

LINCOLN EDUCATIONAL SERVICES CORP  
Form 10-Q  
August 08, 2014

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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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 June 30, 2014

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

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Commission File Number 000-51371

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LINCOLN EDUCATIONAL SERVICES CORPORATION  
(Exact name of registrant as specified in its charter)

New Jersey 57-1150621  
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)

200 Executive Drive, Suite 340 07052  
West Orange, NJ (Zip Code)  
(Address of principal executive offices)

(973) 736-9340  
(Registrant's telephone number, including area code)

No change  
(Former name, former address and former fiscal year, if changed since last report)

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

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of August 6, 2014, there were 24,099,629 shares of the registrant’s common stock outstanding.

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LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES

INDEX TO FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

|   | June 30,<br>2014<br>(Unaudited) | December<br>31,<br>2013 |
|---|---------------------------------|-------------------------|
| <b>ASSETS</b>   |                                 |                         |
| <b>CURRENT ASSETS:</b>  |                                 |                         |
| Cash and cash equivalents   | \$ 6,759                        | \$ 12,886               |
| Restricted cash   | -                               | 54,500                  |
| Accounts receivable, less allowance of \$13,738 and \$13,787 at June 30, 2014 and December 31, 2013, respectively   | 18,569                          | 16,127                  |
| Inventories   | 2,193                           | 2,269                   |
| Prepaid income taxes and income taxes receivable  | 8,010                           | 8,517                   |
| Assets held for sale  | 6,310                           | 6,310                   |
| Prepaid expenses and other current assets   | 4,088                           | 3,013                   |
| Total current assets  | 45,929                          | 103,622                 |
| <b>PROPERTY, EQUIPMENT AND FACILITIES - At cost, net of accumulated depreciation and amortization of \$156,373 and \$146,795 at June 30, 2014 and December 31, 2013, respectively</b> |                                 |                         |
|   | 121,282                         | 127,332                 |
| <b>OTHER ASSETS:</b>  |                                 |                         |
| Noncurrent receivables, less allowance of \$988 and \$982 at June 30, 2014 and December 31, 2013, respectively  | 6,668                           | 6,869                   |
| Deferred finance charges  | 191                             | 1,163                   |
| Goodwill  | 62,465                          | 62,465                  |
| Other assets, net   | 3,624                           | 4,498                   |
| Total other assets  | 72,948                          | 74,995                  |
| <b>TOTAL</b>  | <b>\$ 240,159</b>               | <b>\$ 305,949</b>       |

See notes to unaudited condensed consolidated financial statements.

IndexLINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

(Continued)

|   | June 30,<br>2014<br>(Unaudited) | December<br>31,<br>2013 |
|---|---------------------------------|-------------------------|
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                 |                         |
| <b>CURRENT LIABILITIES:</b>   |                                 |                         |
| Current portion of long-term debt and lease obligations   | \$ 15,452                       | \$ 435                  |
| Unearned tuition  | 27,597                          | 30,195                  |
| Accounts payable  | 11,097                          | 14,603                  |
| Accrued expenses  | 14,781                          | 10,655                  |
| Other short-term liabilities  | 830                             | 693                     |
| Total current liabilities   | 69,757                          | 56,581                  |
| <b>NONCURRENT LIABILITIES:</b>  |                                 |                         |
| Long-term debt and lease obligations, net of current portion  | 34,950                          | 89,681                  |
| Pension plan liabilities  | 1,278                           | 1,522                   |
| Deferred income taxes, net  | 5,290                           | 4,528                   |
| Accrued rent  | 7,250                           | 7,695                   |
| Other long-term liabilities   | 670                             | 746                     |
| Total liabilities   | 119,195                         | 160,753                 |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                                 |                         |
| <b>STOCKHOLDERS' EQUITY:</b>  |                                 |                         |
| Preferred stock, no par value - 10,000,000 shares authorized, no shares issued and outstanding at March 31, 2014 and December 31, 2013  | -                               | -                       |
| Common stock, no par value - authorized: 100,000,000 shares at June 30, 2014 and December 31, 2013; issued and outstanding: 30,010,170 shares at June 30, 2014 and 29,919,761 shares at December 31, 2013 | 141,377                         | 141,377                 |
| Additional paid-in capital  | 25,769                          | 24,177                  |
| Treasury stock at cost - 5,910,541 shares at June 30, 2014 and December 31, 2013  | (82,860 )                       | (82,860 )               |
| Retained earnings   | 40,015                          | 66,064                  |
| Accumulated other comprehensive loss  | (3,337 )                        | (3,562 )                |
| Total stockholders' equity  | 120,964                         | 145,196                 |
| <b>TOTAL</b>  | <b>\$ 240,159</b>               | <b>\$ 305,949</b>       |

See notes to unaudited condensed consolidated financial statements.

IndexLINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS(In thousands, except per share amounts)  
(Unaudited)

|  | Three Months<br>Ended<br>June 30, |            | Six Months Ended<br>June 30, |             |
|--|-----------------------------------|------------|------------------------------|-------------|
|  | 2014                              | 2013       | 2014                         | 2013        |
| REVENUE  | \$77,152                          | \$81,751   | \$157,119                    | \$168,021   |
| COSTS AND EXPENSES:                                    |                                   |            |                              |             |
| Educational services and facilities                    | 41,544                            | 42,398     | 84,233                       | 85,971      |
| Selling, general and administrative                    | 45,617                            | 45,640     | 92,354                       | 95,660      |
| Gain on sale of assets                                 | (6 )                              | (196 )     | (61 )                        | (207 )      |
| Impairment of goodwill and long-lived assets           | -                                 | 3,815      | -                            | 3,908       |
| Total costs & expenses                                 | 87,155                            | 91,657     | 176,526                      | 185,332     |
| OPERATING LOSS   | (10,003)                          | (9,906 )   | (19,407 )                    | (17,311 )   |
| OTHER:   |                                   |            |                              |             |
| Interest income  | 16                                | 15         | 72                           | 17          |
| Interest expense                                       | (1,178 )                          | (1,202 )   | (2,494 )                     | (2,294 )    |
| Other income   | -                                 | 18         | -                            | 18          |
| LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES    | (11,165)                          | (11,075)   | (21,829 )                    | (19,570 )   |
| PROVISION (BENEFIT) FOR INCOME TAXES                   | 431                               | (4,387 )   | 862                          | (7,599 )    |
| LOSS FROM CONTINUING OPERATIONS                        | (11,596)                          | (6,688 )   | (22,691 )                    | (11,971 )   |
| LOSS FROM DISCONTINUED OPERATIONS, NET OF INCOME TAXES | -                                 | (2,690 )   | -                            | (4,894 )    |
| NET LOSS   | \$(11,596)                        | \$(9,378 ) | \$(22,691 )                  | \$(16,865 ) |
| Basic  |                                   |            |                              |             |
| Loss per share from continuing operations              | \$(0.51 )                         | \$(0.30 )  | \$(1.00 )                    | \$(0.53 )   |
| Loss per share from discontinued operations            | -                                 | (0.12 )    | -                            | (0.22 )     |
| Net loss per share                                     | \$(0.51 )                         | \$(0.42 )  | \$(1.00 )                    | \$(0.75 )   |
| Diluted  |                                   |            |                              |             |
| Loss per share from continuing operations              | \$(0.51 )                         | \$(0.30 )  | \$(1.00 )                    | \$(0.53 )   |
| Loss per share from discontinued operations            | -                                 | (0.12 )    | -                            | (0.22 )     |
| Net loss per share                                     | \$(0.51 )                         | \$(0.42 )  | \$(1.00 )                    | \$(0.75 )   |
| Weighted average number of common shares outstanding:  |                                   |            |                              |             |
| Basic  | 22,800                            | 22,497     | 22,762                       | 22,456      |
| Diluted  | 22,800                            | 22,497     | 22,762                       | 22,456      |

See notes to unaudited condensed consolidated financial statements.

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LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)  
(Unaudited)

|   | Three Months |           | Six Months Ended |            |
|---|--------------|-----------|------------------|------------|
|   | Ended        |           | June 30,         |            |
|   | June 30,     | 2013      | 2014             | 2013       |
|   | 2014         |           | 2014             | 2013       |
| Net loss  | \$(11,596)   | \$(9,378) | \$(22,691)       | \$(16,865) |
| Other comprehensive income                      |              |           |                  |            |
| Employee pension plan adjustments, net of taxes | 113          | 150       | 225              | 300        |
| Comprehensive loss                              | \$(11,483)   | \$(9,228) | \$(22,466)       | \$(16,565) |

See notes to unaudited condensed consolidated financial statements.

IndexLINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except share amounts)

(Unaudited)

|  | Common Stock |            | Additional | Treasury   | Retained  | Accumulated   |            |
|--|--------------|------------|------------|------------|-----------|---------------|------------|
|  | Shares       | Amount     | Paid-in    | Stock      | Earnings  | Other         | Total      |
|  |              |            | Capital    |            | Loss      | Comprehensive |            |
| BALANCE - January 1, 2014                          | 29,919,761   | \$ 141,377 | \$ 24,177  | \$(82,860) | \$66,064  | \$ (3,562 )   | \$ 145,196 |
| Net loss   | -            | -          | -          | -          | (22,691)  | -             | (22,691 )  |
| Employee pension plan adjustments, net of taxes    | -            | -          | -          | -          | -         | 225           | 225        |
| Stock-based compensation expense                   |              |            |            |            |           |               |            |
| Restricted stock                                   | 118,091      | -          | 1,652      | -          | -         | -             | 1,652      |
| Stock options                                      | -            | -          | 52         | -          | -         | -             | 52         |
| Net share settlement for equity-based compensation | (27,682 )    | -          | (112 )     | -          | -         | -             | (112 )     |
| Cash dividend of \$0.14 per common share           | -            | -          | -          | -          | (3,358 )  | -             | (3,358 )   |
| BALANCE - June 30, 2014                            | 30,010,170   | \$ 141,377 | \$ 25,769  | \$(82,860) | \$ 40,015 | \$ (3,337 )   | \$ 120,964 |

See notes to unaudited condensed consolidated financial statements.



IndexLINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|   | Six Months Ended<br>June 30, |                 |
|---|------------------------------|-----------------|
|   | 2014                         | 2013            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                |                              |                 |
| Net loss  | \$(22,691)                   | \$(16,865)      |
| Adjustments to reconcile net loss to net cash used in operating activities: |                              |                 |
| Depreciation and amortization   | 10,031                       | 11,637          |
| Amortization of deferred finance charges                                    | 412                          | 246             |
| Deferred income taxes   | 762                          | (1,514 )        |
| Gain on disposition of assets   | (61 )                        | (207 )          |
| Impairment of long-lived assets   | -                            | 6,194           |
| Fixed asset donation  | (51 )                        | (16 )           |
| Provision for doubtful accounts   | 7,491                        | 7,546           |
| Stock-based compensation expense  | 1,704                        | 2,361           |
| Deferred rent   | (330 )                       | (150 )          |
| (Increase) decrease in assets:  |                              |                 |
| Accounts receivable   | (9,732 )                     | (10,668)        |
| Inventories   | 76                           | (273 )          |
| Prepaid income taxes and income taxes receivable                            | 507                          | (9,458 )        |
| Prepaid expenses and current assets   | (1,110 )                     | 132             |
| Other assets  | 518                          | (411 )          |
| Increase (decrease) in liabilities:   |                              |                 |
| Accounts payable  | (3,880 )                     | (3,597 )        |
| Accrued expenses  | 4,011                        | 5,642           |
| Pension plan liabilities  | (90 )                        | (478 )          |
| Unearned tuition  | (2,598 )                     | (4,734 )        |
| Other liabilities   | 132                          | 341             |
| Total adjustments   | 7,792                        | 2,593           |
| Net cash used in operating activities                                       | (14,899)                     | (14,272)        |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                |                              |                 |
| Capital expenditures  | (2,611 )                     | (1,871 )        |
| Proceeds from sale of property and equipment                                | 67                           | 251             |
| Net cash used in investing activities                                       | (2,544 )                     | (1,620 )        |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                |                              |                 |
| Payments on borrowings  | (54,500)                     | (37,500)        |
| Reclassifications of payments of borrowings from restricted cash            | 54,500                       | -               |
| Proceeds from borrowings  | 15,000                       | -               |
| Net share settlement for equity-based compensation                          | (112 )                       | (389 )          |
| Dividends paid  | (3,358 )                     | (3,342 )        |
| Payment of deferred finance fees  | -                            | (112 )          |
| Principal payments under capital lease obligations                          | (214 )                       | (207 )          |
| Net cash provided by (used in) financing activities                         | 11,316                       | (41,550)        |
| <b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>                            | <b>(6,127 )</b>              | <b>(57,442)</b> |
| <b>CASH AND CASH EQUIVALENTS—Beginning of period</b>                        | <b>12,886</b>                | <b>61,708</b>   |

|   |         |         |
|---|---------|---------|
| CASH AND CASH EQUIVALENTS—End of period | \$6,759 | \$4,266 |
|---|---------|---------|

See notes to unaudited condensed consolidated financial statements.

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LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)  
(Unaudited)  
(Continued)

Six Months  
Ended  
June 30,  
2014 2013

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the year for:

|              |         |         |
|--------------|---------|---------|
| Interest     | \$2,063 | \$1,970 |
| Income taxes | \$118   | \$375   |

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

|  |       |     |
|--|-------|-----|
| Liabilities accrued for or noncash purchases of fixed assets | \$867 | \$- |
|--|-------|-----|

See notes to unaudited condensed consolidated financial statements.

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LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
THREE AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013

(In thousands, except share and per share amounts and unless otherwise stated)

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Activities – Lincoln Educational Services Corporation and Subsidiaries (the “Company”) is a provider of diversified career-oriented post-secondary education. The Company offers recent high school graduates and working adults career-oriented programs in five areas of study: Automotive Technology, Health Sciences, Skilled Trades, Hospitality Services and Business and Information Technology. The Company currently has 31 campuses and five training sites in 15 states across the United States.

Basis of Presentation – The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission and in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Certain information and footnote disclosures normally included in annual financial statements have been omitted or condensed pursuant to such regulations. These statements, which should be read in conjunction with the December 31, 2013 consolidated financial statements of the Company, reflect all adjustments, consisting of normal recurring adjustments, including impairments necessary to present fairly the consolidated financial position, results of operations and cash flows for such periods. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2014.

The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates in the Preparation of Financial Statements – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. On an ongoing basis, the Company evaluates the estimates and assumptions, including those related to revenue recognition, bad debts, fixed assets, goodwill and other intangible assets, stock-based compensation, income taxes, benefit plans and certain accruals and contingencies. Actual results could differ from those estimates.

New Accounting Pronouncements – In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The amendments in this ASU provide guidance on the financial statement presentation of unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this ASU did not materially impact the presentation of the Company’s financial condition, results of operation and disclosures.

In April 2014, FASB issued amended guidance on the use and presentation of discontinued operations in an entity's consolidated financial statements. The new guidance restricts the presentation of discontinued operations to business circumstances when the disposal of business operations represents a strategic shift that has or will have a major effect on an entity's operations and financial results. The guidance becomes effective on January 1, 2015. Adoption is on a prospective basis.

In May 2014, FASB issued a new standard related to revenue recognition, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The new standard will replace most of the existing revenue recognition standards in GAAP when it becomes effective on January 1, 2017. Early adoption is not permitted. The new standard can be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of the change recognized at the date of the initial application. The Company is assessing the potential impact of the new standard on financial reporting and has not yet selected a transition method.

Stock-Based Compensation – The Company measures the value of stock options on the grant date at fair value, using the Black-Scholes option valuation model. The Company amortizes the fair value of stock options, net of estimated forfeitures, utilizing straight-line amortization of compensation expense over the requisite service period of the grant.

The Company measures the value of service and performance-based restricted stock on the fair value of a share of common stock on the date of the grant. The Company amortizes the fair value of service-based restricted stock utilizing straight-line amortization of compensation expense over the requisite service period of the grant.

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The Company amortizes the fair value of the performance-based restricted stock based on the determination of the probable outcome of the performance condition. If the performance condition is expected to be met, then the Company amortizes the fair value of the number of shares expected to vest utilizing straight-line basis over the requisite performance period of the grant. However, if the associated performance condition is not expected to be met, then the Company does not recognize the stock-based compensation expense.

**Income Taxes** – The Company accounts for income taxes in accordance with FASB ASC Topic 740, “Income Taxes” (“ASC 740”). This statement requires an asset and liability approach for measuring deferred taxes based on temporary differences between the financial statement and tax bases of assets and liabilities existing at each balance sheet date using enacted tax rates for years in which taxes are expected to be paid or recovered.

In accordance with ASC 740, the Company assesses its deferred tax asset to determine whether all or any portion of the asset is more likely than not unrealizable. A valuation allowance is required to be established or maintained when, based on currently available information, it is more likely than not that all or a portion of a deferred tax asset will not be realized. In accordance with ASC 740, the Company’s assessment considers whether there has been sufficient income in recent years and whether sufficient income is expected in future years in order to utilize the deferred tax asset. In evaluating the realizability of deferred income tax assets, the Company considered, among other things, historical levels of income, expected future income, the expected timing of the reversals of existing temporary reporting differences, and the expected impact of tax planning strategies that may be implemented to prevent the potential loss of future income tax benefits. Significant judgment is required in determining the future tax consequences of events that have been recognized in the Company’s consolidated financial statements and/or tax returns. Differences between anticipated and actual outcomes of these future tax consequences could have a material impact on the Company’s consolidated financial position or results of operations. Changes in, among other things, income tax legislation, statutory income tax rates, or future income levels could materially impact the Company’s valuation of income tax assets and liabilities and could cause the Company’s income tax provision to vary significantly among financial reporting periods.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. During the three and six months ended June 30, 2014 and 2013, the interest and penalties expense associated with uncertain tax positions did not materially impact the Company’s results of operations or financial position.

## 2. WEIGHTED AVERAGE COMMON SHARES

The weighted average number of common shares used to compute basic and diluted loss per share for the three and six months ended June 30, 2014 and 2013 was as follows:

|                                  | Three Months Ended |            | Six Months Ended |            |
|----------------------------------|--------------------|------------|------------------|------------|
|                                  | June 30,<br>2014   | 2013       | June 30,<br>2014 | 2013       |
| Basic shares outstanding         | 22,800,471         | 22,497,013 | 22,761,811       | 22,455,586 |
| Dilutive effect of stock options | -                  | -          | -                | -          |
| Diluted shares outstanding       | 22,800,471         | 22,497,013 | 22,761,811       | 22,455,586 |

For the three months ended June 30, 2014 and 2013, options to acquire 55,144 and 199,569 shares, respectively, were excluded from the above table because the Company reported a net loss for each quarter and therefore their impact on reported loss per share would have been antidilutive. For the six months ended June 30, 2014 and 2013, options to acquire 116,053 and 210,407 shares, respectively, were excluded from the above table because the Company reported a net loss for each quarter and therefore their impact on reported loss per share would have been antidilutive. For the three and six months ended June 30, 2014 and 2013, options to acquire 485,625 and 803,775 shares, respectively,

were excluded from the above table because they have an exercise price that is greater than the average market price of the Company's common stock and therefore their impact on reported loss per share would have been antidilutive.

In 2011 and 2013, the Company issued performance shares that vest when certain performance conditions are satisfied. As of June 30, 2014, these performance conditions were not met. As a result, the Company has determined these shares to be contingently issuable. Accordingly, 418,408 shares of outstanding performance shares have been excluded from the computation of diluted earnings per share for the three and six months ended June 30, 2014, and 448,737 shares have been excluded for the three and six months ended June 30, 2013. Refer to Note 6 for more information on performance shares.

### 3. DISCONTINUED OPERATIONS

On June 18, 2013, the Company's Board of Directors approved a plan to cease operations at four campuses in Ohio and one campus in Kentucky consisting of the Company's Dayton institution and its branch campuses. Federal legislation implemented on July 1, 2012 that prohibits "ability to benefit" students from participating in federal student financial aid programs led to a dramatic decrease in the number of students attending these five campuses. Accordingly, the Company ceased operations at these campuses as of December 31, 2013. The results of operations of these campuses are reflected as discontinued operations in the consolidated financial statements.

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The results of operations at these five campuses for the three and six months ended June 30, 2013 was as follows (in thousands):

|                    | Three<br>Months<br>Ended<br>June 30,<br>2013 | Six<br>Months<br>Ended<br>June 30,<br>2013 |
|--------------------|--|--|
| Revenue            | \$3,466                                      | \$7,279                                    |
| Operating expenses | 7,942  | 15,424                                     |
| Operating loss     | \$(4,476)                                    | \$(8,145)                                  |

Amounts include impairments of goodwill and long-lived assets for these campuses of \$0.7 million and \$2.3 million for the three and six months ended June 30, 2013, respectively.

#### 4. GOODWILL AND LONG-LIVED ASSETS

The Company reviews long-lived assets for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. There was no long-lived asset impairment during the three and six months ended June 30, 2014. The Company concluded as of June 30, 2013, there was sufficient evidence to conclude that there were impairments of certain long-lived assets at two of the Company's campuses. Long-lived assets had been tested at these campuses as a result of certain financial indicators such as the Company's history of losses, current respective period losses, as well as future projected losses at these campuses. The long-lived assets impairment resulted in a pre-tax charge of \$1.4 million (of which \$0.7 million is included in discontinued operations) and \$1.7 million (of which \$1.6 million is included in discontinued operations) for leasehold improvements as of June 30, 2013 and March 31, 2013, respectively.

The Company reviews goodwill and intangible assets for impairment when indicators of impairment exist. Annually, or more frequently if necessary, the Company evaluates goodwill and intangible assets with indefinite lives for impairment, with any resulting impairment reflected as an operating expense. The Company concluded that at June 30, 2014 there was no indicator of potential impairment for reporting units with goodwill and, accordingly, the Company did not test goodwill for impairment.

As of June 30, 2013, the Company concluded that current period losses at two reporting units, which resulted in a deterioration of current and projected cash flows, was an indicator of potential impairment and, accordingly, tested goodwill for impairment. The test indicated that these two reporting units were impaired, which resulted in a pre-tax non-cash charge of \$3.1 million for the three months ended June 30, 2013.

The carrying amount of goodwill at June 30, 2014 is as follows:

|                               | Gross<br>Goodwill<br>Balance | Accumulated<br>Impairment<br>Losses | Net<br>Goodwill<br>Balance |
|-------------------------------|------------------------------|-------------------------------------|----------------------------|
| Balance as of January 1, 2014 | \$117,176                    | \$ (54,711 )                        | \$ 62,465                  |
| Adjustments                   | -                            | -                                   | -                          |
| Balance as of June 30, 2014   | \$117,176                    | \$ (54,711 )                        | \$ 62,465                  |





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Intangible assets, which are included in other assets in the accompanying condensed consolidated balance sheets, consist of the following:

|                               |                   | Indefinite |        |               |            |             |          |
|-------------------------------|-------------------|------------|--------|---------------|------------|-------------|----------|
|                               |                   | Trade      | Trade  | Accreditation | Curriculum | Non-compete | Total    |
|                               |                   | Name       | Name   |               |            |             |          |
| Gross carrying amount at      | December 31, 2013 | \$ 180     | \$ 335 | \$ 1,166      | \$ 1,124   | \$ 200      | \$ 3,005 |
| Adjustments                   |                   | -          | -      | -             | -          | -           | -        |
| Gross carrying amount at      | June 30, 2014     | 180        | 335    | 1,166         | 1,124      | 200         | 3,005    |
| Accumulated amortization at   | December 31, 2013 | -          | 228    | -             | 828        | 68          | 1,124    |
| Amortization                  |                   | -          | 25     | -             | 56         | 20          | 101      |
| Accumulated amortization at   | June 30, 2014     | -          | 253    | -             | 884        | 88          | 1,225    |
| Net carrying amount at        | June 30, 2014     | \$ 180     | \$ 82  | \$ 1,166      | \$ 240     | \$ 112      | \$ 1,780 |
| Weighted average amortization | period (years)    | Indefinite | 7      | Indefinite    | 9          | 5           |          |

Amortization of intangible assets was approximately \$0.1 million for each of the three and six months ended June 30, 2014 and 2013.

The following table summarizes the estimated future amortization expense:

Year Ending December 31.

|                   |        |
|-------------------|--------|
| Remainder of 2014 | \$ 100 |
| 2015              | 156    |
| 2016              | 112    |
| 2017              | 46     |
| 2018              | 19     |
| Thereafter        | 1      |
|                   | \$ 434 |

## 5. LONG-TERM DEBT AND LEASE OBLIGATIONS

Long-term debt and lease obligations consist of the following:

|   | June 30, | December  |
|---|----------|-----------|
|   | 2014     | 31, 2013  |
| Credit agreement (a)                      | \$15,000 | \$ 54,500 |
| Finance obligation (b)                    | 9,672    | 9,672     |
| Capital lease-property (rate of 8.0%) (c) | 25,730   | 25,944    |
|   | 50,402   | 90,116    |
| Less current maturities                   | (15,452) | (435 )    |
|   | \$34,950 | \$ 89,681 |

(a) On April 5, 2012, the Company, as borrower, and certain of its wholly-owned subsidiaries, as guarantors, entered into a secured revolving credit agreement with a syndicate of four lenders led by Bank of America, N.A., as

administrative agent and letter of credit issuer (the “Credit Facility”). The April 5, 2012 agreement, along with subsequent amendments dated June 18, 2013 and December 20, 2013, are collectively referred to as the “Credit Agreement.”

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As of December 31, 2013, the aggregate principal amount available under the Credit Facility was \$60 million. Under the terms of the Credit Agreement, amended January 16, 2014, this amount was reduced to \$40 million. The Credit Facility may be used to finance capital expenditures and permitted acquisitions, to pay transaction expenses, for the issuance of letters of credit and for general corporate purposes. The Credit Agreement includes a \$25 million letter of credit sublimit. The original term of the Credit Facility is 36 months, maturing on April 5, 2015.

The Credit Agreement provides that the lenders will receive first priority lien on substantially all of the tangible and intangible non-real property assets of the Company and its subsidiaries as well as a first priority lien on substantially all real property owned by the Company and its subsidiaries and that all net proceeds of future sales of real property by the Company and its subsidiaries be used to prepay revolving loans and permanently reduce the principal amount of revolving loans available under the Credit Facility.

Amounts borrowed as revolving loans under the Credit Facility will bear interest, at the Company's option, at either (i) an interest rate based on LIBOR and adjusted for any reserve percentage obligations under Federal Reserve Bank regulations (the "Eurodollar Rate") for specified interest periods or (ii) the Base Rate (as defined in the Credit Agreement), in each case, plus an applicable margin rate as determined under the Credit Agreement. The "Base Rate", as defined under the Credit Agreement, is the highest of (a) the rate of interest announced from time to time by Bank of America, N.A. as its prime rate, (b) the Federal Funds rate plus 0.50% and (c) a daily rate equal to the one-month LIBOR rate plus 1.0%. Pursuant to the Credit Agreement, the margin interest rate is subject to adjustment within a range of 2.50% to 6.00% based upon changes in the Company's consolidated leverage ratio and depending on whether the Company has chosen the Eurodollar Rate or the Base Rate option. Letters of credit will require a fee equal to the applicable margin rate multiplied by the daily amount available to be drawn under each issued letter of credit plus an agreed upon fronting fee and customary issuance, presentation, amendment and other processing fees associated with letters of credit.

At June 30, 2014, the Company had outstanding letters of credit aggregating \$5.3 million, which were primarily comprised of letters of credit for the Department of Education, or DOE, matters and real estate leases.

The Credit Agreement contains representations, warranties and covenants including consolidated adjusted net worth, consolidated leverage ratio, consolidated fixed charge coverage ratio, minimum financial responsibility composite score, cohort default rate and other financial covenants, certain restrictions on capital expenditures as well as affirmative and negative covenants and events of default customary for facilities of this type. In addition, the Company is paying fees to the lenders that are customary for facilities of this type. As of June 30, 2014 the Company is in compliance with all financial covenants.

As of June 30, 2014 the Company borrowed \$15.0 million under the Credit Facility. The interest rates on these borrowings ranged from 6.25% to 7.25%. The Company had \$54.5 million outstanding under the Credit Agreement as of December 31, 2013 which was repaid on January 3, 2014. The interest rate on this borrowing was 7.25%.

(b) The Company completed a sale and a leaseback of several facilities on December 28, 2001. The Company retains a continuing involvement in the lease and, as a result, it is prohibited from utilizing sale-leaseback accounting. Accordingly, the Company has treated this transaction as a finance lease. The lease expires on December 31, 2016.

(c) In 2009, the Company assumed real estate capital leases in Fern Park, Florida and Hartford, Connecticut. These leases bear interest at 8% and expire in 2032 and 2031, respectively.

Scheduled maturities of long-term debt and lease obligations at June 30, 2014 are as follows:

Year ending December 31,

|      |           |
|------|-----------|
| 2014 | \$ 15,452 |
|------|-----------|

|            |          |
|------------|----------|
| 2015       | 490      |
| 2016       | 10,360   |
| 2017       | 778      |
| 2018       | 843      |
| Thereafter | 22,479   |
|            | \$50,402 |

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6. STOCKHOLDERS' EQUITY

Restricted Stock

The Company has two stock incentive plans: a Long-Term Incentive Plan (the "LTIP") and a Non-Employee Directors Restricted Stock Plan (the "Non-Employee Directors Plan").

Under the LTIP, certain employees received awards of restricted shares of common stock based on service and performance. The number of shares granted to each employee is based on the fair market value of a share of common stock on the date of grant.

All service-based restricted shares granted prior to February 23, 2011 vest ratably on the first through fifth anniversaries of the grant date. The service-based restricted shares granted on or after February 23, 2011 vest ratably on the grant date and the first through fourth anniversaries of the grant date.

On June 2, 2014, performance-based shares were granted which vest over three years based upon the attainment of (i) a specified operating income margin during any one or more of the fiscal years in the period beginning January 1, 2015 and ending December 31, 2017 and (ii) the attainment of earnings before interest, taxes, depreciation and amortization targets during each of the fiscal years ended December 31, 2015 through 2017. There is no vesting period on the right to vote or the right to receive dividends on any of the restricted shares.

On April 29, 2013, performance-based shares were granted which vest over four years based upon the attainment of (i) a specified operating income margin during any one or more of the fiscal years in the period beginning January 1, 2013 and ending December 31, 2016 and (ii) the attainment of earnings before interest, taxes, depreciation and amortization targets during each of the fiscal years ended December 31, 2013 through 2016. There is no vesting period on the right to vote or the right to receive dividends on any of the restricted shares.

On April 29, 2011, performance-based shares were granted which vest over four years based upon the attainment of (i) a specified operating income margin during any one or more of the fiscal years in the period beginning January 1, 2011 and ending December 31, 2014 and (ii) the attainment of earnings before interest, taxes, depreciation and amortization targets during each of the fiscal years ended December 31, 2011 through 2014. There is no vesting period on the right to vote or the right to receive dividends on any of the restricted shares.

Pursuant to the Non-Employee Directors Plan, each non-employee director of the Company receives an annual award of restricted shares of common stock on the date of the Company's annual meeting of shareholders. The number of shares granted to each non-employee director is based on the fair market value of a share of common stock on that date. The restricted shares vest on the first anniversary of the grant date; however, there is no vesting period on the right to vote or the right to receive dividends on these restricted shares.

For the six months ended June 30, 2014 and 2013, the Company completed a net share settlement for 27,682 and 60,552 restricted shares, respectively, on behalf of certain employees that participate in the LTIP upon the vesting of the restricted shares pursuant to the terms of the LTIP. The net share settlement was in connection with income taxes incurred on restricted shares that vested and were transferred to the employee during 2014 and/or 2013, creating taxable income for the employee. At the employees' request, the Company will pay these taxes on behalf of the employees in exchange for the employees returning an equivalent value of restricted shares to the Company. These transactions resulted in a decrease of approximately \$0.1 million and \$0.4 million for the six months ended June 30, 2014 and 2013, respectively, to equity on the consolidated balance sheets as the cash payment of the taxes effectively was a repurchase of the restricted shares granted in previous years.

The following is a summary of transactions pertaining to restricted stock:

|   | Shares     | Weighted<br>Average<br>Grant<br>Date Fair<br>Value<br>Per Share |
|---|------------|---|
| Nonvested restricted stock outstanding at December 31, 2013 | 1,247,946  | \$ 6.77   |
| Granted   | 229,955    | 3.83  |
| Canceled  | (111,864 ) | 9.99  |
| Vested  | (156,694 ) | 4.52  |
| Nonvested restricted stock outstanding at June 30, 2014     | 1,209,343  | 5.81  |

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The restricted stock expense for the three months ended June 30, 2014 and 2013 was \$0.7 million and \$1.0 million, respectively. The restricted stock expense for the six months ended June 30, 2014 and 2013 was \$1.7 million and \$2.3 million, respectively. The unrecognized restricted stock expense as of June 30, 2014 and December 31, 2013 was \$5.5 million and \$6.8 million, respectively. As of June 30, 2014, outstanding restricted shares under the LTIP had aggregate intrinsic value of \$5.4 million.

## Stock Options

The fair value of the stock options used to compute stock-based compensation is the estimated present value at the date of grant using the Black-Scholes option pricing model. The following is a summary of transactions pertaining to stock options:

|                                  | Shares    | Weighted Average Exercise Price Per Share | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (in thousands) |
|----------------------------------|-----------|---|---|--|
| Outstanding at December 31, 2013 | 547,125   | \$ 14.73                                  | 4.56 years                                  | \$ -                                     |
| Canceled                         | (61,500 ) | 20.88                                     |   | -  |
| Outstanding at June 30, 2014     | 485,625   | 13.96                                     | 4.41 years                                  | -  |
| Vested or expected to vest       | 476,493   | 14.08                                     | 4.34 years                                  | -  |
| Exercisable as of June 30, 2014  | 439,965   | 14.60                                     | 4.07 years                                  | -  |

As of June 30, 2014, the unrecognized pre-tax compensation expense for all unvested stock option awards was \$0.1 million. This amount will be expensed over the weighted-average period of approximately 0.67 years.

The following table presents a summary of stock options outstanding:

| Range of Exercise Prices | At June 30, 2014          |   |                        | Stock Options |                                 |
|--------------------------|---------------------------|---|------------------------|---------------|---------------------------------|
|                          | Stock Options Outstanding |   | Exercisable            |               |                                 |
|                          | Shares                    | Contractual Weighted Average Life (years) | Weighted Average Price | Shares        | Weighted Average Exercise Price |
| \$4.00-\$13.99           | 244,792                   | 5.62                                      | \$ 9.63                | 199,132       | \$ 10.05                        |
| \$14.00-\$19.99          | 182,333                   | 2.86                                      | 17.67                  | 182,333       | 17.67                           |
| \$20.00-\$25.00          | 58,500                    | 4.17                                      | 20.48                  | 58,500        | 20.48                           |
|                          | 485,625                   | 4.41                                      | 13.96                  | 439,965       | 14.60                           |

## 7. INCOME TAXES

The provision for income taxes for the three months ended June 30, 2014 was \$0.4 million, or (3.9%) of pretax loss, compared to a benefit for income taxes of \$4.4 million, or 39.6%, of pretax loss for the quarter ended June 30, 2013.

The provision for income taxes for the six months ended June 30, 2014 was \$0.9 million, or (3.9%) of pretax loss, compared to a benefit for income taxes of \$7.6 million, or 38.8%, of pretax loss for the six months ended June 30,



2013. No federal or state income tax benefit was recognized for the current period loss due to the recognition of a full valuation allowance. Income tax expense for the three and six months ended June 30, 2014 resulted from an increase in deferred tax liabilities associated with indefinite-lived intangible assets and various state tax expenses.

The Company assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant piece of objective negative evidence was the cumulative losses incurred by the Company in recent years. On the basis of this evaluation the realization of the Company's deferred tax assets was not deemed to be more likely than not and thus the Company maintained a valuation allowance on its net deferred tax assets as of June 30, 2014.

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8. CONTINGENCIES

In the ordinary conduct of its business, the Company is subject to lawsuits, investigations and claims, including, but not limited to, claims involving students or graduates and routine employment matters. Although the Company cannot predict with certainty the ultimate resolution of lawsuits, investigations and claims asserted against it, the Company does not believe that any currently pending legal proceedings to which it is a party will have a material adverse effect on the Company's business, financial condition, and results of operations or cash flows.

9. PENSION PLAN

The Company sponsors a noncontributory defined benefit pension plan covering some of the Company's employees who were employed by the Company prior to 1995. Benefits are provided based on employees' years of service and earnings. This plan was frozen on December 31, 1994. The total amount of the Company's contributions paid under its pension plan was \$0.1 million for the six months ended June 30, 2014 and \$0.5 million for the six months ended June 30, 2013.

10. DIVIDENDS

In May 2014, the Company's Board of Directors declared a quarterly cash dividend of \$0.07 per share of common stock outstanding, which was paid on June 30, 2014 to shareholders of record on June 13, 2014. The establishment of future record and payment dates is subject to the final determination of the Company's Board of Directors.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion may contain forward-looking statements regarding us, our business, prospects and our results of operations that are subject to certain risks and uncertainties posed by many factors and events that could cause our actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those described in the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the Securities and Exchange Commission ("SEC") and in our other filings with the SEC. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the SEC that advise interested parties of the risks and factors that may affect our business.

The interim financial statements filed on this Form 10-Q and the discussions contained herein should be read in conjunction with the annual financial statements and notes included in our Form 10-K for the year ended December 31, 2013, as filed with the SEC, which includes audited consolidated financial statements for our three fiscal years ended December 31, 2013.

General

We are a leading provider of diversified career-oriented post-secondary education. We offer recent high school graduates and working adults career-oriented programs in five areas of study: automotive technology, health sciences, skilled trades, hospitality services and business and information technology. Each area of study is specifically designed to appeal to and meet the educational objectives of our student population, while also satisfying the criteria established by industry and employers. The resulting diversification limits dependence on any one industry for enrollment growth or placement opportunities and broadens potential branches for introducing new programs. As of June 30, 2014, we enrolled 13,648 students in diploma and degree programs and 150 in short programs at our 31 campuses and five training sites in 15 states. Our campuses primarily attract students from their local communities and surrounding areas, although our five destination campuses attract students from across the United States, and in some cases, from abroad.

Discontinued Operations

On June 18, 2013, our Board of Directors approved a plan to cease operations at four campuses in Ohio and one campus in Kentucky consisting of our Dayton institution and its branch campuses. Federal legislation implemented on July 1, 2012 that prohibits "ability to benefit" students from participating in federal student financial aid programs led to a dramatic decrease in the number of students attending these five campuses. Accordingly, the Company ceased operations at these campuses as of December 31, 2013. The results of operations of these campuses are reflected as discontinued operations in the consolidated financial statements.

The results of operations at these five campuses for the three and six months ended June 30, 2013 was as follows (in thousands):

|          |          |
|----------|----------|
| Three    | Six      |
| Months   | Months   |
| Ended    | Ended    |
| June 30, | June 30, |
| 2013     | 2013     |

|                    |           |           |
|--------------------|-----------|-----------|
| Revenue            | \$3,466   | \$7,279   |
| Operating expenses | 7,942     | 15,424    |
| Operating loss     | \$(4,476) | \$(8,145) |

Amounts include impairments of goodwill and long-lived assets for these campuses of \$0.7 million and \$2.3 million for the three and six months ended June 30, 2013, respectively.

#### Critical Accounting Policies and Estimates

Our discussions of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. On an ongoing basis, we evaluate our estimates and assumptions, including those related to revenue recognition, bad debts, fixed assets, goodwill and other intangible assets, income taxes and certain accruals and contingencies. Actual results could differ from those estimates. The critical accounting policies discussed herein are not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not result in significant management judgment in the application of such principles. We believe that the following accounting policies are most critical to us in that they represent the primary areas where financial information is subject to the application of management's estimates, assumptions and judgment in the preparation of our consolidated financial statements.

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Revenue recognition. Revenues are derived primarily from programs taught at our schools. Tuition revenues, textbook sales and one-time fees, such as nonrefundable application fees and course material fees, are recognized on a straight-line basis over the length of the applicable program, which is the period of time from a student's start date through his or her graduation date, including internships or externships that take place prior to graduation. If a student withdraws from a program prior to a specified date, any paid but unearned tuition is refunded. Refunds are calculated and paid in accordance with federal, state and accrediting agency standards. Other revenues, such as tool sales and contract training revenues are recognized as services are performed or goods are delivered. On an individual student basis, tuition earned in excess of cash received is recorded as accounts receivable, and cash received in excess of tuition earned is recorded as unearned tuition.

Allowance for uncollectible accounts. Based upon our experience and judgment, we establish an allowance for uncollectible accounts with respect to tuition receivables. We use an internal group of collectors, augmented by third-party collectors as deemed appropriate, in our collection efforts. In establishing our allowance for uncollectible accounts, we consider, among other things, current and expected economic conditions, a student's status (in-school or out-of-school), whether or not a student is currently making payments and overall collection history. Changes in trends in any of these areas may impact the allowance for uncollectible accounts. The receivables balances of withdrawn students with delinquent obligations are reserved based on our collection history. Although we believe that our reserves are adequate, if the financial condition of our students deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be necessary, which will result in increased selling, general and administrative expenses in the period such determination is made.

Our bad debt expense as a percentage of revenue for the three months ended June 30, 2014 and 2013 was 5.7% and 3.3%, respectively. Our bad debt expense as a percentage of revenue for the six months ended June 30, 2014 and 2013 was 4.8% and 3.7%, respectively. Bad debt was negatively impacted for the three and six months ended June 30, 2014 by slower than normal collections due to our emphasis on accelerating the packaging of third quarter starts. Our exposure to changes in our bad debt expense could impact our operations. A 1% increase in our bad debt expense as a percentage of revenues for the six months ended June 30, 2014 and 2013 would have resulted in an increase in bad debt expense of \$1.6 million and \$1.7 million, respectively.

We do not believe that there is any direct correlation between tuition increases, the credit we extend to students and our loan commitments. Our loan commitments to our students are made on a student-by-student basis and are predominantly a function of the specific student's financial condition. We only extend credit to the extent there is a financing gap between the tuition charged for the program and the amount of grants, loans and parental loans each student receives. Each student's funding requirements are unique. Factors that determine the amount of aid available to a student are student status (whether they are dependent or independent students), Pell Grants awarded, Plus loans awarded or denied to parents and family contributions. As a result, it is extremely difficult to predict the number of students that will need us to extend credit to them. Our tuition increases have ranged historically from 3% to 5% annually and have not meaningfully impacted overall funding requirements.

Because a substantial portion of our revenue is derived from Title IV programs, any legislative or regulatory action that significantly reduces the funding available under Title IV programs or the ability of our students or schools to participate in Title IV programs could have a material effect on the realizability of our receivables.

Goodwill. We test our goodwill for impairment annually, or whenever events or changes in circumstances indicate an impairment may have occurred, by comparing its fair value to its carrying value. Impairment may result from, among other things, deterioration in the performance of the acquired business, adverse market conditions, adverse changes in applicable laws or regulations, including changes that restrict the activities of the acquired business, and a variety of other circumstances. If we determine that impairment has occurred, we are required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made. In evaluating the recoverability of the carrying value of goodwill and other indefinite-lived intangible assets, we must

make assumptions regarding estimated future cash flows and other factors to determine the fair value of the acquired assets. Changes in strategy or market conditions could significantly impact these judgments in the future and require an adjustment to the recorded balances.

Goodwill represents a significant portion of our total assets. As of June 30, 2014, goodwill represented approximately \$62.5 million, or 26.0%, of our total assets.

There was no goodwill impairment during the three and six months ended June 30, 2014. As of June 30, 2013, we concluded that current period losses at two reporting units, which resulted in a deterioration of current and projected cash flows, was an indicator of potential impairment and, accordingly, tested goodwill and long-lived assets for impairment. The tests indicated that these two reporting units were impaired, which resulted in a pre-tax non-cash charge of \$3.1 million for the three months ended June 30, 2013.

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Long-lived assets. We review the carrying value of our long-lived assets and identifiable intangibles for possible impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. We evaluate long-lived assets for impairment by examining estimated future cash flows. These cash flows are evaluated by using weighted probability techniques as well as comparisons of past performance against projections. Assets may also be evaluated by identifying independent market values. If we determine that an asset's carrying value is impaired, we will record a write-down of the carrying value of the asset and charge the impairment as an operating expense in the period in which the determination is made.

There was no long-lived asset impairment during the three and six months ended June 30, 2014. We concluded as of June 30, 2013 and March 31, 2013, there was sufficient evidence to conclude that there were impairments of certain long-lived assets at four and two of our campuses, respectively. Long lived assets had been tested at these campuses as a result of certain financial indicators such as our history of losses, our current respective period losses, as well as future projected losses at these campuses. The long-lived assets impairment resulted in a pre-tax charge of \$1.4 million (of which \$0.7 million is included in discontinued operations) and \$1.7 million (of which \$1.6 million is included in discontinued operations) for leasehold improvements as of June 30, 2013 and March 31, 2013, respectively.

Bonus costs. We accrue the estimated cost of our bonus programs using current financial information as compared to target financial achievements and key performance objectives. Although our recorded liability for bonuses is based on our best estimate of the obligation, actual results could differ and require adjustment of the recorded balance.

Income taxes. We account for income taxes in accordance with FASB ASC Topic 740, "Income Taxes" ("ASC 740"). This statement requires an asset and liability approach for measuring deferred taxes based on temporary differences between the financial statement and tax bases of assets and liabilities existing at each balance sheet date using enacted tax rates for years in which taxes are expected to be paid or recovered.

In accordance with ASC 740, we assess our deferred tax asset to determine whether all or any portion of the asset is more likely than not unrealizable. A valuation allowance is required to be established or maintained when, based on currently available information, it is more likely than not that all or a portion of a deferred tax asset will not be realized. In accordance with ASC 740, our assessment considers whether there has been sufficient income in recent years and whether sufficient income is expected in future years in order to utilize the deferred tax asset. In evaluating the realizability of deferred income tax assets, we considered, among other things, historical levels of income, expected future income, the expected timing of the reversals of existing temporary reporting differences, and the expected impact of tax planning strategies that may be implemented to prevent the potential loss of future income tax benefits. Significant judgment is required in determining the future tax consequences of events that have been recognized in our consolidated financial statements and/or tax returns. Differences between anticipated and actual outcomes of these future tax consequences could have a material impact on our consolidated financial position or results of operations. Changes in, among other things, income tax legislation, statutory income tax rates, or future income levels could materially impact our valuation of income tax assets and liabilities and could cause our income tax provision to vary significantly among financial reporting periods. On the basis of this evaluation the realization of our deferred tax assets was not deemed to be more likely than not and thus we have provided a valuation allowance on our net deferred tax assets.

We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense. During the three and six months ended June 30, 2014 and 2013, there were no interest and penalties expense associated with uncertain tax positions.

## Effect of Inflation

Inflation has not had a material effect on our operations.





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## Results of Continuing Operations

Certain reported amounts in our analysis have been rounded for presentation purposes.

The following table sets forth selected consolidated statements of operations data as a percentage of revenues for each of the periods indicated:

|   | Three Months |         | Six Months |         |
|---|--------------|---------|------------|---------|
|   | Ended        |         | Ended      |         |
|   | June 30,     |         | June 30,   |         |
|   | 2014         | 2013    | 2014       | 2013    |
| Revenue   | 100.0%       | 100.0%  | 100.0%     | 100.0%  |
| Costs and expenses:                                 |              |         |            |         |
| Educational services and facilities                 | 53.8 %       | 51.9 %  | 53.6 %     | 51.2 %  |
| Selling, general and administrative                 | 59.1 %       | 55.8 %  | 58.8 %     | 56.9 %  |
| Gain on sale of assets                              | 0.0 %        | -0.3 %  | 0.0 %      | -0.2 %  |
| Impairment of goodwill and long-lived assets        | 0.0 %        | 4.7 %   | 0.0 %      | 2.3 %   |
| Total costs and expenses                            | 112.9%       | 112.1%  | 112.4%     | 110.2%  |
| Operating loss                                      | -12.9 %      | -12.1 % | -12.4 %    | -10.2 % |
| Interest expense, net                               | -1.5 %       | -1.5 %  | -1.5 %     | -1.4 %  |
| Loss from continuing operations before income taxes | -14.4 %      | -13.6 % | -13.9 %    | -11.6 % |
| Provision (benefit) for income taxes                | 0.6 %        | -5.4 %  | 0.5 %      | -4.5 %  |
| Loss from continuing operations                     | -15.0 %      | -8.2 %  | -14.4 %    | -7.1 %  |

## Three Months Ended June 30, 2014 Compared to Three Months Ended June 30, 2013

Revenue. Revenue decreased by \$4.6 million, or 5.6%, to \$77.2 million for the quarter ended June 30, 2014 from \$81.8 million for the quarter ended June 30, 2013. The decrease was primarily attributable to a 4.8% decrease in average student population, which decreased to 13,803 for the quarter ended June 30, 2014 from 14,500 for the quarter ended June 30, 2013 and a 0.9% decrease in average revenue per student. We began 2014 with approximately 1,800 or 11.4%, fewer students than we had on January 1, 2013.

Average revenue per student decreased 0.9% for the quarter ended June 30, 2014 compared to the quarter ended June 30, 2013 primarily due to an increase in institutional scholarships. For a general discussion of trends in our student enrollment, see “- Seasonality and Trends” below.

Educational services and facilities expense. Our educational services and facilities expense decreased by \$0.9 million, or 2.0%, to \$41.5 million for the quarter ended June 30, 2014 from \$42.4 million for the quarter ended June 30, 2013. This decrease in educational services and facilities expense was primarily due to a \$0.5 million, or 2.3%, decrease in instructional expenses and a \$0.3 million, or 7.4%, decrease in books and tools expense.

The decrease in instructional expenses was primarily due to a reduction in the number of instructors and other related costs at our campuses resulting from a lower average student population. The decrease in books and tools expense is also attributable to the decrease in average student population of approximately 700 students for the quarter ended June 30, 2014 compared to the quarter ended June 30, 2013.

Our educational expenses contain a high fixed cost component and are not as leverageable as some of our other expenses. As our student population decreases, we typically experience a reduction in average class size and, therefore, are not always able to align these expenses with the corresponding decrease in population.

As a result, educational services and facilities expenses, as a percentage of revenue, increased to 53.8% for the quarter ended June 30, 2014 from 51.9% for the quarter ended June 30, 2013.

**Selling, general and administrative expense.** Our selling, general and administrative expense for the quarter ended June 30, 2014 was \$45.6 million, essentially flat compared to the quarter ended June 30, 2013. The administrative expenses portion of selling, general and administrative expense increased by \$0.3 million, or 1.3% which was offset by a decrease of \$0.3 million, or 1.7%, in sales and marketing expenses.

The increase in administrative expenses was primarily due to a \$1.6 million increase in bad debt expense and a \$0.5 million increase resulting from the consolidation of two of our campuses, offset by a \$1.9 million decrease in compensation and benefits.

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Bad debt expense as a percentage of revenue was 5.7% for the quarter ended June 30, 2014, compared to 3.3% for the quarter ended June 30, 2013. Bad debt was negatively impacted for the three months ended June 30, 2014 by slower than normal collections due to our emphasis on accelerating the packaging of third quarter starts.

The decrease in sales and marketing expenses was primarily due to a reduction in marketing expenses as well as a reduction in the number of admissions representatives as we continued to align our cost structure to our student population.

As a percentage of revenues, selling, general and administrative expense for the quarter ended June 30, 2014 increased to 59.1% from 55.8% for the quarter ended June 30, 2013.

As of June 30, 2014, we had outstanding loan commitments to our students of \$31.3 million, as compared to \$33.7 million at March 31, 2014. Loan commitments, net of interest that would be due on the loans through maturity, were \$22.5 million at June 30, 2014, as compared to \$23.9 million at March 31, 2014. The decrease in loan commitments is primarily due to lower average student population.

Impairment of goodwill and long-lived assets. As of June 30, 2014, we concluded that there was no indicator of potential impairment for reporting units with goodwill and, accordingly, we did not test goodwill for impairment. As of June 30, 2013, we tested goodwill and long-lived assets for impairment and determined that an impairment of approximately \$4.5 million (\$0.7 million included in discontinued operations) existed for two reporting units related to goodwill and two asset groups related to long-lived assets.

Income taxes. Our provision for income taxes for the quarter ended June 30, 2014 was \$0.4 million, or (3.9%) of pretax loss, compared to a benefit for income taxes of \$4.4 million, or 39.6%, of pretax loss for the quarter ended June 30, 2013. No federal or state income tax benefit was recognized for the current period loss due to the recognition of a full valuation allowance. Income tax expense for the quarter ended June 30, 2014 resulted from an increase in deferred tax liabilities associated with indefinite-lived intangible assets and various state tax expenses.

We assess the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant piece of objective negative evidence was the cumulative losses incurred by us in recent years. On the basis of this evaluation, the realization of our deferred tax assets was not deemed to be more likely than not and thus we maintained a valuation allowance on our net deferred tax assets as of June 30, 2014.

Six Months Ended June 30, 2014 Compared to Six Months Ended June 30, 2013

Revenue. Revenue decreased by \$10.9 million, or 6.5%, to \$157.1 million for the six months ended June 30, 2014 from \$168.0 million for the six months ended June 30, 2013. The decrease was primarily attributable to a 7.0% decrease in average student population, which decreased to 13,984 for the six months ended June 30, 2014 from 15,034 for the six months ended June 30, 2013 partially offset by a 0.6% increase in average revenue per student. We began 2014 with approximately 1,800, or 11.4%, fewer students than we had on January 1, 2013.

Average revenue per student increased 0.6% for the six months ended June 30, 2014 compared to the six months ended June 30, 2013 primarily due improved student retention partially offset by an increase in institutional scholarships. For a general discussion of trends in our student enrollment, see “- Seasonality and Trends” below.

Educational services and facilities expense. Our educational services and facilities expense decreased by \$1.7 million, or 2.0%, to \$84.2 million for the six months ended June 30, 2014 from \$86.0 million for the six months ended June 30, 2013. This decrease in educational services and facilities expense was primarily due to a \$1.9 million, or 4.3%, decrease in instructional expenses.

The decrease in instructional expenses was primarily due to a reduction in the number of instructors and other related costs at our campuses resulting from a lower average student population.

Our educational expenses contain a high fixed cost component and are not as leverageable as some of our other expenses. As our student population decreases, we typically experience a reduction in average class size and, therefore, are not always able to align these expenses with the corresponding decrease in population. As a result, educational services and facilities expenses, as a percentage of revenue, increased to 53.6% for the six months ended June 30, 2014 from 51.2% for the six months ended June 30, 2013.

**Selling, general and administrative expense.** Our selling, general and administrative expense for the six months ended June 30, 2014 was \$92.4 million, a decrease of \$3.3 million, or 3.5%, from \$95.7 million for the six months ended June 30, 2013. The decrease in our selling, general and administrative expense was primarily due to a \$2.0 million, or 3.7%, decrease in administrative expenses and a \$1.2 million, or 3.4%, decrease in sales and marketing expense.

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The decrease in administrative expenses was primarily due to a \$3.3 million decrease in compensation and benefits offset by a \$1.3 million increase in bad debt expense.

Bad debt expense as a percentage of revenue was 4.8% for the six months ended June 30, 2014, as compared to 3.7% the six months ended June 30, 2013. Bad debt was negatively impacted for the six months ended June 30, 2014 by slower than normal collections due to our emphasis on accelerating the packaging of third quarter starts.

The decrease in sales and marketing expenses was primarily due to a reduction in marketing expenses as well as a reduction in the number of admissions representatives as we continued to align our cost structure to our student population.

As a percentage of revenues, selling, general and administrative expense for the six months ended June 30, 2014 increased to 58.8% from 56.9% for the six months ended June 30, 2013.

As of June 30, 2014, we had outstanding loan commitments to our students of \$31.3 million, as compared to \$36.5 million at December 31, 2013. Loan commitments, net of interest that would be due on the loans through maturity, were \$22.5 million at June 30, 2014, as compared to \$26.5 million at December 31, 2013. The decrease in loan commitments is primarily due to lower student population.

Impairment of goodwill and long-lived assets. As of June 30, 2014, we concluded that there was no indicator of potential impairment for reporting units with goodwill and, accordingly, we did not test goodwill for impairment. As of June 30, 2013 and March 31, 2014, we tested goodwill and long-lived assets for impairment and determined that an impairment of approximately \$6.2 million (\$2.3 million included in discontinued operations) existed for two reporting units related to goodwill and six asset groups related to long-lived assets.

Income taxes. Our provision for income taxes for the six months ended June 30, 2014 was \$0.9 million, or (3.9%) of pretax loss, compared to a benefit for income taxes of \$7.6 million, or 38.8%, of pretax loss for the six months ended June 30, 2013. No federal or state income tax benefit was recognized for the current period loss due to the recognition of a full valuation allowance. Income tax expense for the six months ended June 30, 2014 resulted from an increase in deferred tax liabilities associated with indefinite-lived intangible assets and various state tax expenses.

We assess the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant piece of objective negative evidence was the cumulative losses incurred by us in recent years. On the basis of this evaluation the realization of our deferred tax assets was not deemed to be more likely than not and thus we continue to maintain a valuation allowance on our net deferred tax assets as of June 30, 2014.

Liquidity and Capital Resources

Our primary capital requirements are for facility maintenance and expansion, acquisitions and the development of new programs. Our principal sources of liquidity have been cash provided from operations and borrowings under our Credit Facility.

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The following chart summarizes the principal elements of our cash flows (in thousands):

|   | Six Months Ended |            |
|---|------------------|------------|
|   | June 30,         |            |
|   | 2014             | 2013       |
| Net cash used in operating activities               | \$(14,899)       | \$(14,272) |
| Net cash used in investing activities               | (2,544 )         | (1,620 )   |
| Net cash provided by (used in) financing activities | 11,316           | (41,550)   |

As of June 30, 2014, we had cash and cash equivalents of \$6.8 million, representing a decrease of approximately \$6.1 million as compared to \$12.9 million of cash and cash equivalents as of December 31, 2013. This decrease is primarily due to a net loss during the six months ended June 30, 2014 of \$22.7 million partially offset by \$15.0 million of borrowings under our Credit Facility during the first six months of 2014. In addition, we repaid \$54.5 million of borrowings under our Credit Facility in the first quarter of 2014 which was included in restricted cash as of December 31, 2013. Historically, we have financed our operating activities and organic growth primarily through cash generated from operations. We have financed acquisitions primarily through borrowings under our Credit Facility and cash generated from operations. We currently anticipate that we will be able to meet our short-term cash needs, as well as our need to fund operations and meet our obligations beyond the next twelve months with cash generated by operations, existing cash balances, borrowings under our Credit Facility and leveraging our owned real property. In addition, we may also consider accessing the financial markets in the future as a source of liquidity for capital requirements, acquisitions and general corporate purposes to the extent such requirements are not satisfied by cash on hand, borrowings under our Credit Facility or operating cash flows. However, we cannot assure you that we will be able to raise additional capital on favorable terms, if at all. As of June 30, 2014, we had \$15.0 million outstanding under our Credit Agreement. As of June 30, 2014, we had outstanding letters of credit aggregating \$5.3 million, which primarily comprised of letters of credit for the DOE and security deposits in connection with certain of our real estate leases.

Our primary source of cash is tuition collected from our students. The majority of students enrolled at our schools rely on funds received under various government-sponsored student financial aid programs to pay a substantial portion of their tuition and other education-related expenses. The largest of these programs are Title IV Programs which represented approximately 80% of our cash receipts relating to revenues in 2013. Students must apply for a new loan for each academic period. Federal regulations dictate the timing of disbursements of funds under Title IV Programs and loan funds are generally provided by lenders in two disbursements for each academic year. The first disbursement is usually received approximately 31 days after the start of a student's academic year and the second disbursement is typically received at the beginning of the sixteenth week from the start of the student's academic year. Certain types of grants and other funding are not subject to a 30-day delay. In certain instances, if a student withdraws from a program prior to a specified date, any paid but unearned tuition or prorated Title IV financial aid is refunded according to federal, state and accrediting agency standards.

As a result of the significance of the Title IV funds received by our students, we are highly dependent on these funds to operate our business. Any reduction in the level of Title IV funds that our students are eligible to receive or any impact on our ability to be able to receive Title IV funds would have a significant impact on our operations and our financial condition. See "Risk Factors" in Item 1A, included in our Annual Report on Form 10-K for the year ended December 31, 2013.

#### Operating Activities

Net cash used in operating activities was \$14.9 million for the six months ended June 30, 2014 as compared to \$14.3 million for six months ended June 30, 2013. The \$0.6 million decrease in net cash primarily resulted from an increase in net loss and other working capital items.

### Investing Activities

Net cash used in investing activities for the six months ended June 30, 2014 was \$2.5 million compared to \$1.6 million for the six months ended June 30, 2013. Our primary use of cash in investing activities was capital expenditures.

Capital expenditures are expected to approximate 1% to 3% of revenues in 2014 as compared to 1.9% in 2013. We expect to fund these capital expenditures with cash generated from operating activities and with borrowings under our credit facility.

We currently lease a majority of our campuses. We own our campuses in Grand Prairie, Texas; West Palm Beach, Florida; Nashville, Tennessee; Cincinnati (Tri-County), Ohio; Suffield, Connecticut; and Denver, Colorado. Our Cincinnati (Tri-County), Ohio and Suffield, Connecticut locations are held for sale. Although our current growth strategy is to continue our organic growth, strategic acquisitions of operations will be considered. To the extent that these potential strategic acquisitions are large enough to require financing beyond available cash from operations and borrowings under our Credit Facility, we may incur additional debt and/or issue additional debt or equity securities.

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Financing Activities

Net cash provided by financing activities was \$11.3 million for the six months ended June 30, 2014, as compared to net cash used in financing activities of \$41.6 million for the six months ended June 30, 2013. The increase of \$52.9 million was primarily attributable to \$15.0 of net proceeds from borrowing for the six months ended June 30, 2014 as compared to net payments on borrowings of \$37.5 million for the six months ended June 30, 2013.

Credit Agreement

On April 5, 2012, we, as borrower, and certain of our wholly-owned subsidiaries, as guarantors, entered into a secured revolving credit agreement with a syndicate of four lenders led by Bank of America, N.A., as administrative agent and letter of credit issuer (the "Credit Facility"). The April 5, 2012 agreement, along with subsequent amendments dated June 18, 2013 and December 20, 2013, are collectively referred to as the "Credit Agreement."

As of December 31, 2013, the aggregate principal amount available under the Credit Facility was \$60 million. Under the terms of the Credit Agreement, effective January 16, 2014, this amount was reduced to \$40 million. The Credit Facility may be used to finance capital expenditures and permitted acquisitions, to pay transaction expenses, for the issuance of letters of credit and for general corporate purposes. The Credit Agreement includes a \$25 million letter of credit sublimit. Borrowings under the Credit Facility are secured by a first priority lien on substantially all of our and our subsidiaries' the tangible and intangible assets of the Company and its subsidiaries including real estate. The term of the Credit Facility is 36 months, maturing on April 5, 2015.

The Credit Agreement provides that the lenders will receive first priority lien on substantially all of our tangible and intangible non-real property assets of our and our subsidiaries as well as a first priority lien on substantially all real property owned by us and our subsidiaries and that all net proceeds of future sales of real property by our and our subsidiaries be used to prepay revolving loans and permanently reduce the principal amount of revolving loans available under the Credit Facility.

Amounts borrowed as revolving loans under the Credit Facility will bear interest, at our option, at either (i) an interest rate based on LIBOR and adjusted for any reserve percentage obligations under Federal Reserve Bank regulations (the "Eurodollar Rate") for specified interest periods or (ii) the Base Rate (as defined in the Credit Agreement), in each case, plus an applicable margin rate as determined under the Credit Agreement. The "Base Rate", as defined under the Credit Agreement, is the highest of (a) the rate of interest announced from time to time by Bank of America, N.A. as its prime rate, (b) the Federal Funds rate plus 0.50% and (c) a daily rate equal to the one-month LIBOR rate plus 1.0%. Pursuant to the Amendment, the margin interest rate is subject to adjustment within a range of 2.50% to 6.00% based upon changes in our consolidated leverage ratio and depending on whether we have chosen the Eurodollar Rate or the Base Rate option. Letters of credit will require a fee equal to the applicable margin rate multiplied by the daily amount available to be drawn under each issued letter of credit plus an agreed upon fronting fee and customary issuance, presentation, amendment and other processing fees associated with letters of credit.

The Credit Agreement contains representations, warranties and covenants including consolidated adjusted net worth, consolidated leverage ratio, consolidated fixed charge coverage ratio, minimum financial responsibility composite score, cohort default rate and other financial covenants, certain restrictions on capital expenditures as well as affirmative and negative covenants and events of default customary for facilities of this type. In addition, we are paying fees to the lenders that are customary for facilities of this type. As of June 30, 2014 we are in compliance with all financial covenants.

The following table sets forth our long-term debt (in thousands):

June 30,



|                                       |           | December<br>31, |
|---------------------------------------|-----------|-----------------|
|                                       | 2014      | 2013            |
| Credit agreement                      | \$ 15,000 | \$ 54,500       |
| Finance obligation                    | 9,672     | 9,672           |
| Capital lease-property (rate of 8.0%) | 25,730    | 25,944          |
|                                       | 50,402    | 90,116          |
| Less current maturities               | (15,452)  | (435 )          |
|                                       | \$ 34,950 | \$ 89,681       |

We believe that our working capital, cash flows from operations, borrowings available from our Credit Facility and leveraging our owned real property will provide us with adequate resources for our ongoing operations through the next twelve months as well as our currently identified and planned capital expenditures.

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## Contractual Obligations

Long-term Debt. As of June 30, 2014, our long-term debt consisted of borrowings under our Credit Facility, the finance obligation in connection with our sale-leaseback transaction in 2001 and amounts due under capital lease obligations.

Lease Commitments. We lease offices, educational facilities and equipment for varying periods through the year 2032 at base annual rentals (excluding taxes, insurance, and other expenses under certain leases).

The following table contains supplemental information regarding our total contractual obligations as of June 30, 2014 (in thousands):

|                                     | Total     | Payments Due by Period |           |           |               |
|-------------------------------------|-----------|------------------------|-----------|-----------|---------------|
|                                     |           | Less than 1 year       | 2-3 years | 4-5 years | After 5 years |
| Credit agreement                    | \$15,000  | \$15,000               | \$-       | \$-       | \$-           |
| Capital leases (including interest) | 48,790    | 2,494                  | 5,142     | 5,356     | 35,798        |
| Operating leases                    | 110,604   | 20,924                 | 32,978    | 27,458    | 29,244        |
| Rent on finance obligation          | 3,909     | 1,564                  | 2,345     | -         | -             |
| Total contractual cash obligations  | \$178,303 | \$39,982               | \$40,465  | \$32,814  | \$65,042      |

## Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of June 30, 2014, except for our letters of credit of \$5.3 million which are primarily comprised of letters of credit for the DOE and security deposits in connection with certain of our real estate leases. These off-balance sheet arrangements do not adversely impact our liquidity or capital resources.

## Seasonality and Trends

## Seasonality

Our revenue and operating results normally fluctuate as a result of seasonal variations in our business, principally due to changes in total student population. Student population varies as a result of new student enrollments, graduations and student attrition. Historically, our schools have had lower student populations in our first and second quarters and we have experienced larger class starts in the third quarter and higher student attrition in the first half of the year. Our second half growth is largely dependent on a successful high school recruiting season. We recruit our high school students several months ahead of their scheduled start dates, and thus, while we have visibility on the number of students who have expressed interest in attending our schools, we cannot predict with certainty the actual number of new student enrollments and the related impact on revenue. Our expenses, however, typically do not vary significantly over the course of the year with changes in our student population and revenue. During the first half of the year, we make significant investments in marketing, staff, programs and facilities to meet our second half of the year targets and, as a result, such expenses do not fluctuate significantly on a quarterly basis. To the extent new student enrollments, and related revenue, in the second half of the year fall short of our estimates, our operating results could be negatively impacted. We expect quarterly fluctuations in operating results to continue as a result of seasonal enrollment patterns. Such patterns may change as a result of new school openings, new program introductions, and increased enrollments of adult students and/or acquisitions.

## 90/10 Rule

Under the HEA reauthorization, a proprietary institution that derives more than 90% of its total revenue from Title IV Programs, or 90/10 Rule percentage, for two consecutive fiscal years becomes immediately ineligible to participate in Title IV Programs and may not reapply for eligibility until the end of at least two fiscal years. An institution with revenues exceeding 90% for a single fiscal year ending after August 14, 2008 will be placed on provisional certification and may be subject to other enforcement measures. If an institution violated the 90/10 Rule and became ineligible to participate in Title IV Programs but continued to disburse Title IV Program funds, the DOE would require the institution to repay all Title IV Program funds received by the institution after the effective date of the loss of eligibility.

We have calculated that, for our 2013 fiscal year, our institutions' 90/10 Rule percentages ranged from 69% to 85%. For 2013 and 2012 none of our existing institutions derived more than 90% of their revenues from Title IV Programs. We regularly monitor compliance with this requirement to minimize the risk that any of our institutions would derive more than the maximum percentage of its revenues from Title IV Programs for any fiscal year. Our calculations may be subject to review by the DOE.

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Effective July 1, 2008, the annual Stafford loans available for undergraduate students under the Federal Family Education Loan Program, or FFEL program, increased. This increase, coupled with increases in grants from the Pell program and other Title IV loan limits, resulted in some of our schools experiencing an increase in the proportion of revenues they receive from Title IV Programs. The HEA reauthorization provided temporary relief from the impact of the loan limit increases by counting as non-Title IV revenue in the 90/10 Rule calculation amounts received from loans received between July 1, 2008 and June 30, 2011 that are attributable to the increased annual loan limits. The HEA authorization also provided other relief by allowing institutions to include as non-Title IV revenue in its 90/10 Rule calculation the net present value of certain institutional loans subject to certain limitations and conditions. Because of the increases in Title IV student loan limits and grants in recent years, it will be increasingly difficult for us to comply with the 90/10 Rule without increasing tuition prices above the applicable maximums for Title IV student loans and grants, because this is one of the more effective methods of reducing the 90/10 Rule percentage, although this method may not be successful. Moreover, the above-mentioned relief from certain loan limit increases expired for loans received on or after July 1, 2011, and the above-mentioned institutional loan relief expired for institutional loans made on or after July 1, 2012. If Congress or the DOE were to amend the 90/10 Rule to treat other forms of federal financial aid as Title IV revenue for 90/10 purposes, to lower the 90% threshold, or to otherwise change the calculation methodology (each of which has been proposed by some members of Congress in proposed legislation), or to make other changes, those changes could make it more difficult for our institutions to comply with the 90/10 Rule. If any of our institutions loses eligibility to participate in Title IV Programs, that loss would cause an event of default under our credit agreement, and would also adversely affect our students' access to various government-sponsored student financial aid programs, which could have a material adverse effect on the rate at which our students enroll in our programs and on our business and results of operations.

## Cohort Default Rates

The HEA limits participation in Title IV Programs by institutions whose former students defaulted on the repayment of federally guaranteed or funded student loans above a prescribed rate (the "cohort default rate"). The DOE calculates these rates based on the number of students who have defaulted, not the dollar amount of such defaults.

Under the HEA, an institution whose FFEL and Federal Direct Loan, or FDL, cohort default rate is 25% or greater for three consecutive federal fiscal years loses eligibility to participate in the FFEL, FDL, and Pell programs for the remainder of the federal fiscal year in which the DOE determines that such institution has lost its eligibility and for the two subsequent federal fiscal years. An institution whose FFEL and FDL cohort default rate for any single federal fiscal year exceeds 40% loses its eligibility to participate in the FFEL and FDL programs for the remainder of the federal fiscal year in which the DOE determines that such institution has lost its eligibility and for the two subsequent federal fiscal years. If an institution's cohort default rate equals or exceeds 25% in any of its three most recent fiscal years, the institution may be placed on provisional certification status.

The HEA increased the measuring period for each cohort default rate calculation by one year. Starting with the 2009 cohort, the DOE calculates both the current two-year and the new three-year cohort default rates. Beginning with the 2011 three-year cohort default rate, which is expected to be published for each of our institutions in September 2014, the three-year rates will be applied for purposes of measuring compliance with the requirements instead of the two-year rates currently used for those purposes. If the 2011 three-year cohort default rate exceeds 40%, the institution will cease to be eligible to participate in the FDL and Federal Stafford Loan programs for the remainder of the fiscal year in which the DOE determines that such institution has lost its eligibility and for the two subsequent fiscal years. If the institution's three-year cohort default rate exceeds 30% (an increase from the current 25% threshold applicable to the two-year cohort default rates) for three consecutive years, beginning with the 2009 cohort, the institution will cease to be eligible to participate in the Pell, FDL, and FFEL programs for the remainder of the fiscal year in which the DOE determines that such institution has lost its eligibility and for the two subsequent fiscal years. If an institution's three-year cohort default rate equals or exceeds 30% in two of the three most recent years for which the DOE has issued three-year rates, the institution may be placed on provisional certification status.

The most recent two-year cohort default rates published by the DOE are for the 2011 federal fiscal year. The rates for our existing institutions for the 2011 federal fiscal year range from 13.2% to 21.5%. None of our existing institutions have final two-year cohort default rates over 25% for the 2011, 2010 or 2009 federal fiscal years.

The most recent three-year cohort default rates published by the DOE are for the 2010 federal fiscal year. The three-year rates for our existing institutions for the 2010 federal fiscal year range from 19.0% to 34.0%. For the 2010 federal fiscal year, two of our institutions, Indianapolis, Indiana and New Britain, Connecticut, have cohort default rates of at least 30%. One of our institutions, Indianapolis, Indiana, has exceeded the 30% three year CDR threshold for two consecutive years (2009 and 2010). In February 2014, the DOE released draft three-year cohort default rates for the 2011 federal fiscal year. None of our existing institutions had draft cohort default rates of at least 30%. The draft cohort default rates are subject to change pending receipt of the final cohort default rates, which the DOE is expected to publish in September 2014.

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While we strive to improve the cohort default rates for each of our institutions, the current economic climate, combined with the demographics of the students that we traditionally serve, makes this objective even more challenging. As a result, we have significantly increased our default management personnel to help enhance the financial literacy of our students and graduates, with the goal of helping students stay current in their loan payments. We have also engaged third-party consultants to assist those institutions who have historically had the highest cohort default rates.

## Gainful Employment and Other Recent and Proposed DOE Regulations

The DOE issued final regulations on October 29, 2010, with a general effective date of July 1, 2011, and which included, but were not limited to: revisions to the incentive compensation rule, the definition of high school diploma for the purpose of establishing institutional eligibility to participate in the Title IV programs and student eligibility to receive Title IV aid, ability to benefit students, misrepresentation of information provided to students and prospective students, incentive compensation, state authorization as a component of institutional eligibility, agreements between institutions of higher education, verification of information included on student aid applications, satisfactory academic progress, monitoring grade point averages, retaking coursework, return of Title IV funds with respect to term based programs with modules or compressed courses and with respect to taking attendance, and the timeliness and method of disbursements of Title IV funds. The topics covered in these regulations also included a new federal definition of a "credit hour" for federal student aid purposes. The new definition has resulted in changes to the number of credit hours awarded for certain of our educational programs and in changes to the amount of federal student aid available to students enrolled in such programs. The implementation of all of the October 2010 final regulations required us to change certain of our practices to comply with these requirements. The changes to our practices, or our inability to comply with the final regulations on or after their effective date, have had and may continue to have a material adverse effect on our business and results of operations.

On March 25, 2014, the DOE published a Notice of Proposed Rulemaking in the Federal Register containing a proposed gainful employment regulation that would apply to all educational programs that are subject to the DOE requirement of preparing students for gainful employment in a recognized occupation. Such educational programs include all of the Title IV-eligible educational programs at each of our institutions.

The proposed regulation would require each educational program to achieve threshold rates in three debt measure categories related to an annual debt to annual earnings ratio, an annual debt to discretionary income ratio, and a program cohort default rate. The various formulas are calculated under complex methodologies and definitions outlined in the draft regulatory language and, in some cases, are based on data that may not be readily accessible to institutions. The draft language outlines various scenarios under which programs could lose Title IV eligibility for failure to achieve threshold rates in one or more measures over certain periods of time ranging from two to four years. The draft language also requires an institution to provide warnings to current and prospective students in programs which may lose Title IV eligibility at the end of an award or fiscal year. In addition, the proposed regulation would impose extensive reporting and disclosure obligations on institutions offering gainful employment programs.

The period for public comment on the proposed regulations has concluded. The DOE will consider revisions to the proposed regulation and then prepare and publish final regulations. The draft regulatory language discussed above is not final and is subject to change by the DOE. Accordingly, we cannot predict the ultimate content of any new regulations that may emerge or the potential impact of such regulations on us or our institutions. New final DOE regulations published on or before November 1, 2014 typically would have an effective date of July 1, 2015, although it is unknown at this time whether some or all of these regulations might have an earlier or later effective date. The implementation of new gainful employment regulations, or any other changes the DOE may propose and implement, could require us to eliminate certain educational programs, and could have a material adverse effect on the rate at which students enroll in our programs and on our business and results of operations.

The DOE also announced additional topics for consideration for new regulations by a negotiated rulemaking committee that began meeting in February 2014. The topics under discussion included, but were not be limited to, the following: clock to credit hour conversion for programs offered in credit hours that do not transfer into degree programs and are subject to the federal conversion formula for determining credit hours; cash management of funds provided under the Title IV Federal student aid programs, including the handling of the use of debit cards and the handling of credit balances; state authorization for programs offered through distance education or correspondence education; state authorization for foreign locations of institutions located in a state; and the definition of "adverse credit" for borrowers of certain loans. Another committee met during sessions beginning in January 2014 and addressing topics related to the scope of campus crime statistics that Title IV participating institutions are required to distribute to current and prospective students and employees.

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The DOE intends to use the negotiated rulemaking process during 2014 to develop new regulations on these and potentially other topics. These regulations typically would be subject to a notice and comment period during which the public comments on proposed regulations and the DOE responds to comments and publishes final regulations. The DOE published a Notice of Proposed Rulemaking in the Federal Register on June 20, 2014 containing proposed regulations arising out of the sessions that began on January 2014 and addressed topics related to campus crime statistics and other matters, but has not published proposed regulations arising out of the sessions that began in February 2014. We cannot predict the ultimate content of any new regulations that may emerge from this process or the potential impact of such regulations on us or our institutions. New final DOE regulations published on or before November 1, 2014 typically would have an effective date of July 1, 2015, although it is unknown at this time whether some or all of these regulations may have an earlier or later effective date. The implementation of any new regulations by DOE could have a material adverse effect on the rate at which students enroll in our programs and on our business and results of operations.

### ATB Students

ATB students are non-GED and non-high school graduates who are allowed to enroll in post-secondary institutions by passing a DOE approved exam. ATB students are traditionally a higher risk population who complete their programs at a lower rate and default on their student loans at a higher rate than non-ATB students. On December 23, 2011, President Obama signed into law the Appropriations Act. This law eliminates the ability of ATB students who first enroll after July 1, 2012 to participate in federal student financial aid programs. As a result, we stopped enrolling ATB students as of July 1, 2012. This reduction in ATB students has negatively impacted our total enrollment and our revenue.

### Outlook

We have experienced significant deterioration in student enrollments over the last several years. This can be attributed to changes to admissions advisor compensation policies, coupled with the current economic slowdown. In addition, to the 90/10 Rule, cohort default rates, the elimination of ATB, gainful employment and other recent and proposed DOE regulations, mentioned above, have all led to the deterioration in student starts. We began to see stabilization in our student starts from our continuing operations and experienced positive student starts in both the first and second quarters of the year. In particular our automotive and skill trade programs appear to have stabilized while our other programs continue to experience challenges. Some of this can be attributable to parents' hesitation to take on debt, parental loan denials, as well as large financing gaps that exist in certain programs. We continue to explore ways to help these students achieve their goals, including reducing tuition of certain programs or providing need based scholarships.

While our student starts leveled off in the first half of the year, we continue to be challenged by the current economic environment as well as the continued hesitation of our student and their parents to incur debt. In addition, recent events in our industry, including the closing and potential sale of one of our competitors has compounded the negative publicity in our industry and has caused a major disruption to our business. We now expect that these events, coupled with the continued economic challenges, will delay the recovery in starts we expected in 2014. We expect that this trend will improve as the economy improves but cannot predict when this will occur.

The continued deterioration in our student population produced negative operating margins in 2013 and the first half of 2014. While we experienced negative margins we expect that this will reverse in the near future. Until that does occur we anticipate that we will be able to meet our short-term cash needs, as well as our need to fund operations and meet our obligations beyond the next twelve months with cash generated by operations, existing cash balances, borrowings under our Credit Facility and leveraging our owned real property.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK



We are exposed to certain market risks as part of our on-going business operations. We have a Credit Agreement with a syndicate of banks. Our obligations under the Credit Agreement are secured by a lien on substantially all of our assets and our subsidiaries and any assets that we or our subsidiaries may acquire in the future, including a pledge of substantially all of our subsidiaries' common stock. Outstanding borrowings bear interest at the rate of 6.25% to 7.25% (as calculated in the credit agreement) as of June 30, 2014. As of June 30, 2014, we had \$15.0 million outstanding under our credit agreement.

Our interest rate risk is associated with miscellaneous capital equipment leases, which is not significant.

Based on our outstanding debt balance as of June 30, 2014, a change of one percent in the interest rate would have caused a change in our interest expense of approximately \$0.2 million, or less than \$0.01 per basic share, on an annual basis. Changes in interest rates could have an impact however on our operations, which are greatly dependent on students' ability to obtain financing. Any increase in interest rates could greatly impact our ability to attract students and have an adverse impact on the results of our operations. The remainder of our interest rate risk is associated with miscellaneous capital equipment leases, which is not significant.

#### Item 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures. Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)) as of the end of the quarterly period covered by this report, have concluded that our disclosure controls and procedures are adequate and effective to reasonably ensure that material information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's Rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting. There were no changes made during our most recently completed fiscal quarter in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

In the ordinary conduct of our business, we are subject to periodic lawsuits, investigations and claims, including, but not limited to, claims involving students or graduates and routine employment matters. Although we cannot predict with certainty the ultimate resolution of lawsuits, investigations and claims asserted against us, we do not believe that any currently pending legal proceeding to which we are a party will have a material adverse effect on our business, financial condition, results of operations or cash flows.

On November 21, 2012, we received a Civil Investigation Demand from the Attorney General of the Commonwealth of Massachusetts relating to their investigation of whether we and certain of our academic institutions have complied with certain Massachusetts state consumer protection and finance laws. On July 29, 2013 and January 17, 2014, we received follow-up Civil Investigative Demands. Pursuant to the Civil Investigative Demands, the Attorney General has requested from us and certain of our academic institutions documents and detailed information from the time period January 1, 2008 to the present. The Company has responded to this request and intends to continue cooperating with the Attorney General's Office.

Item 6. EXHIBITS

EXHIBIT INDEX

The following exhibits are filed with or incorporated by reference into this Form 10-Q.

Exhibit

Number Description

- |      |  |
|------|--|
| 3.1  | Amended and Restated Certificate of Incorporation of the Company (1).  |
| 3.2  | Amended and Restated By-laws of the Company (2).   |
| 4.1  | Management Stockholders Agreement, dated as of January 1, 2002, by and among Lincoln Technical Institute, Inc., Back to School Acquisition, L.L.C. and the Stockholders and other holders of options under the Management Stock Option Plan listed therein (1).                              |
| 4.2  | Assumption Agreement and First Amendment to Management Stockholders Agreement, dated as of December 20, 2007, by and among Lincoln Educational Services Corporation, Lincoln Technical Institute, Inc., Back to School Acquisition, L.L.C. and the Management Investors parties therein (3). |
| 4.3  | Registration Rights Agreement, dated as of June 27, 2005, between the Company and Back to School Acquisition, L.L.C. (2).  |
| 4.4  | Specimen Stock Certificate evidencing shares of common stock (1).  |
| 10.1 | Credit Agreement, dated as of April 5, 2012, among the Company, the Guarantors from time to time parties thereto, the Lenders from time to time parties thereto and Bank of America, N.A., as Administrative Agent (5).  |
| 10.2 | First Amendment to the Credit Agreement, dated as of June 18, 2013, among the Company, the Guarantors from time to time parties thereto, the Lenders from time to time parties thereto and Bank of America, N.A.,  |

as Administrative Agent (11).

10.3 Second Amendment to the Credit Agreement, dated as of December 20, 2013, among the Company, the Guarantors from time to time parties thereto, the Lenders from time to time parties thereto and Bank of America, N.A., as Administrative Agent (12).

10.4 Employment Agreement, dated as of January 8, 2013, between the Company and Scott M. Shaw (8).

10.5 Employment Agreement, dated as of January 8, 2013, between the Company and Cesar Ribeiro (8).

10.6 Employment Agreement, dated as of January 8, 2013, between the Company and Shaun E. McAlmont (8).

10.7 Employment Agreement, dated as of January 8, 2013, between the Company and Piper P. Jameson (8).

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- 10.8 \* Employment Agreement, dated as of June 2, 2014, between the Company and Kenneth M. Swisstack.
- 10.9 Lincoln Educational Services Corporation Amended and Restated 2005 Long-Term Incentive Plan (7).
- 10.10 Lincoln Educational Services Corporation 2005 Non-Employee Directors Restricted Stock Plan (13).
- 10.11 Lincoln Educational Services Corporation 2005 Deferred Compensation Plan (1).
- 10.12 Lincoln Technical Institute Management Stock Option Plan, effective January 1, 2002 (1).
- 10.13 Form of Stock Option Agreement, dated January 1, 2002, between Lincoln Technical Institute, Inc. and certain participants (1).
- 10.14 Form of Stock Option Agreement under our 2005 Long-Term Incentive Plan (4).
- 10.15 Form of Restricted Stock Agreement under our 2005 Long-Term Incentive Plan (10).
- 10.16 Form of Performance-Based Restricted Stock Award Agreement under our Amended & Restated 2005 Long-Term Incentive Plan (9).
- 10.17 Management Stock Subscription Agreement, dated January 1, 2002, among Lincoln Technical Institute, Inc. and certain management investors (1).
- 10.18 Stock Repurchase Agreement, dated as of December 15, 2009, among Lincoln Educational Services Corporation and Back to School Acquisition, L.L.C (6).
- 31.1 \* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 \* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 \* Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101\*\* The following financial statements from Lincoln Educational Services Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, filed on August 8, 2014, formatted in XBRL: (i) Condensed Consolidated Statements of Operations, (ii) Condensed Consolidated Balance Sheets, (iii) Condensed Consolidated Statements of Cash Flows, (iv) Condensed Consolidated Statement of Changes in Stockholders' Equity, and (v) the Notes to Condensed Consolidated Financial Statements, tagged as blocks of text and in detail.

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- (1) Incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-123644).
- (2) Incorporated by reference to the Company's Form 8-K filed June 28, 2005.
- (3) Incorporated by reference to the Company's Registration Statement on Form S-3 (Registration No. 333-148406).
- (4) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2007.
- (5) Incorporated by reference to the Company's Form 8-K filed April 11, 2012.

- (6) Incorporated by reference to the Company's Form 8-K filed December 21, 2009.
  - (7) Incorporated by reference to the Company's Form 8-K filed May 6, 2013.
  - (8) Incorporated by reference to the Company's Form 8-K filed January 10, 2013.
  - (9) Incorporated by reference to the Company's Form 8-K filed May 5, 2011.
  - (10) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2012.
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(11) Incorporated by reference to the Company's Form 8-K filed June 20, 2013.

(12) Incorporated by reference to the Company's Form 8-K filed December 27, 2013.

(13) Registration Statement on Form S-8 (Registration No. 333-188240).

\* Filed herewith.

\*\* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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SIGNATURES

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

LINCOLN  
EDUCATIONAL  
SERVICES  
CORPORATION

Date: August 8, 2013 By: /s/ Cesar Ribeiro  
Cesar Ribeiro  
Chief Financial  
Officer  
(Duly Authorized  
Officer, Principal  
Accounting and  
Financial Officer)