financial assets as of September 30, 2008:

| Description | As of 9/30/2008 | Fair Value Measurements at Reporting Date Using | | |
|-------------------------------|-----------------|---|---|---|
| | | (Level 1) Quoted Prices in Active Markets for Identical Assets | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
| Available-for-sale securities | \$150,000 | \$150,000 | \$-- | \$-- |

We used quoted prices in active markets to value our available-for-sale securities.

3. New Accounting Pronouncements

In May 2008, the FASB issued SFAS No. 163, “Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60” (“SFAS No. 163”), which clarifies how FASB Statement No. 60 applies to financial guarantee insurance contracts, including the recognition and measurement of premium revenue and claim liabilities. SFAS No. 163 is effective for fiscal years beginning after December 15, 2008. We do not believe that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

Also in May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"), which identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. SFAS No. 162 will be effective beginning November 15, 2008. We do not believe that the adoption of this guidance will have a material impact on our consolidated financial statements.

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In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133" ("SFAS No. 161"), which expands the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. We do not believe that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS No. 160"), which establishes accounting and reporting standards for the noncontrolling interest of a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We do not believe that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

Also in December 2007, the FASB revised and replaced SFAS No. 141, "Business Combinations," with SFAS No. 141(R), "Business Combinations" ("SFAS No. 141(R)"), which establishes principles and requirements for how a company recognizes and measures assets, liabilities and noncontrolling interests acquired or assumed in a business combination. SFAS No. 141(R) will apply to any of our business combinations or acquisitions after December 31, 2008.

In November 2007, FASB's Emerging Issues Task Force ("EITF") issued EITF 07-01, "Accounting for Collaborative Arrangements" ("EITF 07-01"), which defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-01 is effective for periods beginning after December 15, 2008 and applies to arrangements in existence as of the effective date. We do not believe that the adoption of this guidance will have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("SFAS No. 158"), which requires a company to measure the funded status of a defined benefit postretirement plan as of the date of the company's year-end balance sheet. This provision of SFAS No. 158 is effective for fiscal years ending after December 15, 2008 and will be adopted by us no later than December 31, 2008. We have estimated the effect that the transition to a fiscal year-end measurement date will have on our pension amounts based on measurements determined for the prior fiscal year-end reporting. The change will be recorded in retained earnings in the fourth quarter of 2008 and will not have a material impact on our consolidated financial statements.

4. Equity Compensation

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

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Stock-based compensation expense | \$1,628 | \$896 | \$5,731 | \$4,067 |
| Income tax (benefit) | (\$627) | (\$345) | (\$2,206) | (\$1,565) |

We did not capitalize any stock-based compensation cost in the three or nine months ended September 30, 2008 or 2007.

As of September 30, 2008, we estimated that pre-tax compensation expense for unvested stock-based compensation grants in the amount of approximately \$11,687, 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.

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

| | Nine Months Ended September 30, 2008 | | | | |
|------------------------------------|---|--|---|--|---|
| | # of Shares | Weighted Average Exercise Price | Aggregate Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value ⁽¹⁾ |
| Outstanding at beginning of period | 1,468,993 | \$50.25 | \$73,816 | | |
| Granted | 177,543 | \$86.83 | 15,416 | | |
| Forfeited | (3,334) | \$61.19 | (204) | | |
| Exercised | (50,725) | \$44.77 | (2,271) | | |
| Expired | (6,000) | \$10.83 | (65) | | |
| Outstanding at end of period | 1,586,477 | \$54.64 | \$86,692 | 4.9 years | \$41,670 |
| Exercisable at end of period | 1,247,274 | \$46.42 | \$57,893 | 4.4 years | \$43,024 |

(1) The aggregate intrinsic value of the stock options was calculated by multiplying the number of shares subject to the options outstanding or exercisable, as applicable, by the closing market price of our common stock on September 30, 2008, and subtracting the applicable aggregate exercise price.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Shares subject to stock options granted | -- | -- | 177,543 | 231,362 |
| Weighted average grant date fair value | \$-- | \$-- | \$36.83 | \$29.11 |
| Shares subject to stock options exercised | 43,442 | 215,272 | 50,725 | 1,071,355 |
| Intrinsic value of stock options exercised | \$1,839 | \$16,717 | \$2,096 | \$78,117 |
| Proceeds received from stock options exercised | \$1,996 | \$6,931 | \$2,271 | \$24,472 |
| Tax benefits realized from stock options exercised | \$706 | \$6,429 | \$796 | \$30,011 |

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, | |
|---|-------------|--|-------------|
| 2008 | 2007 | 2008 | 2007 |

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| | | | | |
|---------------------------|----------------|----------------|------|-------------|
| Risk-free interest rates | Not applicable | Not applicable | 2.7% | 4.5% - 4.8% |
| Expected lives (in years) | Not applicable | Not applicable | 4.0 | 4.7 |
| Volatility | Not applicable | Not applicable | 53% | 35% |
| Dividend yield | Not applicable | Not applicable | None | None |

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

| | Nine Months Ended September 30, 2008 | | | |
|---------------------------------|---|------------------------------------|---|-------------------|
| | # of Shares of Restricted Stock | | Weighted Average Grant Date Fair Value | |
| | Weighted Average Grant Date | Weighted Average Grant Date | # of RSUs | Fair Value |
| Unvested at beginning of period | 22,672 | \$61.02 | 58,097 | \$84.40 |
| Granted | -- | -- | 43,419 | 81.32 |
| Forfeited | (3,139) | 59.93 | (6,296) | 84.72 |
| Vested | -- | -- | -- | -- |
| Unvested at end of period | 19,533 | \$61.19 | 95,220 | \$82.98 |

5. Stock Repurchases

As of September 30, 2008, 3,972,100 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 | | Nine Months Ended | |
|-------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Number of shares | 184,700 | 829,100 | 1,049,700 | 2,359,000 |
| Total cost | \$15,971 | \$87,316 | \$87,774 | \$228,079 |
| Average price per share | \$86.47 | \$105.31 | \$83.62 | \$96.68 |

6. Debt

On December 17, 2007, we entered into an Amended and Restated Credit Agreement (the "Credit Agreement") with a single lender to borrow up to \$160,000 under two revolving credit facilities: one in the maximum principal amount of \$50,000; and the other in the maximum principal amount of \$110,000. We can borrow under the credit facilities on either a secured or unsecured basis. The Credit Agreement matures on July 1, 2010.

Borrowings under the Credit Agreement bear interest at the London Interbank Offered Rate ("LIBOR"), plus an applicable margin based on our indebtedness to net worth ratio, adjusted quarterly. We pay a commitment fee of 0.15% per annum of the average daily unused amount of the

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credit facilities. As of September 30, 2008, the borrowings under the Credit Agreement were \$150,000, all of which were secured and bore interest at a rate of 3.31% per annum. Approximately \$157,950 of our investments and cash equivalents served as collateral for the secured borrowings as of September 30, 2008.

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The following table sets forth the interest expense on our borrowings under the Credit Agreement that we recognized in the periods indicated:

| Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|---------|------------------------------------|---------|
| 2008 | 2007 | 2008 | 2007 |
| \$1,012 | \$2,117 | \$3,536 | \$6,248 |

7. Investments

The following table sets forth how our investments were classified on our Condensed Consolidated Balance Sheets as of the dates indicated:

| | As of: September 30, 2008 | | | December 31, 2007 | | | September 30, 2007 | | |
|-------------------------|------------------------------|------------------|-----------|--------------------|------------------|-----------|--------------------|------------------|-----------|
| | Available-for-Sale | Held-to-Maturity | Total | Available-for-Sale | Held-to-Maturity | Total | Available-for-Sale | Held-to-Maturity | Total |
| Short-term investments | \$150,000 | \$-- | \$150,000 | \$303,360 | \$-- | \$303,360 | \$261,760 | \$-- | \$261,760 |
| Non-current investments | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| | \$150,000 | \$-- | \$150,000 | \$303,360 | \$-- | \$303,360 | \$261,760 | \$-- | \$261,760 |

The following table sets forth the aggregate fair market value of our available-for-sale investments as of the dates indicated:

| | As of: | | |
|---------------------------------|--------------------|-------------------|--------------------|
| | September 30, 2008 | December 31, 2007 | September 30, 2007 |
| Available-for-Sale Investments: | | | |
| Auction rate debt securities | \$-- | \$130,575 | \$ 51,175 |
| Variable rate demand notes | \$150,000 | \$172,785 | \$210,585 |
| | \$150,000 | \$303,360 | \$261,760 |

We had no material gross unrealized holding or realized gains (losses) from our investments in auction rate securities and variable rate demand notes in the three or nine months ended September 30, 2008 and 2007. All income generated from those investments was recorded as interest income. The interest income recognized from our investments in the periods indicated was as follows:

| Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|---------|------------------------------------|---------|
| 2008 | 2007 | 2008 | 2007 |
| \$1,563 | \$2,427 | \$4,767 | \$8,006 |

The following table sets forth the contractual maturities of our debt securities classified as available-for-sale as of September 30, 2008:

| Contractual Maturity | Available-for-Sale |
|--|---------------------------|
| Due within five years | \$ -- |
| Due after five years through ten years | 28,150 |
| Due after ten years | 121,850 |
| | \$150,000 |

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8. Earnings Per Common Share

Earnings per common share for all periods have been calculated in conformity with SFAS No. 128, "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, 2008 | | Nine Months Ended September 30, 2008 | |
|---|--|--------|---|--------|
| | 2007 | | 2007 | |
| | (In thousands) | | | |
| Shares: | | | | |
| Weighted average number of shares of common stock outstanding | 38,777 | 39,958 | 38,938 | 40,437 |
| Shares assumed issued (less shares assumed purchased for treasury) for stock-based compensation | 418 | 614 | 353 | 650 |
| Outstanding shares for diluted earnings per share calculation | 39,195 | 40,572 | 39,291 | 41,087 |

A total of 265,825 shares at September 30, 2008 and 0 shares at September 30, 2007 were excluded from the calculation of our diluted earnings per common share because the effect was anti-dilutive.

9. Employee Pension Benefits

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------|---|-------------|--|-------------|
| | 2008 | 2007 | 2008 | 2007 |
| Interest cost | \$769 | \$769 | \$2,307 | \$2,307 |
| Expected return on assets | (1,307) | (1,202) | (3,921) | (3,606) |
| Recognized net actuarial loss | -- | 138 | -- | 414 |
| Net periodic pension (benefit) | (\$538) | (\$295) | (\$1,614) | (\$885) |

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 or amortization of prior service cost have been included in the net periodic pension benefit.

We made no contributions to the ESI Pension Plan during the three or nine months ended September 30, 2008 and 2007. We do not expect to make any contributions to the ESI Pension Plan in 2008.

10. 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, 2008, the total face amount of those surety bonds was approximately \$19,464.

We are also 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 institutes to additional regulatory scrutiny.

Guarantees. In October 2007, we entered into a risk sharing agreement (“RSA”) with an unaffiliated lender for private education loans to be provided to our students by or through that lender to help pay the students’ cost of education that student financial aid from federal, state and other sources do not cover. Under the RSA, if more than a certain percentage of the private education loans, based on dollar volume, are charged off by the lender, we guarantee the repayment of any private education loans that the lender charges off above that percentage. Our obligations under the RSA will remain in effect until all private education loans made under the RSA are paid in full or charged off by the lender. We will have the right to pursue repayment from the borrowers for those charged off private education loans under the RSA that we pay to the lender pursuant to our guarantee obligation. The RSA was terminated effective February 22, 2008, such that no private education loans have been made under the RSA after that date.

The RSA requires that we comply with certain covenants, including that we maintain certain financial ratios which are measured as of December 31 in each year. If we are not in compliance with those ratios at any measurement date, we are obligated to provide the lender with a letter of credit in an amount based on a percentage of the outstanding private education loans under the RSA that have not been paid in full or charged off from time to time.

The maximum potential future payments that we could be required to make pursuant to our guarantee obligation under the RSA are affected by:

- the amount of the private education loans made under the RSA;
- the fact that those loans consist of a large number of loans of individually immaterial amounts;
- the interest and fees associated with those loans;
- the repayment performance of those loans; and
- when during the life of those loans they are charged off.

As a result, we are not able to estimate the undiscounted maximum potential future payments that we could be required to make under the RSA. Our recorded liability related to the RSA as of September 30, 2008 was not material.

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:

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- *business conditions and growth in the postsecondary education industry and in the general economy;*
- *changes in federal and state governmental regulations with respect to education and accreditation standards, or the interpretation or enforcement of those 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;*
- *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 institutes;*
- *our ability to implement our growth strategies;*
- *our failure to maintain or renew required regulatory authorizations or accreditation of our institutes;*

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- *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; 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, 2007 filed with the SEC and those discussed in Part II, Item 1A. "Risk Factors." of our Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2008 and 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 "institute" (in singular or plural form) refer to an individual school owned and operated by ITT/ESI, including its learning sites, if any. The terms "institution" or "campus group" (in singular or plural form) mean 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, 2007 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 federal student financial aid programs under Title IV (the "Title IV Programs") of the Higher Education Act of 1965, as amended (the "HEA");
 - 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 education loans;
- 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.

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Background

We are a leading provider of technology-oriented postsecondary education programs in the United States based on revenue and student enrollment. As of September 30, 2008, we were offering master, bachelor and associate degree programs to more than 61,000 students. As of September 30, 2008, we had 103 institutes and nine learning sites of those institutes located in 36 states. All of our institutes are authorized by the applicable education authorities of the states in which they operate, and are accredited by an accrediting commission recognized by the ED. We design our education programs, after consultation with employers, 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.

In the third quarter of 2008, we began operations at one new institute. We plan to begin operations at up to two additional locations in 2008. Our overall expansion plans include:

- operating new institutes;
- adding learning sites to existing institutes;
- offering a broader range of both residence and online programs at our existing institutes; and
- increasing the number of our institutes that offer bachelor degree programs.

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, 2007 filed with the SEC. There have been no material changes to those critical accounting policies or the underlying accounting estimates or judgments, except as discussed below.

Accounts Receivable and Allowance for Doubtful Accounts. We extend unsecured credit to our students for tuition and fees and we record a receivable for the tuition and fees earned in excess of the payment received from or on behalf of a student. The individual student balances of these receivables are insignificant. We record an allowance for doubtful accounts with respect to accounts receivable on an institute-by-institute basis. We review the historical collection experience for each institute, consider other facts and circumstances related to an institute and record an allowance for doubtful accounts based on that review and consideration.

Beginning in the second quarter of 2008, we have extended larger amounts of unsecured credit to our students due to a decrease in private education loans made to our students by third-party lenders. We categorized these receivables based on the credit profiles of our students and recorded an allowance for doubtful accounts based on our historical collection experience related to amounts owed by students with similar credit profiles.

If our collection trends were to differ significantly from our historical collection experience, we would make a corresponding adjustment to our allowance for doubtful accounts. We write off the accounts receivable due from former students when we conclude that collection is not

probable.

Fair Value. Effective January 1, 2008, we adopted SFAS No. 157 for financial assets and financial liabilities measured on a recurring basis. This statement defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures regarding fair value measurements. SFAS No. 157 applies whenever other accounting pronouncements require or permit fair value measurements for assets and liabilities.

In February 2008, the FASB issued FSP No. 157-2, which delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We will apply this provision of SFAS No. 157 beginning on January 1, 2009. We do not expect it to have a material effect on our consolidated financial statements, because we do not have any nonfinancial assets or nonfinancial liabilities recognized or disclosed at fair value.

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SFAS No. 157 defines fair value for financial reporting as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants at the measurement date. The fair value measurement of our financial assets utilized assumptions categorized as observable inputs under SFAS No. 157. Observable inputs are assumptions based on independent market data sources.

The following table sets forth information regarding the fair value measurement of our financial assets as of September 30, 2008:

| Description | As of 9/30/2008 | Fair Value Measurements at Reporting Date Using | | |
|-------------------------------|-----------------|---|---|---|
| | | (Level 1) Quoted Prices in Active Markets for Identical Assets (In thousands) | (Level 2) Significant Other Observable Inputs | (Level 3) Significant Unobservable Inputs |
| Available-for-sale securities | \$150,000 | \$150,000 | \$-- | \$-- |

We used quoted prices in active markets to value our available-for-sale securities.

New Accounting Pronouncements

In May 2008, the FASB issued SFAS No. 163, which clarifies how FASB Statement No. 60 applies to financial guarantee insurance contracts, including the recognition and measurement of premium revenue and claim liabilities. SFAS No. 163 is effective for fiscal years beginning after December 15, 2008. We do not believe that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

Also in May 2008, the FASB issued SFAS No. 162, which identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. SFAS No. 162 will be effective beginning November 15, 2008. We do not believe that the adoption of this guidance will have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, which permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 was effective for us on January 1, 2008. This pronouncement did not have any effect on our condensed consolidated financial statements, because we did not elect the fair value methodology under SFAS No. 159 for any of our financial instruments or other items that are not currently required to be measured at fair value.

In March 2008, the FASB issued SFAS No. 161, which expands the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. We do not believe that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, which establishes accounting and reporting standards for the noncontrolling interest of a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. We do not believe that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

Also in December 2007, the FASB revised and replaced SFAS No. 141 with SFAS No. 141(R), which establishes principles and requirements for how a company recognizes and measures assets, liabilities and noncontrolling interests acquired or assumed in a business combination. SFAS No. 141(R) will apply to any of our business combinations or acquisitions after December 31, 2008.

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In November 2007, FASB's EITF issued EITF 07-01, which defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. EITF 07-01 is effective for periods beginning after December 15, 2008 and applies to arrangements in existence as of the effective date. We do not believe that the adoption of this guidance will have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, which requires a company to measure the funded status of a defined benefit postretirement plan as of the date of the company's year-end balance sheet. This provision of SFAS No. 158 is effective for fiscal years ending after December 15, 2008 and will be adopted by us no later than December 31, 2008. We have estimated the effect that the transition to a fiscal year-end measurement date will have on our pension amounts based on measurements determined for the prior fiscal year-end reporting. The change will be recorded in retained earnings in the fourth quarter of 2008 and will not have a material impact on our 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 | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Revenue | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of educational services | 37.4% | 40.7% | 38.4% | 42.3% |
| Student services and administrative expenses | 30.8% | 30.4% | 30.9% | 31.9% |
| Operating income | 31.8% | 28.9% | 30.7% | 25.8% |
| Interest income, net | 0.2% | 0.1% | 0.2% | 0.3% |
| Income before provision for income taxes | 32.0% | 29.0% | 30.9% | 26.1% |

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

| | 2008 | | 2007 | |
|--------------------------|-------------------|-------------------|-------------------|-------------------|
| | Total | Increase | Total | Increase |
| Total Student | Student | Over | Student | Over |
| Enrollment as of: | Enrollment | Prior Year | Enrollment | Prior Year |
| March 31 | 54,194 | 9.9% | 49,295 | 12.4% |
| June 30 | 54,793 | 12.1% | 48,873 | 11.0% |
| September 30 | 61,556 | 14.7% | 53,675 | 11.5% |
| December 31 | Not applicable | Not applicable | 53,027 | 13.1% |

Total student enrollment includes all new and continuing students. A continuing student is any student who, in the academic quarter being measured, is enrolled in a program of study at an ITT Technical Institute and was enrolled in the same program at any ITT Technical Institute at the end of the immediately preceding academic quarter. A new student is any student who, in the academic quarter being measured, enrolls in and begins attending any program of study at an ITT Technical Institute:

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

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

| New Student Enrollment in the Three Months Ended: | 2008 | | 2007 | |
|--|---------------------------------------|---|---------------------------------------|---|
| | New Student Enrollment | Increase Over Prior Year | New Student Enrollment | Increase Over Prior Year |
| March 31 | 13,844 | 8.7% | 12,738 | 13.1% |
| June 30 | 14,751 | 22.5% | 12,043 | 3.2% |
| September 30 | 21,807 | 19.4% | 18,270 | 8.8% |
| December 31 | Not applicable | Not applicable | 11,542 | 13.1% |
| Total for the year | Not applicable | Not applicable | 54,593 | 9.3% |

We generally organize the academic schedule for programs of study offered at our institutes on the basis of four 12-week academic quarters in a calendar year that 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 quarter is divided by the total student enrollment in the immediately preceding academic quarter.

The following table sets forth the rates of our students' persistence for the periods indicated:

| Year | Student Persistence for the Three Months Ended: | | | |
|-------------|--|----------------|---------------------|--------------------|
| | March 31 | June 30 | September 30 | December 31 |
| 2006 | 75.8% | 73.7% | 71.2% | 76.2% |
| 2007 | 78.0% | 74.7% | 72.4% | 77.3% |
| 2008 | 76.1% | 73.9% | 72.5% | Not applicable |

Changes that we made to how we deliver certain program courses, primarily those courses taught either entirely or partially online over the Internet, have impacted our students' persistence over the past several years. Student retention is typically lower in the courses that we teach online over the Internet compared to the courses that we teach in residence on campus. Our students' persistence decreased as a result of teaching certain courses online over the Internet. In the second quarter of 2006, we began modifying the academic qualifications for students to take online courses, which led to year-over-year improvements in persistence in each quarter of 2007 as compared to 2006. The decrease in the student persistence rate in the first quarter of 2008 compared to the same period in 2007 was primarily due to a change in our 2008 academic calendar, which eliminated a break in classes in the first quarter of 2008 compared to the first quarter of 2007. We believe that this change in the academic calendar resulted in approximately 500 additional student withdrawals occurring in the first quarter of 2008 than would have occurred if we had not changed the academic calendar. The decrease in the student persistence rate in the three months ended June 30, 2008 compared to the same period in 2007 was primarily due to a higher number of students who graduated at the end of the March 2008 academic quarter compared to the end of the March 2007 academic quarter.

Three Months Ended September 30, 2008 Compared with Three Months Ended September 30, 2007. Revenue increased \$36.3 million, or 16.7%, to \$254.3 million in the three months ended September 30, 2008 compared to \$217.9 million in the three months ended September 30, 2007, primarily due to:

- a 12.1% increase in total student enrollment at June 30, 2008 compared to June 30, 2007; and

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- a 5.0% increase in tuition rates in March 2008.

The increase in student enrollment was primarily due to:

- student enrollment growth in programs of study and at locations that were in existence prior to 2007;
- new programs of study offered by our institutes; and
- operating new institutes.

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Cost of educational services increased \$6.2 million, or 7.0%, to \$95.0 million in the three months ended September 30, 2008 compared to \$88.8 million in the three months ended September 30, 2007, primarily due to:

- increased costs associated with operating new institutes and learning sites; and
- the costs required to service the increased total student enrollment.

The increase in cost of educational services was partially offset by:

- greater efficiencies in the operation of our institutes; and
- decreased costs associated with decreased sales of laptop computers.

Cost of educational services as a percentage of revenue decreased 330 basis points to 37.4% in the three months ended September 30, 2008 compared to 40.7% in the three months ended September 30, 2007, primarily due to greater efficiencies in the operation of our institutes. The decrease in cost of educational services as a percentage of revenue was partially offset by the costs associated with operating new institutes.

Student services and administrative expenses increased \$12.3 million, or 18.6%, to \$78.5 million in the three months ended September 30, 2008 compared to \$66.2 million in the three months ended September 30, 2007. The principal causes of this increase included:

- an increase in bad debt expense associated with increases in internally funded student financing;
- an increase in media advertising costs; and
- an increase in compensation and benefit costs associated with a greater number of employees.

Student services and administrative expenses increased to 30.8% of revenue in the three months ended September 30, 2008 compared to 30.4% of revenue in the three months ended September 30, 2007, primarily due to an increase in bad debt expense. The increase in student services and administrative expenses as a percentage of revenue was partially offset by media advertising costs and compensation and benefit costs increasing at a lower rate than the increase in revenue. Bad debt expense as a percentage of revenue increased to 5.0% in the three months ended September 30, 2008 compared to 1.8% in the three months ended September 30, 2007. We believe that our bad debt expense as a percentage of revenue could increase further during the remainder of 2008, primarily due to increases in internally funded student financing.

Operating income increased \$17.8 million, or 28.4%, to \$80.8 million in the three months ended September 30, 2008 compared to \$62.9 million in the three months ended September 30, 2007. The operating margin increased to 31.8% in the three months ended September 30, 2008 compared to 28.9% in the three months ended September 30, 2007.

Interest income decreased \$0.9 million, or 35.7%, to \$1.6 million in the three months ended September 30, 2008 compared to \$2.4 million in the three months ended September 30, 2007, primarily due to a decrease in investment returns in the overall market and a more conservative

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investment strategy. Interest expense decreased \$1.1 million, or 52.3%, to \$1.0 million in the three months ended September 30, 2008 compared to \$2.1 million in the three months ended September 30, 2007, primarily due to a decrease in the effective interest rate on our revolving credit facilities.

Our combined federal and state effective income tax rate was 38.3% in the three months ended September 30, 2008 compared to 37.3% in the three months ended September 30, 2007. The increase in our combined federal and state effective income tax rate was primarily due to less tax-exempt interest income and certain expenses that were not deductible for income tax purposes.

Nine Months Ended September 30, 2008 Compared with Nine Months Ended September 30, 2007. Revenue increased \$96.4 million, or 15.1%, to \$735.5 million in the nine months ended September 30, 2008 compared to \$639.1 million in the nine months ended September 30, 2007, primarily due to:

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- a 5.0% increase in tuition rates in March 2008 and March 2007;
- a 12.1% increase in total student enrollment at June 30, 2008 compared to June 30, 2007;
- a 9.9% increase in total student enrollment at March 31, 2008 compared to March 31, 2007; and
- a 13.1% increase in total student enrollment at December 31, 2007 compared to December 31, 2006.

The increase in student enrollment was primarily due to:

- student enrollment growth in programs of study and at locations that were in existence prior to 2007;
- new programs of study offered by our institutes; and
- operating new institutes.

Cost of educational services increased \$12.0 million, or 4.5%, to \$282.2 million in the nine months ended September 30, 2008 compared to \$270.2 million in the nine months ended September 30, 2007, primarily due to:

- increased costs associated with operating new institutes; and
- the costs required to service the increased total student enrollment.

The increase in cost of educational services was partially offset by:

- greater efficiencies in the operation of our institutes;
- lower amortization expense due to certain assets being fully amortized in 2007; and
- decreased costs associated with decreased sales of laptop computers.

Cost of educational services as a percentage of revenue decreased 390 basis points to 38.4% in the nine months ended September 30, 2008 from 42.3% in the nine months ended September 30, 2007, primarily due to greater efficiencies in the operation of our institutes and decreased costs associated with decreased sales of laptop computers. The decrease in cost of educational services as a percentage of revenue was partially offset by the costs associated with operating new institutes.

Student services and administrative expenses increased \$23.3 million, or 11.4%, to \$227.5 million in the nine months ended September 30, 2008 compared to \$204.2 million in the nine months ended September 30, 2007. The principal causes of this increase included:

- an increase in bad debt expense associated with increases in internally funded student financing;
- an increase in compensation and benefit costs associated with a greater number of employees; and
- an increase in media advertising expenditures.

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The increase in student services and administrative expenses was partially offset by an increase in direct marketing costs which were capitalized.

Student services and administrative expenses decreased to 30.9% of revenue in the nine months ended September 30, 2008 compared to 31.9% of revenue in the nine months ended September 30, 2007, primarily due to media advertising costs and compensation and benefit costs increasing at a lower rate than the increase in revenue. The decrease in student services and administrative expenses as a percentage of revenue was partially offset by an increase in bad debt expense. Bad debt expense as a percentage of revenue increased to 4.0% in the nine months ended September 30, 2008 compared to 2.2% in the nine months ended September 30, 2007.

Operating income increased \$61.1 million, or 37.1%, to \$225.8 million in the nine months ended September 30, 2008 compared to \$164.7 million in the nine months ended September 30, 2007. The operating margin increased to 30.7% of revenue in the nine months ended September 30, 2008 compared to 25.8% in the nine months ended September 30, 2007.

Interest income decreased \$3.4 million, or 41.6%, to \$4.8 million in the nine months ended September 30, 2008 compared to \$8.2 million in the nine months ended September 30, 2007, primarily due to a decrease in investment returns in the overall market and a more conservative investment strategy. Interest expense decreased \$2.7 million, or 43.1%, to \$3.6 million in the nine months ended September 30, 2008 compared to \$6.3 million in the nine months ended September 30, 2007, primarily due to a decrease in the effective interest rate on our revolving credit facilities.

Our combined federal and state effective income tax rate was 38.3% in the nine months ended September 30, 2008 compared to 38.1% in the nine months ended September 30, 2007.

Financial Condition, Liquidity and Capital Resources

Cash and cash equivalents were \$136.7 million as of September 30, 2008 compared to \$7.2 million as of December 31, 2007 and \$10.3 million as of September 30, 2007. We also had short-term investments of \$150.0 million as of September 30, 2008 compared to \$303.4 million as of December 31, 2007 and \$261.8 million as of September 30, 2007. The increase in our cash and cash equivalents and the decrease in our short-term investments as of September 30, 2008 compared to December 31, 2007 and September 30, 2007, were primarily due to the execution of a revised investment strategy focused on liquidity in response to uncertainty in the capital markets. In total, our cash and cash equivalents and short-term investments were \$286.7 million as of September 30, 2008 compared to \$310.6 million as of December 31, 2007 and \$272.1 million as of September 30, 2007. The total amount of cash and cash equivalents and short-term investments as of September 30, 2008 was negatively impacted by a decrease in funds received from private education loans made to our students by third-party lenders. This negative impact was partially offset by a decrease in the amount spent to repurchase shares of our common stock.

We are required to recognize the funded status of our defined benefit postretirement plans on our balance sheet. As of September 30, 2008, the balance recognized for the ESI Pension Plan, a non-contributory defined benefit pension plan commonly referred to as a cash balance plan, was an asset of \$16.5 million and the balance recognized for the ESI Excess Pension Plan, a nonqualified, unfunded retirement plan, was a liability of \$0.7 million.

We do not expect to make any contribution to the ESI Pension Plan in 2008.

Operations. Cash from operating activities increased \$6.1 million to \$59.0 million in the three months ended September 30, 2008 compared to \$52.9 million in the three months ended September 30, 2007 primarily due to an increase in operating income and certain Title IV Program loan funds. The increase in operating cash flow was partially offset by:

- a decrease in funds received from private education loans made to our students by third-party lenders; and
- higher income tax payments primarily resulting from lower tax benefits from the exercise of stock options.

Cash from operating activities decreased \$21.9 million to \$90.1 million in the nine months ended September 30, 2008 compared to \$112.0 million in the nine months ended September 30, 2007, primarily due to:

- a decrease in funds received from private education loans made to our students by third-party lenders; and
- higher income tax payments primarily resulting from lower tax benefits from the exercise of stock options.

The decrease in cash from operating activities was partially offset by:

- an increase in operating income;
- an increase in certain Title IV Program loan funds; and
- the timing of payroll payments.

See “—Student Financing Update” below for a discussion of the impact on our liquidity and cash flows from operations as a result of increases in internally funded student financing.

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Accounts receivable less allowance for doubtful accounts was \$33.3 million as of September 30, 2008 compared to \$16.4 million as of September 30, 2007. Days sales outstanding was 12.1 days at September 30, 2008 compared to 6.9 days at September 30, 2007. Both increases were primarily due to increases in internally funded student financing. We believe that our days sales outstanding could increase further during the remainder of 2008, primarily due to increases in internally funded student financing.

Investing. In the three months ended September 30, 2008, we spent \$3.9 million to renovate, expand or construct buildings at 14 of our locations, compared to \$2.8 million for similar expenditures at eight facilities in the three months ended September 30, 2007. In the nine months ended September 30, 2008, we spent \$1.5 million to purchase a parcel of land on which we are building a facility and \$15.6 million to purchase, renovate, expand or construct buildings at 17 of our locations compared to \$11.5 million for similar expenditures at 14 facilities in the nine months ended September 30, 2007. We do not currently intend to purchase any additional properties or facilities during the remainder of 2008, but we do expect to incur additional expenditures to continue renovating, expanding and constructing facilities.

Capital expenditures, excluding facility and land purchases and facility construction, totaled:

- \$4.3 million in the three months ended September 30, 2008 compared to \$4.4 million in the three months ended September 30, 2007; and
- \$12.1 million in the nine months ended September 30, 2008 compared to \$11.3 million in the nine months ended September 30, 2007.

These expenditures consisted primarily of classroom and laboratory equipment (such as computers and electronic equipment), classroom and office furniture, software and leasehold improvements. We plan to continue to upgrade and expand current facilities and equipment throughout the remainder of 2008. Cash generated from operations is expected to be sufficient to fund our capital expenditure requirements.

Financing. On December 17, 2007, we entered into the Credit Agreement to borrow up to \$160.0 million under two revolving credit facilities: one in the maximum principal amount of \$50.0 million; and the other in the maximum principal amount of \$110.0 million. The borrowings under the Credit Agreement were used to allow us to continue repurchasing shares of our common stock while maintaining compliance with certain financial ratios required by the ED, the state education authorities that regulate our institutes and the accrediting agency that accredits our institutes.

Both lines of credit under the Credit Agreement mature on July 1, 2010. The borrowings under each line of credit may be secured or unsecured at our election, provided that we have not defaulted under the Credit Agreement, in which case, any borrowings made on a secured basis must remain secured. Investments held in a pledged account serve as the collateral for any secured borrowings under the Credit Agreement.

Borrowings under the Credit Agreement bear interest at LIBOR plus an applicable margin based on our indebtedness to net worth ratio, adjusted quarterly. We pay a commitment fee of 0.15% per annum of the average daily unused amount of the credit facilities. As of September 30, 2008, the borrowings under the Credit Agreement were \$150.0 million, all of which were secured, and bore interest at a rate of 3.31% per annum. Approximately \$158.0 million of our investments and cash equivalents served as collateral for the secured borrowings as of September 30, 2008.

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The availability of borrowings under the Credit Agreement is subject to our ability at the time of borrowing to satisfy certain specified conditions. These conditions include the absence of default by us, as defined in the Credit Agreement, and that certain representations and warranties contained in the Credit Agreement continue to be true and accurate. We are also required to maintain a certain maximum leverage ratio and a minimum ratio of cash and investments to outstanding indebtedness at the end of each of our fiscal quarters. We were in compliance with those ratio requirements as of September 30, 2008.

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:

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|--|----------|---------------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| | (Dollars in thousands, except per share data) | | | |
| Number of shares | 184,700 | 829,100 | 1,049,700 | 2,359,000 |
| Total cost | \$15,971 | \$87,316 | \$87,774 | \$228,079 |
| Average price per share | \$86.47 | \$105.31 | \$83.62 | \$96.68 |

The shares that remained available for repurchase under the Repurchase Program were 3,972,100 as of September 30, 2008. We may repurchase additional shares of our common stock under the Repurchase Program, from time to time, in the future depending on market conditions and other considerations.

We believe that cash generated from operations and our investments will be adequate to satisfy our working capital and capital expenditure requirements for the foreseeable future. We also believe that any reduction in cash and cash equivalents or investments that may result from their use to provide student financing, purchase facilities, construct facilities 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. We continue to work with new lenders for them to provide private education loans to our students. The tighter credit markets, along with the time required to integrate third-party lenders, has resulted in us providing increased internally funded financing to our students. We intend to maintain our current admission standards and to continue providing internally funded financing to our students who fail to qualify for private education loans made by third-party lenders. We may also enter into additional risk sharing or other guarantee arrangements with third-party lenders in order to help our students qualify for private education loans from those third-party lenders.

We indirectly derived approximately 29% of our revenue in 2007, and approximately 34% of our revenue in 2006, from private education loan programs. Primarily as a result of the Continued Access Act and its increases in the level of certain Title IV Program loans, we anticipate a decline in the percentage of our revenue that we indirectly derive from private education loans made to our students, including internally funded student financing, in 2008. Although we cannot quantify with certainty the effect that the increases in those Title IV Program loans will have on the amount of our revenue that is derived from private education loans made to our students, we believe that the percentage of our revenue that we indirectly derive from private education loans, including internally funded student financing, in 2008 could be in the range of 12% to 13%. We are still in the early stages of data collection and experience with new third-party lenders of private education loans to our students and, therefore, we are not yet able to predict with certainty the portion of our revenue in 2008 that will be derived from private education loans made by third-party lenders or the portion that will be internally funded by us.

The increased internally funded financing that we are providing to our students could further negatively impact our liquidity and exposes us to new and greater credit risk. Internally funded financing provides for payments to us by our students over an extended term, which could have a material adverse effect on our cash flows from operations in 2008. In addition, we have the risk of collection with respect to our internally funded financing, which could continue to cause us to increase our allowance for doubtful accounts in 2008 compared to prior year periods and result in an increase in our bad debt expense as a percentage of revenue in 2008 compared to prior year periods. We believe that our bad debt expense as a percentage of revenue for the full year of 2008 will exceed the historical range of 1% to 3%. Increases in our bad debt expense in 2008 will continue to result in increased student services and administrative expenses in 2008 compared to prior year periods.

Further, increases in internally funded financing will continue to increase our accounts receivable and our days sales outstanding in 2008 compared to prior year periods. We believe that our days sales outstanding in 2008 will continue to exceed the historical range of six to eight days.

In our experience so far in 2008, lenders have continued to make Title IV Program loans to our students. We have, however, prepared our institutes in the event that our students need to access the William D. Ford Federal Direct Loan Program for Title IV Program loans in the future.

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Contractual Obligations

The following table sets forth our specified contractual obligations as of September 30, 2008:

| Contractual Obligations | Payments Due by Period | | | | |
|--|---------------------------------|-----------------------------|----------------------|----------------------|------------------------------|
| | Total (In thousands) | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
| Operating lease obligations | \$153,334 | \$33,789 | \$56,191 | \$37,786 | \$25,568 |
| Long-term debt, including scheduled interest payments | \$158,687 | \$4,964 | \$153,723 | \$-- | \$-- |
| Total | \$312,021 | \$38,753 | \$209,914 | \$37,786 | \$25,568 |

The long-term debt represents our revolving credit facilities under the Credit Agreement and assumes that the amounts outstanding under the facilities as of September 30, 2008 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. Interest payments have been calculated based on their scheduled payment dates using the interest rate charged on our borrowings as of September 30, 2008.

Off-Balance Sheet Arrangements

As of September 30, 2008, 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 15 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, 2008, the total face amount of those surety bonds was approximately \$19.5 million.

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In October 2007, we entered into the RSA with an unaffiliated lender for private education loans to be provided to our students by or through that lender to help pay the students' cost of education that student financial aid from federal, state and other sources do not cover. Under the RSA, if more than a certain percentage of the private education loans, based on dollar volume, are charged off by the lender, we guarantee the repayment of any private education loans that the lender charges off above that percentage. The RSA was terminated effective February 22, 2008, such that no private education loans have been made under the RSA after that date. Our recorded liability related to the RSA as of September 30, 2008 was not material. Based on the prior repayment history of our students with respect to private education loans, we do not believe that our guarantee obligation under the RSA will have a material adverse effect on our financial condition, results of operations or cash flows. See Note 10 of the Notes to Condensed Consolidated Financial Statements for further discussion of the RSA.

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 return on our investments and the cost of our financing activities. Our primary interest rate risk exposure results from changes in short-term interest rates and the LIBOR.

Our investments consist primarily of variable rate demand notes. We estimate that the market risk associated with these investments can best be measured by a potential decrease in the fair value of these investments from a hypothetical 10% increase in interest rates. If such a hypothetical increase in rates were to occur, the reduction in the market value of our portfolio of marketable securities would not be material.

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 results from operations and cash flow would not have been material for the three and nine months ended September 30, 2008.

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 2008, 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.

(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 institutes to additional regulatory scrutiny.

Item 1A. Risk Factors.

You should carefully consider the risks and uncertainties we describe in both our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 and our Quarterly Reports on Form 10-Q 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 or cash flows could be materially adversely affected. Except as set forth below, 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, 2007 and current report on Form 10-Q for the fiscal quarter ended June 30, 2008.

Action by the U.S. Congress to revise the laws governing the federal student financial aid programs or reduce funding for those programs could reduce our student population and increase our costs of operation. Political and budgetary concerns significantly affect Title IV Programs. The U.S. Congress enacted the HEA to be reauthorized on a periodic basis, which most recently occurred in August 2008. The 2008 reauthorization of the HEA, called the Higher Education Opportunity Act (“HEOA”), made significant changes to the requirements governing the Title IV Programs, including changes that, among other things:

- regulate non-federal, private education loans;
- regulate the relationship between institutions and lenders that make education loans;
- increase the annual maximum amount and availability of Pell grants;
- increase the amount of financial aid available to active military personnel and family members;
- revise the calculation of the student default rate on the Federal Family Education Loan (“FFEL”) and the William D. Ford Federal Direct Loan (“FDL”) program loans attributed to an institution and the threshold rate at which sanctions will be imposed against an institution;
- adjust the types of revenue that an institution is deemed to have derived from Title IV Programs and the sanctions imposed on an institution that derives too much revenue from Title IV Programs;
- increase the type and amount of information that an institution must disclose to current and prospective students and the public; and
- increase the types of policies and practices that an institution must adopt and follow.

Some of the changes to the requirements governing the Title IV Programs will increase our administrative burden, but we do not believe that the increased burden will have a material adverse effect on our operations.

In addition, the U.S. Congress can change the laws affecting Title IV Programs in the annual federal appropriations bills and other laws it enacts between the HEA reauthorizations. In May 2008, the U.S. Congress enacted the Ensuring Continued Access to Student Loans Act of 2008 (“Continued Access Act”) which, among other things:

- increased the annual and total amount of certain Title IV Program loans that students can receive;
- expanded student eligibility for, and potentially increased the amount of funds available to fund grants under, certain Title IV Programs;
- expanded parent eligibility and created payment deferment options for parent loans under the Title IV Programs; and
- authorized the ED to purchase certain Title IV Program loans from lenders until July 1, 2009 (which period was extended until July 1, 2010 by the U.S. Congress in September 2008).

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We believe that most of the changes to the Title IV Programs in the Continued Access Act are positively impacting our students' ability to fund their educational expenses.

Although the Continued Access Act was intended to encourage third-party lenders to continue to provide, or to begin to again provide, FFEL program loans, we cannot assure you that it will have its intended effect or that our students will be able to continue to obtain FFEL program loans from third-party lenders. All of our institutes are prepared to participate in the FDL program in the event our students are unable to obtain FFEL program loans from third-party lenders. As a result, we do not believe that our students' loss of access to FFEL program loans from third-party lenders would have a material adverse effect on our cash flows, financial condition or operations.

Numerous changes to the HEA may result from other laws that may be passed, but at this time we cannot predict all of the changes that the U.S. Congress will ultimately make. Since a significant percentage of our revenue is indirectly derived from Title IV Programs, any action by the U.S. Congress that significantly reduces Title IV Program funding or the ability of our institutes or students to participate in Title IV Programs could have a material adverse effect on our financial condition, results of operations and cash flows.

If one or more of our institutes lost its eligibility to participate in Title IV Programs, or if the U.S. Congress significantly reduced the amount of available Title IV Program funding, we would try to arrange or provide alternative sources of financial aid for the students at the affected institutes. We cannot assure you that one or more private organizations would be willing to provide loans to students attending those institutes or that the interest rate and other terms of those loans would be as favorable as for Title IV Program loans. In addition, the private organizations could require us to guarantee all or part of this assistance on terms that are less favorable to us than our guarantee obligation under the RSA, and we might incur other additional costs. If we provided more direct financial assistance to our students, we would incur additional costs and assume increased credit risks.

Legislative action may also increase our administrative costs and burden and require us to modify our practices in order for our institutes to comply fully with the legislative requirements, which could have a material adverse effect on our financial condition or results of operations.

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

The following table sets forth information regarding purchases made by us of shares of our common stock on a monthly basis in the three months ended September 30, 2008:

| Issuer Purchases of Equity Securities | | | | |
|--|---|-------------------------------------|--|--|
| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾ | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs ⁽¹⁾ |
| July 1, 2008 through July 31, 2008 | -- | \$-- | -- | 4,156,800 |
| August 1, 2008 through August 31, 2008 | 184,700 | 86.47 | 184,700 | 3,972,100 |
| September 1, 2008 through September 30, 2008 | -- | -- | -- | 3,972,100 |
| Total | 184,700 | \$86.47 | 184,700 | |

(1) Our Board of Directors has authorized us to repurchase the following number of shares of our common stock pursuant to the Repurchase Program:

| Number of Shares | Board Authorization Date |
|-------------------------|---------------------------------|
| 2,000,000 | April 1999 |
| 2,000,000 | April 2000 |
| 5,000,000 | October 2002 |
| 5,000,000 | April 2006 |
| 5,000,000 | April 2007 |

The shares that remained available for repurchase under the Repurchase Program were 3,972,100 as of September 30, 2008. 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 Exchange Act. 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.

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 23, 2008

By: /s/ Daniel M. Fitzpatrick

Daniel M. Fitzpatrick

*Senior Vice President, Chief Financial Officer
(Duly Authorized Officer, Principal Financial Officer
and Principal Accounting Officer)*

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 2008 second fiscal quarter report on Form 10-Q) |
| 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 |