

CAREER EDUCATION CORP  
Form 10-Q  
August 08, 2007

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark one)

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

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007**

**OR**

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

FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 0-23245

## CAREER EDUCATION CORPORATION

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)  
**2895 Greenspoint Parkway, Suite 600,**  
**Hoffman Estates, Illinois**  
(Address of principal executive offices)

**36-3932190**  
(I.R.S. Employer  
Identification No.)

**60169**  
(Zip Code)

Registrant's telephone number, including area code: **(847) 781-3600**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Number of shares of registrant's common stock, par value \$0.01, outstanding as of August 6, 2007: 91,205,657

---

CAREER EDUCATION CORPORATION

INDEX

	Page
<b>PART I FINANCIAL INFORMATION</b>	
<u>Item 1.</u>	
<u>Financial Statements</u>	3
<u>Unaudited Condensed Consolidated Balance Sheets</u>	3
<u>Unaudited Condensed Consolidated Statements of Income</u>	4
<u>Unaudited Condensed Consolidated Statement of Stockholders' Equity</u>	5
<u>Unaudited Condensed Consolidated Statements of Cash Flows</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	46
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	73
<u>Item 4.</u>	
<u>Controls and Procedures</u>	74
<b><u>PART II OTHER INFORMATION</u></b>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	76
<u>Item 1A.</u>	
<u>Risk Factors</u>	76
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	76
<u>Item 4.</u>	
<u>Submission of Matters to a Vote of Security Holders</u>	77
<u>Item 6.</u>	
<u>Exhibits</u>	77
<b><u>SIGNATURES</u></b>	78

**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****CAREER EDUCATION CORPORATION AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share amounts)

	June 30, 2007	December 31, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 99,161	\$ 187,853
Investments	264,095	259,766
Total cash and cash equivalents and investments	363,256	447,619
Receivables:		
Students, net of allowance for doubtful accounts of \$29,504 and \$28,709 as of June 30, 2007, and December 31, 2006, respectively	45,030	48,564
Other, net	9,229	8,094
Prepaid expenses	39,207	29,621
Inventories	18,375	16,853
Deferred income tax assets	7,105	11,357
Assets held for sale	60,692	63,156
Other current assets	18,725	32,064
Total current assets	561,619	657,328
<b>PROPERTY AND EQUIPMENT, net</b>	<b>341,954</b>	<b>352,270</b>
<b>GOODWILL</b>	<b>380,450</b>	<b>349,760</b>
<b>INTANGIBLE ASSETS, net</b>	<b>45,550</b>	<b>33,984</b>
<b>OTHER ASSETS</b>	<b>24,565</b>	<b>32,321</b>
<b>TOTAL ASSETS</b>	<b>\$ 1,354,138</b>	<b>\$ 1,425,663</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current maturities of long-term debt	\$ 11,311	\$ 12,098
Accounts payable	26,665	30,095
Accrued expenses:		
Payroll and related benefits	26,636	27,012
Income taxes	4,586	
Other	87,742	78,885
Deferred tuition revenue	114,598	132,186
Liabilities held for sale	31,246	31,879
Total current liabilities	302,784	312,155
<b>LONG-TERM LIABILITIES:</b>		
Long-term debt, net of current maturities	3,304	2,763
Deferred rent obligations	91,660	90,360
Deferred income tax liabilities	16,328	16,527
Other	8,413	7,980
Total long-term liabilities	119,705	117,630
<b>SHARE-BASED AWARDS SUBJECT TO REDEMPTION</b>	<b>13,827</b>	<b>13,477</b>
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; no shares issued or outstanding		
Common stock, \$0.01 par value; 300,000,000 shares authorized; 107,562,174 and 106,923,310 shares issued, 92,827,210 and 96,148,825 shares outstanding as of June 30, 2007, and December 31, 2006, respectively	1,076	1,069
Additional paid-in capital	688,554	666,780
Accumulated other comprehensive income	9,431	5,683
Retained earnings	710,001	675,188
Cost of 14,734,964 and 10,774,485 shares in treasury as of June 30, 2007, and December 31, 2006, respectively	(491,240 )	(366,319 )
Total stockholders equity	917,822	982,401
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 1,354,138</b>	<b>\$ 1,425,663</b>

Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

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

3

---

**CAREER EDUCATION CORPORATION AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except per share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended March 31,	
	2007	2006	2007	2006
<b>REVENUE:</b>				
Tuition and registration fees	\$ 389,243	\$ 435,443	\$ 797,531	\$ 905,122
Other	16,028	17,141	35,789	37,451
Total revenue	405,271	452,584	833,320	942,573
<b>OPERATING EXPENSES:</b>				
Educational services and facilities	143,958	136,663	288,263	278,462
General and administrative	229,717	233,405	448,540	465,454
Depreciation and amortization	19,662	19,371	38,443	37,760
Goodwill impairment charge		84,975		84,975
Total operating expenses	393,337	474,414	775,246	866,651
Income (loss) from operations	11,934	(21,830)	58,074	75,922
<b>OTHER INCOME (EXPENSE):</b>				
Interest income	4,132	4,679	8,836	8,973
Interest expense	(209)	(347)	(563)	(685)
Share of affiliate earnings	949	696	2,661	1,599
Miscellaneous income (expense)	479	(251)	716	(95)
Total other income	5,351	4,777	11,650	9,792
Income (loss) before provision for income taxes	17,285	(17,053)	69,724	85,714
<b>PROVISION FOR INCOME TAXES</b>	<b>6,287</b>	<b>22,959</b>	<b>25,449</b>	<b>61,395</b>
Income (loss) from continuing operations	10,998	(40,012)	44,275	24,319
<b>LOSS FROM DISCONTINUED OPERATIONS, net of tax</b>	<b>(5,873)</b>	<b>(7,497)</b>	<b>(9,112)</b>	<b>(19,129)</b>
<b>NET INCOME (LOSS)</b>	<b>\$ 5,125</b>	<b>\$ (47,509)</b>	<b>\$ 35,163</b>	<b>\$ 5,190</b>
<b>NET INCOME (LOSS) PER SHARE BASIC:</b>				
Income (loss) from continuing operations	0.12	\$ (0.41)	\$ 0.47	\$ 0.25
Loss from discontinued operations	(0.07)	(0.08)	(0.10)	(0.20)
Net income (loss)	\$ 0.05	\$ (0.49)	\$ 0.37	\$ 0.05
<b>NET INCOME (LOSS) PER SHARE DILUTED:</b>				
Income (loss) from continuing operations	\$ 0.12	\$ (0.41)	\$ 0.46	\$ 0.24
Loss from discontinued operations	(0.07)	(0.08)	(0.09)	(0.19)
Net income (loss)	\$ 0.05	\$ (0.49)	\$ 0.37	\$ 0.05
<b>WEIGHTED AVERAGE SHARES OUTSTANDING:</b>				
Basic	93,924	96,989	95,103	97,563
Diluted	94,659	96,989	95,715	99,631

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

## CAREER EDUCATION CORPORATION AND SUBSIDIARIES

## UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(In thousands)

	Common Stock Issued Shares	Par Value	Treasury Stock Purchased Shares	Cost	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
<b>BALANCE</b> , December 31, 2006	106,924	\$ 1,069	(10,774 )	\$ (366,319 )	\$ 666,780	\$ 5,683	\$ 675,188	\$ 982,401
Net income							35,163	35,163
Foreign currency translation						3,727		3,727
Unrealized gain on investments						21		21
Total comprehensive income								38,911
Treasury stock purchased			(3,961 )	(124,921 )				(124,921 )
Share-based compensation expense					8,225			8,225
Common stock issued under:								
Stock option plans	564	5			9,302			9,307
Employee stock purchase plan	74	2			1,681			1,683
Tax benefit of options exercised					2,566			2,566
Adjustment to share-based awards subject to redemption							(350 )	(350 )
<b>BALANCE</b> , June 30, 2007	107,562	\$ 1,076	(14,735 )	\$ (491,240 )	\$ 688,554	\$ 9,431	\$ 710,001	\$ 917,822

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



**CAREER EDUCATION CORPORATION AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Net income (loss)	\$ 5,125	\$ (47,509 )	\$ 35,163	\$ 5,190
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Goodwill impairment charge		84,975		95,364
Depreciation and amortization expense	19,662	21,942	38,443	42,951
Bad debt expense	12,513	17,787	20,962	32,263
Compensation expense related to share-based awards	5,124	4,471	8,225	8,486
(Gain) loss on disposition of property and equipment	(217 )	232	(216 )	255
Share of affiliate earnings, net of dividends received	20	(696 )	250	(1,599 )
Changes in operating assets and liabilities, net of acquisitions	(43,115 )	(72,378 )	(14,568 )	(51,449 )
Net cash provided by (used in) operating activities	(888 )	8,824	88,259	131,461
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Business acquisition, net of acquired cash			(30,324 )	
Acquisition transaction costs	(326 )		(1,432 )	
Purchases of property and equipment	(14,518 )	(25,608 )	(31,330 )	(43,151 )
Purchases of available-for-sale investments	(79,230 )	(190,831 )	(288,684 )	(552,450 )
Sales of available-for-sale investments	99,377	293,513	286,332	537,285
Other	(197 )	(105 )	(191 )	(110 )
Net cash provided by (used in) investing activities	5,106	76,969	(65,629 )	(58,426 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Purchase of treasury stock	(74,954 )	(99,920 )	(124,921 )	(124,845 )
Issuance of common stock	3,846	4,479	10,990	7,411
Tax benefit associated with stock option exercises	641	1,330	2,566	2,050
Payments of capital lease obligations and other long-term debt	(1,347 )	(95 )	(1,376 )	(184 )
Net cash used in financing activities	(71,814 )	(94,206 )	(112,741 )	(115,568 )
<b>EFFECT OF FOREIGN CURRENCY EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS:</b>	1,207	(20 )	1,912	814
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(66,389 )</b>	<b>(8,433 )</b>	<b>(88,199 )</b>	<b>(41,719 )</b>
<b>DISCONTINUED OPERATIONS CASH ACTIVITY INCLUDED ABOVE:</b>				
Add: Cash balance of discontinued operations at beginning of the period	2,478	1,898	1,964	3,094
Less: Cash balance of discontinued operations at end of the period	2,457	1,083	2,457	1,083
<b>CASH AND CASH EQUIVALENTS, beginning of the period</b>	<b>165,529</b>	<b>97,124</b>	<b>187,853</b>	<b>129,214</b>
<b>CASH AND CASH EQUIVALENTS, end of the period</b>	<b>\$ 99,161</b>	<b>\$ 89,506</b>	<b>\$ 99,161</b>	<b>\$ 89,506</b>

**CAREER EDUCATION CORPORATION AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. DESCRIPTION OF THE COMPANY**

We are a dynamic educational services company committed to quality, career-focused learning and led by passionate professionals who inspire individual worth and lifelong achievement. Since our founding in 1994, we have progressed rapidly toward our goal of becoming the world's leading provider of quality educational services. We are one of the world's leading on-ground providers of private, for-profit, postsecondary education and have a substantial presence in online education. Our schools and universities prepare students for professionally and personally rewarding careers through the continuing operation of 76 on-ground campuses located throughout the United States and in France, Canada, Italy, and the United Kingdom and three fully-online academic platforms.

Our schools and universities offer doctoral degree, master's degree, bachelor's degree, associate degree, and non-degree certificate and diploma programs in the following core career-oriented disciplines:

- *Culinary Arts:* Programs within this discipline include culinary arts, hotel and restaurant management, and baking and pastry arts.
- *Visual Communication and Design Technologies:* Programs within this discipline include desktop publishing, graphic design, fashion design and merchandising, interior design, graphic imaging, web page design, animation, photography, game design, digital film and media, and visual journalism.
- *Health Education:* Programs within this discipline include medical assistance, medical billing and coding, massage therapy, pharmacy technician, diagnostic medical ultrasound, cardiovascular technician, surgical technician, dental assistance, and medical office administration.
- *Business Studies:* Programs within this discipline include business administration, business operations, merchandising management, business administration and marketing, paralegal studies, hospitality management, criminal justice, and education.
- *Information Technology:* Programs within this discipline include PC/LAN, PC/Net, computer technical support, computer network operation, computer information management, computer science, computer engineering, and computer programming.

**2. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the financial statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. The condensed consolidated balance sheet as of December 31, 2006, has been derived from the audited consolidated financial statements as of that date. For additional information, refer to the consolidated financial statements and notes to consolidated financial statements as of and for the year ended December 31, 2006, included in Part IV, Item 15 of our Annual Report on Form 10-K for the year ended December 31, 2006, filed with the Securities and Exchange Commission ( SEC ) on March 1, 2007.

As used in this Quarterly Report on Form 10-Q, the terms we, us, our, and CEC refer to Career Education Corporation and our wholly-owned subsidiaries. The terms school and university refer to an individual, branded, proprietary educational institution, owned by us and including its campus locations. The term campus refers to an individual main or branch campus operated by one of our schools or universities.

The unaudited condensed consolidated financial statements presented herein include the accounts of CEC and our wholly-owned subsidiaries. All inter-company transactions and balances have been eliminated. The results of operations of all acquired businesses have been consolidated for all periods subsequent to the date of acquisition.

During the second quarter of 2007, we announced our decision to teach-out our two Brooks College campuses, which previously were held for sale. Accordingly, the results of operations of our two Brooks College campuses previously reported in discontinued operations as of December 31, 2006, and March 31, 2007, are now included in our results from continuing operations in our unaudited condensed consolidated statements of income for all 2007 and 2006 periods presented. Additionally, our audited condensed consolidated balance sheet as of December 31, 2006, has been restated to reflect our treatment of Brooks College as a continuing operation. See Note 12 Discontinued Operations of the notes to our unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional discussion on our decision to teach-out our two Brooks College locations.

### 3. BUSINESS ACQUISITION

On January 25, 2007, we acquired 100% of the issued and outstanding stock of Istituto Marangoni for approximately \$37.2 million. The purchase price was funded with cash generated from operating activities. Istituto Marangoni is a world-renowned private, for-profit, post-secondary fashion and design school with locations in Milan, Italy; London, England; and Paris, France. We acquired Istituto Marangoni primarily because of its potential for market leadership, the economic attractiveness of the educational markets that it serves, and its potential for strong returns on invested capital. The acquisition of Istituto Marangoni also provides us with a platform for additional expansion in Europe and represents our entry into the Italian educational market.

The purchase price of approximately \$39.6 million, including acquisition costs of approximately \$2.4 million, was allocated to the estimated fair values of acquired tangible and identifiable intangible assets of approximately \$27.0 million and assumed liabilities of approximately \$16.2 million as of January 25, 2007. Intangible assets acquired include, among others, trade names with a total estimated fair value of approximately \$9.8 million and student contracts with an estimated fair value of approximately \$1.5 million. Based on our preliminary purchase price allocation, we have recorded goodwill of approximately \$28.8 million. We do not expect any portion of this goodwill balance to be deductible for income tax reporting purposes.

Subsequent adjustments may be made to the purchase price and the purchase price allocation. However, we do not believe that any such adjustments will be significant.

## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

The following table summarizes the estimated fair values of assets acquired and liabilities assumed as of January 25, 2007 (in thousands):

Current assets	\$ 12,648
Property and equipment	2,099
Intangible assets not subject to amortization	
Trade names	9,782
Intangible assets subject to amortization	
Student contracts (1.5-year useful life)	1,456
Covenant not to compete (3-year useful life)	479
Goodwill	28,793
Other assets	541
Total assets acquired	55,798
Current liabilities	11,134
Long-term liabilities	5,070
Total liabilities assumed	16,204
Net assets acquired	\$ 39,594

Supplemental pro forma financial statement disclosures have not been included as this acquisition was not material to our consolidated financial position or results of operations.

#### 4. FINANCIAL INSTRUMENTS

##### Cash and Cash Equivalents and Investments

Cash equivalents include short-term investments with a term to maturity of less than 90 days.

The postsecondary education industry includes approximately 6,500 institutions that participate in federally-sponsored financial aid programs authorized by Title IV of the Higher Education Act of 1965, as amended ( HEA, ), which we refer to as Title IV Programs. The U.S. Department of Education ( ED ) requires that Title IV Program funds collected in advance of student billings be kept in a separate cash account until the students are billed for the portion of their program related to those Title IV Program funds collected. The ED further requires that Title IV Program funds be disbursed to students within three business days of receipt. As of June 30, 2007, and December 31, 2006, the amount of restricted cash balances held in separate cash accounts was not significant. Restrictions on cash balances have not affected our ability to fund daily operations.

Investments, which primarily consist of municipal auction rate securities, are classified as available-for-sale in accordance with the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 115, Accounting for Certain Investments in Debt and Equity Securities, and are recorded at fair value. Any unrealized gains or temporary unrealized losses, net of income tax effects, are reported as a component of accumulated other comprehensive income on our consolidated balance sheet. Realized gains and losses are computed on the basis of specific identification and are included in miscellaneous other income (expense) in our consolidated income statement. As of June 30, 2007, the stated terms to maturity of certain of our available-for-sale investments are greater than one year. However, all of our available-for-sale investments are classified as current assets on our consolidated balance sheets because the investments are readily marketable, available for use in our current operations, and reasonably expected to be sold within one year.

Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Cash and cash equivalents and investments consist of the following as of June 30, 2007, and December 31, 2006 (in thousands):

	June 30, 2007			Fair Value
	Cost	Gross Unrealized Gain	(Loss)	
Cash and cash equivalents:				
Cash	\$ 76,379	\$	\$	\$ 76,379
Money market funds	22,782			22,782
Total cash and cash equivalents	99,161			99,161
Investments (available-for-sale):				
Auction rate municipal bonds	263,347			263,347
Mortgage-backed securities	748	2	(2)	748
Total investments	264,095	2	(2)	264,095
Total cash and cash equivalents and investments	\$ 363,256	\$ 2	\$ (2)	\$ 363,256

	December 31, 2006			Fair Value
	Cost	Gross Unrealized Gain	(Loss)	
Cash and cash equivalents:				
Cash	\$ 48,959	\$	\$	\$ 49,959
Money market funds	120,934			120,934
Commercial paper	17,958	2		17,960
Total cash and cash equivalents	187,851	2		187,853
Investments (available-for-sale):				
Auction rate municipal bonds	249,007	2	(1)	249,008
Asset-backed securities	8,203		(2)	8,201
Mortgage-backed securities	2,566		(9)	2,557
Total investments	259,776	2	(12)	259,766
Total cash and cash equivalents and investments	\$ 447,627	\$ 4	\$ (12)	\$ 447,619

**Student Receivables Valuation Allowance**

Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Changes in our student receivables allowance during the three and six months ended June 30, 2007 and 2006, were as follows:

	<b>Balance, Beginning of Period (In thousands)</b>	<b>Charges to Expense</b>	<b>Amounts Written-off</b>	<b>Purchase Accounting Adjustment</b>	<b>Balance, End of Period</b>
For the three months ended June 30, 2007	\$ 26,922	\$ 10,994	\$ (8,412 )	\$	\$ 29,504
For the three months ended June 30, 2006	\$ 35,961	\$ 16,590	\$ (18,180 )	\$	\$ 34,371
For the six months ended June 30, 2007	\$ 28,709	\$ 18,708	\$ (17,922 )	\$ 9	\$ 29,504
For the six months ended June 30, 2006	\$ 38,223	\$ 29,967	\$ (33,819 )	\$	\$ 34,371

## Credit Agreements

As of June 30, 2007, we have outstanding under our \$200.0 million U.S. Credit Agreement revolving loans totaling \$10.4 million and letters of credit totaling \$15.6 million. Credit availability under our U.S. Credit Agreement as of June 30, 2007, is \$174.0 million.

As of June 30, 2007, we have no revolving loans outstanding under our \$10.0 million (USD) Canadian Credit Agreement.

## 5. RECOURSE LOAN AGREEMENTS

We have entered into agreements with Sallie Mae and Stillwater National Bank ( Stillwater ) to provide private recourse loans to qualifying students.

*Sallie Mae.* Our original recourse loan agreement with Sallie Mae was effective from July 1, 2002, to February 28, 2006. We entered into a new risk sharing agreement with Sallie Mae effective March 1, 2006, which has an expiration date of June 30, 2009. Under both our original and subsequent recourse loan agreements with Sallie Mae, we are required to deposit 20% of all recourse loans funded into a Sallie Mae reserve account.

Under our original recourse loan agreement, loans funded were intended for students whose credit scores were less than the credit score required under Sallie Mae's non-recourse loan program for our students. A student was generally eligible for a Sallie Mae recourse loan under the original agreement if (1) the student demonstrated a specified minimum credit score, (2) any bankruptcy proceeding involving the student had been discharged for at least 18 months, and (3) the student was not in default or delinquent with respect to any prior student loan. Under the terms of the original agreement, we are obligated to purchase, with funds that have been deposited into the reserve account as discussed above, recourse loans funded under the original agreement (a) that have been delinquent for 150 days or (b) upon the bankruptcy, death, or total and permanent disability of the borrower. The amount of our repurchase obligation under the original agreement may not exceed 20% of loans funded under the original agreement, which also represents the amount that is withheld by Sallie Mae and deposited into the reserve account. Any balance remaining in the reserve account after all recourse loans have been either repaid in full or repurchased by us will be paid to us. Our new recourse loan agreement with Sallie Mae has substantially similar terms, with the exception that students and, if applicable, their qualified co-borrowers, must demonstrate a slightly higher specified minimum credit score than the credit score required under the original agreement to be eligible for a recourse loan.

We record amounts withheld by Sallie Mae in the reserve account as a deposit in long-term assets on our consolidated balance sheet. Amounts on deposit may ultimately be utilized to purchase loans in default, in which case recoverability of such amounts would be in question. Therefore, we establish a 100% reserve against amounts on deposit through the use of a deposit contra-account. We believe that costs associated with our Sallie Mae recourse loan programs are directly attributable to the educational activity of our schools and the support of our students. Therefore, such costs are classified as educational services and facilities expense in our consolidated statement of income. Costs are recognized on a straight-line basis over the course of the instructional term for which the underlying loan was granted as the related revenues are earned. Upon purchasing Sallie Mae loans in default, we transfer an amount equal to the total balance of the loans purchased from the deposit account to a long-term recourse loan receivable account and transfer an offsetting amount from the deposit contra-account to a long-term recourse loan receivable contra-account, such that the net book value of the purchased loans is generally zero.

In October of 2006, we negotiated an amendment to our risk sharing agreement that reduced the minimum credit score required for our students to qualify for non-recourse loans under Sallie Mae's non-recourse loan program. The amendment also reduced loan fees and interest rates charged to our students

for both non-recourse and recourse loans funded by Sallie Mae. Under the amendment, we are obligated to pay Sallie Mae a discount fee equal to 25% of all recourse loans funded under the agreement after March 1, 2007. Pursuant to the amendment, we are no longer required to deposit a portion of loans funded under the agreement into a Sallie Mae reserve account. In addition, we are not required to repurchase any loans funded under the agreement.

*Stillwater.* The private student loans subject to the Stillwater purchase agreement were made by Stillwater to students at our schools if (1) the student demonstrates a specified minimum credit score, which is less than the minimum credit score required pursuant to our risk sharing agreement with Sallie Mae, (2) any bankruptcy proceeding involving the student has been discharged for at least 18 months, and (3) the student is not in default or delinquent with respect to any prior student loan. The loans are serviced by Sallie Mae. Under the terms of the purchase agreement, Stillwater retained 50% of the loan amounts disbursed and deposited this amount into a reserve account. Under the terms of the purchase agreement, Stillwater has an option, but not an obligation, to sell to us 100% of these private student loans on a monthly basis. We were required to purchase all private student loans offered for sale by Stillwater for a price equal to the current principal balance plus accrued interest. To date, we have purchased all private student loans offered for sale by Stillwater. Upon purchase of private student loans from Stillwater, we receive all funds that were placed into the reserve account with respect to the specific loans purchased.

Amounts held in reserve with Stillwater will be used to finance 50% of the principal balance of any loans that we are required to purchase pursuant to the agreement. We record such amounts as a deposit in long-term assets on our consolidated balance sheet. Based on our collection experience, we establish a 100% reserve against Stillwater funds on deposit. Due to the high level of uncollectible amounts expected under the Stillwater agreement, the associated costs are classified as a reduction of the related tuition revenue in our consolidated statement of income. Costs are recognized on a straight-line basis over the course of the instructional term for which the underlying loan was granted as the related revenues are earned and classified as a reduction of related revenue. Upon purchasing Stillwater loans in default, we record the total balance of the loans as a long-term recourse loan receivable and transfer the reserve for recourse loans withheld by the lender, totaling approximately 50% of the related principal balance, from the deposit contra-account to the long-term loan receivable contra-account, such that the net book value of the purchased loans is approximately 50% of the related principal balance. Based on our collection experience, we believe that the 50% reserve is reasonable to provide for Stillwater loans that have been purchased or that may be purchased and that may be ultimately uncollectible. We evaluate the collectibility of the Stillwater loan receivables on a periodic basis and may adjust our reserve estimates in future periods based on collections experience.

On January 29, 2007, we provided Stillwater with a 90-day notice to terminate the purchase agreement. Pursuant to such notice, the purchase agreement terminated on April 29, 2007. However, we are still obligated to purchase any loans made by Stillwater prior to this termination date when offered by Stillwater for sale.



Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

The following table reflects selected information with respect to each of our recourse loan agreements, including cumulative loan disbursements and purchase activity under the agreements from inception through June 30, 2007 (in millions, except for cumulative loan limits per student):

Lender	Agreement Effective Date	Disbursed Loan Limit		Cumulative Loan Limit Per Student (5)	Loans Disbursed	Loans Purchased	Loans We May be Required to Purchase
Sallie Mae	July 2002 to June 2009 (1)	\$ 180.0	(3)	\$12,000 to \$39,000	\$ 139.8	\$ 28.0	\$ 0.4
Stillwater	December 2003 to April 2007 (2)	\$ 20.0	(4)	\$7,500 to \$13,500	\$ 25.1	\$ 30.1	\$ 0.7

- (1) Our original recourse loan agreement with Sallie Mae was effective from July 1, 2002 to February 28, 2006. We entered into a new recourse loan agreement effective March 1, 2006, that has an expiration date of June 30, 2009.
- (2) The Stillwater purchase agreement commenced in December 2003 and had no stated termination date. This agreement terminated effective April 29, 2007.
- (3) Prior to the new agreement effective March 1, 2006, the Sallie Mae agreement had no stated limit for the amount of loans disbursed under the agreement. Loans funded prior to March 1, 2006, were subject to this previous agreement. Under the new agreement, the total amount of loans that may be funded may not exceed \$180.0 million through June 30, 2008, with annual funding limits of \$20.0 million for the period March 1, 2006, to June 30, 2006, \$80.0 million for the period July 1, 2006, to June 30, 2007, and \$80.0 million for the period July 1, 2007, to June 30, 2008. There is currently no stated loan funding limit for the period of July 1, 2008, to June 30, 2009. Instead, any funding limit must be negotiated by both parties prior to July 1, 2008.
- (4) Under the Stillwater purchase agreement, the total amount of loans held by Stillwater under the agreement at any time could not exceed \$20.0 million.
- (5) Loan limit per student generally represents the maximum loan amount available to an individual student during his or her complete academic program at one of our schools. Loan limits vary based on the length of the student's academic program.

Costs associated with our recourse loan agreements as of and for the three and six months ended June 30, 2007 and 2006, are set forth below (in thousands). As discussed above, costs incurred in connection with our Sallie Mae agreements are classified as a component of educational services and facilities expense in our consolidated statement of income, and costs incurred in connection with our Stillwater agreement are classified as a reduction of tuition and registration fee revenue in our consolidated statement of income.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Sallie Mae	\$ 2,070	\$ 1,839	\$ 4,318	\$ 3,430
Stillwater	\$ 133	\$ 861	\$ 292	\$ 2,064

Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Outstanding recourse loan deposit, contra-deposit, loan receivable, and contra-loan receivable balances as of June 30, 2007, and December 31, 2006, are set forth below (in thousands).

	Deposits	Contra-Deposits	Net Book Value
<b>Sallie Mae</b>			
As of June 30, 2007	\$ 509	\$ 264	\$ 245
As of December 31, 2006	\$ 764	\$ 143	\$ 621
<b>Stillwater</b>			
As of June 30, 2007	\$ 492	\$ 492	\$
As of December 31, 2006	\$ 702	\$ 702	\$

  

	Loan Receivable	Allowance For Uncollectible Loans	Net Book Value
<b>Sallie Mae</b>			
As of June 30, 2007	\$ 27,548	\$ 27,548	\$
As of December 31, 2006	\$ 24,266	\$ 24,266	\$
<b>Stillwater</b>			
As of June 30, 2007	\$ 24,426	\$ 15,139	\$ 9,287
As of December 31, 2006	\$ 24,870	\$ 15,353	\$ 9,517

## 6. GOODWILL

Changes in the carrying amount of goodwill during the six months ended June 30, 2007, by reportable segment are as follows (in thousands):

	Academy segment	Colleges segment	Culinary Arts segment	Health Education segment	International segment	University segment	Total
<b>Goodwill balance as of December 31, 2006</b>	\$ 14,064	\$ 27,940	\$ 75,148	\$ 131,060	\$ 13,982	\$ 87,566	\$ 349,760
Goodwill related to 2007 acquisitions					28,793		28,793
Effect of foreign currency exchange rate changes	356				1,541		1,897
<b>Goodwill balance as of June 30, 2007</b>	\$ 14,420	\$ 27,940	\$ 75,148	\$ 131,060	\$ 44,316	\$ 87,566	\$ 380,450

On the first day of January of each year, our goodwill balances are reviewed for impairment through the application of a fair-value-based test. The results of the test as of January 1, 2007, indicated no goodwill impairment, as, for all reporting units, which we define as our school operating divisions, our estimate of reporting unit fair value exceeded the carrying value of the reporting unit. Our estimate of fair value for each of our reporting units was based primarily on projected future operating results and cash flows and other assumptions. Although we believe our projections and resulting estimates of fair value are reasonable, historically, our projections have not always been achieved.

## 7. COMMITMENTS AND CONTINGENCIES

### Litigation

We are, or were, a party to the following pending legal proceedings that are outside the scope of ordinary routine litigation incidental to our business.

#### *Employment Litigation*

*Vander Vennet, et al. v. American InterContinental University, Inc., et al.* As previously disclosed, on August 24, 2005, former admissions advisors of American InterContinental University ( AIU ) Online



filed a lawsuit in the United States District Court for the Northern District of Illinois alleging that we, AIU Online, and the President of our University division violated the Fair Labor Standards Act ( FLSA ), the Illinois Minimum Wage Law, and the Illinois Wage Payment and Collection Act by failing to pay the plaintiffs for all of the overtime hours they allegedly worked. Plaintiffs seek unspecified lost wages, liquidated damages, attorneys' fees, and injunctive relief. The plaintiffs are also seeking certification as a class under the FLSA. On December 22, 2005, and April 7, 2006, the court granted plaintiffs' motions to send FLSA Notice, and plaintiffs' counsel has distributed such notice to certain current and former admissions advisors. On April 7, 2006, the court granted the plaintiffs' motion to expand the class to include temporary admissions advisors. The deadline for potential plaintiffs to opt-in to this lawsuit was June 23, 2006. Less than 10 percent of the persons to whom notice of the suit was sent, including current and former admissions advisors, have joined the litigation. Defendants deny all of the material allegations in the complaint and are vigorously defending the claims and opposing class certification. The parties are currently engaged in discovery.

Due to the inherent uncertainties of litigation, we cannot predict the ultimate outcome of this matter. An unfavorable outcome could have a material adverse impact on our business, results of operations, cash flows, and financial position.

### ***Securities Litigation***

*In re Career Education Corporation Securities Litigation.* As previously disclosed, *In re Career Education Corporation Securities Litigation* represents the consolidation into one suit of six purported class action lawsuits filed between December 9, 2003, and February 5, 2004, in the United States District Court for the Northern District of Illinois by and on behalf of certain purchasers of our common stock, against us, John M. Larson, a former officer of CEC, and Patrick K. Pesch, a current officer of the Company. The lawsuit alleged that, in violation of Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act) and Rule 10b-5 promulgated thereunder, the defendants made certain material misrepresentations and failed to disclose certain material facts about the condition of our business and prospects during the putative class period, causing the respective plaintiffs to purchase shares of our common stock at artificially inflated prices. The plaintiffs further claimed that Larson and Pesch were liable as control persons under Section 20(a) of the Exchange Act. On March 29, 2007, the court granted the defendants' motion to dismiss for failure to state a claim and dismissed with prejudice the plaintiffs' third amended consolidated complaint. Plaintiffs filed a notice of appeal on April 24, 2007.

*Derivative Actions.* As previously disclosed, on January 5, 2004, a derivative action captioned *McSparran v. John M. Larson, et al.* ( *McSparran* ) was filed in the United States District Court for the Northern District of Illinois on behalf of CEC against John M. Larson, Patrick K. Pesch, Wallace O. Laub, Keith K. Ogata, Dennis H. Chookaszian, Robert E. Dowdell, Thomas B. Lally, Nick Fluge, Jacob P. Gruver, and Todd H. Steele and CEC as a nominal defendant. Each individual defendant in this action is or was one of our officers or directors. The lawsuit alleged breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment, and breach of fiduciary duties for insider stock sales and misappropriation of information, generally based on allegations of conduct similar to that complained of in the *In re Career Education Corporation Securities Litigation* matter described above. On February 28, 2007, the court granted the defendants' motion to dismiss for failure to plead demand futility and dismissed with prejudice the plaintiffs' amended derivative complaint. Plaintiffs filed a notice of appeal on March 26, 2007. Plaintiffs moved to voluntarily dismiss their appeal on May 25, 2007, and the Seventh Circuit Court of Appeals granted their motion on May 30, 2007. In accordance with that final judgment, this matter is now closed.

As previously disclosed, on July 2, 2004, a derivative action captioned *Xiao-Qiong Huang v. John M. Larson, et al.*, was filed in the Circuit Court of Cook County, Illinois, Chancery Division, on behalf of CEC against John M. Larson, Patrick K. Pesch, Wallace O. Laub, Keith K. Ogata, Dennis H. Chookaszian,

Robert E. Dowdell, Thomas B. Lally, Nick Fluge, and Jacob P. Gruver and CEC as a nominal defendant. Each of the individual defendants is or was one of our officers or directors. The lawsuit alleged breach of fiduciary duty and misappropriation of confidential information for personal profit by the individual defendants and sought contribution and indemnification on behalf of CEC. On September 12, 2005, the court granted defendants' motion to stay the case until further order of the court in deference to the prior filed *McSparran* action. The plaintiff voluntarily dismissed her complaint with prejudice on June 27, 2007, following the dismissal of the *McSparran* action. In accordance with that dismissal, this matter is now closed.

As previously disclosed, on November 10, 2004, a derivative suit captioned *Nicholas v. Dowdell, et al.*, was filed in the Chancery Court of New Castle County, Delaware, on behalf of CEC against John M. Larson, Patrick K. Pesch, Wallace O. Laub, Keith K. Ogata, Dennis H. Chookaszian, Robert E. Dowdell, Thomas B. Lally, Nick Fluge, and Jacob P. Gruver and CEC as a nominal defendant. The lawsuit alleges breach of fiduciary duty for insider stock sales and misappropriation of confidential information, breach of fiduciary duty of good faith, and unjust enrichment and seeks a constructive trust, disgorgement of profits, damages, costs, and attorneys' fees. On March 17, 2005, the court granted the parties' joint motion to stay the action pending final resolution of the *McSparran* action. The court has not yet addressed what effect, if any, the final judgment in the *McSparran* action will have on the case.

As previously disclosed, on June 3, 2005, a derivative suit captioned *Romero v. Dowdell, et al.*, was filed in the Chancery Court of New Castle County, Delaware, on behalf of CEC against John M. Larson, Patrick K. Pesch, Wallace O. Laub, Keith K. Ogata, Dennis H. Chookaszian, Robert E. Dowdell, Thomas B. Lally and CEC as a nominal defendant. The court subsequently consolidated the *Romero* action with *Neel v. Dowdell, et al.*, a case filed in the same court against the same defendants on May 15, 2006. Each of the individual defendants in the *Romero* and *Neel* actions is or was one of our officers or directors. On July 18, 2006, plaintiffs filed a consolidated derivative complaint under the caption *In re Career Education Corporation Derivative Litigation*. The consolidated derivative complaint alleges conduct similar to that complained of in the lawsuits captioned *In re Career Education Corporation Securities Litigation, McSparran, Huang, and Nicholas*, described above, and seeks imposition of a constructive trust and disgorgement of profits, unspecified damages, and equitable relief and reimbursement of the plaintiffs' costs and disbursement of the action. On March 8, 2007, the court held a hearing on the defendants' motion to dismiss the consolidated derivative complaint or, in the alternative, to stay the case. Defendants are awaiting a ruling from the court on that motion.

Due to the inherent uncertainties of litigation, we cannot predict the ultimate outcome of the *In re Career Education Corporation Securities Litigation, Nicholas* or *In re Career Education Corporation Derivative Litigation* matters. An unfavorable outcome of any one or more of these matters could have a material adverse impact on our business, results of operations, cash flows, and financial position.

#### ***Special Committee Investigation***

As previously disclosed, in June 2004, our Board of Directors formed a Special Committee to conduct an independent investigation of allegations of securities laws violations against us. These allegations were asserted in the *In re Career Education Corporation Securities Litigation* matter described above (the Class Action). In July 2004, the Special Committee retained the law firm of McDermott, Will & Emery LLP, which in turn retained the forensic accounting firm Navigant Consulting, Inc., to assist in the investigation. Among other things, the investigation reviewed the allegations related to our accounting practices and reported statistics relating to starts, student population, and placement.

As previously disclosed, the Special Committee did not find support for the claims that CEC or its senior management engaged in the securities laws violations alleged in the Class Action. The Special

Committee did find wrongful conduct by individual employees of CEC but specifically found that the wrongful activity was not directed or orchestrated by our senior management.

The Special Committee conducted a further investigation of assertions related to the claims of securities laws violations made for the first time, and not previously examined, in the second and third amended complaints filed in the Class Action on April 1, 2005, and May 1, 2006, respectively. The Special Committee completed its investigation of these new assertions and concluded that it did not find support for them. In so doing, the Special Committee reaffirmed its prior conclusion that it did not find support for the claims that CEC or its senior management engaged in the securities laws violations alleged in the Class Action.

We have undertaken a number of steps to improve our internal controls in the areas of finance and compliance, including the further development and expansion of our compliance, legal, and internal audit infrastructure processes. The Special Committee recommended additional improvements relating to our financial, compliance, and other controls. Our Board of Directors and senior management are continuing to evaluate the results and recommendations of the Special Committee. Our Board of Directors has requested that the Special Committee and its counsel remain in place and available, as needed.

***Action against Former Owners of Western School of Health and Business Careers***

As previously disclosed, on March 12, 2004, we filed a lawsuit in the U.S. District Court for the Western District of Pennsylvania against the former owners of Western School of Health and Business Careers ( Western ). In the lawsuit, we allege that the former owners of Western made material misrepresentations of fact and breached certain representations and warranties regarding the accreditation and approval of several programs of study offered by Western and seek full indemnification for all resulting losses, costs, and damages, including attorneys' fees. On July 12, 2004, we filed a similar complaint in the Court of Common Pleas of Allegheny County, Pennsylvania, and subsequently voluntarily dismissed the federal lawsuit. Subsequently, we amended our complaint to assert a claim for breach of contract against Western's former accounting firm. Discovery is in progress.

The misrepresentations we allege in this matter came to light during a routine change of ownership review undertaken by the Accrediting Commission of Career Schools and Colleges of Technology ( ACCSCT ) subsequent to our acquisition of Western. On March 4, 2004, ACCSCT notified us of discrepancies in accreditation and approval documents related to several academic programs. Western suspended marketing, new enrollments, and disbursement of funds issued under Title IV Programs for all affected academic programs, and promptly applied for approval of all such programs. The diploma programs were approved in June 2004, and Western then resumed marketing, enrolling new students, and disbursement of Title IV Program aid to students in those programs. In July 2004, ACCSCT approved the degree programs effective upon Western's satisfaction of certain stipulations. Western subsequently satisfied all stipulations and resumed marketing, enrollment of new students, and disbursing of Title IV Program funds to students in those programs. We are working in close cooperation with the ED and the U.S. Department of Justice to resolve any remaining issues in a manner that will best serve the interest of Western's students. As a result of this matter, we expect that we will be required to reimburse the ED for a portion of Title IV Program funds improperly disbursed in relation to the affected programs, and we have recorded in our consolidated financial statements a reserve for the amount of the refund that we expect to pay to the ED.

The pending lawsuit seeks to recover any such funds from the former owners of Western and its former accounting firm. Due to the inherent uncertainties of litigation, we cannot predict the ultimate outcome of this matter, but we do not expect such outcome to have a significant impact on our consolidated financial position or results of operations.

***Student Litigation***

*Laronda Sanders, et al. v. Ultrasound Technical Services, Inc., et al.* The *Sanders* action, filed on March 15, 2006 and currently pending in the United States District Court for the District of Maryland, Greenbelt Division, was brought by 21 current and former students of the Landover, Maryland, campus of Sanford-Brown Institute ( SBI ), one of our schools, on behalf of themselves and a putative class, against us and Ultrasound Technical Services, Inc. ( UTS ), one of our subsidiaries. Plaintiffs' second amended complaint, filed on March 12, 2007, alleges that the defendants made fraudulent misrepresentations and violated the Maryland consumer fraud act by misrepresenting or failing to disclose, among other things, details regarding instructors' experience or preparedness, availability of clinical externship assignments, and estimates for the dates upon which the plaintiffs would receive their certificates and be able to enter the work force. The complaint also alleges that defendants breached plaintiffs' enrollment contracts by failing to provide the promised instruction, training, externships, and placement services. Plaintiffs seek actual damages, punitive damages, and costs. Discovery is ongoing.

*McCarten, et al. v. Allentown Business School, Ltd. t/a Lehigh Valley College.* As previously disclosed, on September 28, 2005, a complaint was filed against Allentown Business School, Ltd. ( Allentown ), one of our subsidiaries, in the Court of Common Pleas of Lehigh County, Pennsylvania. The complaint purports to be brought on behalf of all former students of Allentown, now known as Lehigh Valley College, who received allegedly high interest private loans, and alleges that Allentown violated Pennsylvania's Unfair Trade Practices and Consumer Protection Law and engaged in intentional misrepresentation, negligent misrepresentation, and negligence in connection with the enrollment and student loan information and application processes. The complaint seeks compensatory and punitive damages in an unspecified amount. On December 12, 2005, the plaintiffs filed an amended complaint asserting the same claims as set forth in the initial complaint. On December 14, 2005, Allentown moved to compel arbitration. The motion was granted by Order dated November 13, 2006. In December 2006, the plaintiffs made a Motion for Reconsideration of the Order compelling arbitration. The court denied the motion for reconsideration by Order dated December 27, 2006.

*Thurston, et al. v. Brooks College, Ltd., et al.* As previously disclosed, on March 21, 2005, a purported class action complaint was filed in the Superior Court for the State of California, County of Los Angeles, against Brooks College, one of our schools. The complaint was purportedly filed on behalf of all current and former attendees of Brooks College. The complaint alleges that Brooks College violated the California Business and Professions Code and Consumer Legal Remedies Act by allegedly misleading potential students regarding Brooks College's admission criteria, transferability of credits, and retention and placement statistics and by engaging in false and misleading advertising. Plaintiffs seek injunctive relief, restitution, unspecified punitive and exemplary damages, attorneys' fees, interest, costs, and other relief. On June 24, 2005, the Court ruled that this action was related to the case captioned *Outten, et al. vs. Career Education Corporation, et al.*, which is described below. Brooks College filed an answer to the complaint on May 31, 2006. Plaintiffs filed a motion for class certification on December 18, 2006, and we filed our opposition motion on March 5, 2007.

The parties are currently negotiating certain of the material terms of a possible settlement agreement in this case and in the Outten and Nilsen cases described below. In the event the parties are able to reach an agreement, any such agreement would be subject to final court approval.

*Nilsen v. Career Education Corporation, et al.* As previously disclosed, on February 4, 2005, three former students of Brooks Institute ( BI ), one of our schools, filed a purported class action complaint in the Superior Court of the State of California, County of Santa Barbara, against us and BI. The action was purportedly brought on behalf of all students who attended BI from February 4, 2001, to the present.

Plaintiffs' operative Third Amended Complaint alleges (1) violations of the California Education Code, (2) violations of the Consumer Legal Remedies Act, (3) fraud, (4) false advertising in violation of





California Business and Professions Code §17500, *et seq.*, and (5) unfair competition in violation of California Business and Professions Code §17200, *et seq.* The plaintiffs primarily allege that BI violated the California Education Code, the California Consumer Legal Remedies Act, and California's Unfair Competition Law by allegedly misleading potential students regarding BI's placement rates and by engaging in false and misleading advertising. The plaintiffs seek injunctive relief, disgorgement of profits, punitive damages, interest, and attorneys' fees and costs. Plaintiffs filed their motion for class certification on February 14, 2007.

As discussed above, the parties are currently negotiating certain of the material terms of a possible settlement agreement in this case and in the Outten and Thurston cases. In the event the parties are able to reach an agreement, any such agreement would be subject to final court approval.

*Outten, et al. v. Career Education Corporation, et al.* As previously disclosed, a purported class action was filed in the Superior Court of the State of California, County of Los Angeles, against us and AIU, one of our schools. The operative complaint, which claims to have been brought on behalf of present and former students of AIU, alleges that AIU violated the California Unfair Competition Law (California Business and Professions Code), the California Consumer Legal Remedies Act, and the California Education Code and engaged in common law consumer fraud by purportedly misleading potential students regarding AIU's placement rates. The plaintiffs, on behalf of the putative class, seek injunctive relief, restitution, unspecified punitive and exemplary damages, attorneys' fees and costs, interest, and other relief. On March 10, 2005, defendants filed an answer to the second amended complaint as well as a cross-complaint against one of the named plaintiffs for unpaid tuition. On June 24, 2005, the Court ruled that this action was related to another action captioned *Thurston, et al. v. Brooks College, Ltd., et al.*, which is described above. A hearing on plaintiffs' motion to certify a class has been continued, with no specific hearing date set.

The parties are currently negotiating certain of the material terms of a possible settlement agreement in this case and in the Nilsen and Thurston cases described above. In the event the parties are able to reach an agreement, any such agreement would be subject to final court approval.

Due to the inherent uncertainties of litigation, we cannot predict the ultimate outcome of these matters. An unfavorable outcome of any one or more of these matters could have a material adverse impact on our business, results of operations, cash flows, and financial position.

#### ***Other Litigation***

In addition to the legal proceedings and other matters described above, we are also subject to a variety of other claims, suits, and investigations that arise from time to time in the ordinary conduct of our business, including, but not limited to, claims involving students or graduates and routine employment matters. While we currently believe that such claims, individually or in aggregate, will not have a material adverse impact on our financial position, cash flows, or results of operations, the litigation and other claims noted above are subject to inherent uncertainties, and management's view of these matters may change in the future. Were an unfavorable final outcome to occur in any one or more of these matters, there exists the possibility of a material adverse impact on our business, reputation, financial position, cash flows, and the results of operations for the period in which the effect becomes probable and reasonably estimable.

#### **Federal, State, and Accrediting Body Regulatory Actions**

Our schools are subject to extensive regulation by federal and state governmental agencies and accrediting bodies. On an ongoing basis, we evaluate the results of our internal compliance monitoring activities and those of applicable regulatory agencies, and, when appropriate, record liabilities to provide for the estimated costs of any necessary remediation. The following is an update of selected recent regulatory and accreditation actions affecting us and certain of our schools.

***Federal Regulatory Matters***

As part of Title IV administration, the ED periodically conducts program reviews at selected schools that receive Title IV funds. ED program reviews, which generally cover a school's main campus and any branch campuses, are currently pending for American InterContinental University; Briarcliffe College; Brooks Institute; California Culinary Academy; Gibbs College - Boston, Massachusetts; Gibbs College - Livingston, New Jersey; Katharine Gibbs School- New York; International Academy of Design and Technology - Chicago; Lehigh Valley College; Sanford-Brown Institute - Atlanta; The Cooking and Hospitality Institute of Chicago; and Western School of Health and Business Careers. The ED has completed its review of Gibbs College in Vienna, Virginia and has issued a final determination letter. We are committed to resolving all issues identified in connection with these program reviews to the ED's satisfaction and ensuring that our schools operate in compliance with all ED regulations.

We cannot predict the outcome of these program reviews, and any unfavorable outcomes could have a material adverse effect on our business, results of operations, cash flows, and financial position.

In December, 2006, we were advised that the Office of Inspector General of the ED (OIG) was conducting an investigation related to our LCB-Atlanta school. In connection with this inquiry, LCB-Atlanta received a subpoena from the OIG seeking certain information. We fully cooperated with the government in response to the subpoena. On August 8, 2007, we were advised by the OIG that it has closed its investigation and that it would take no further action in relation to the matter.

*SEC and Department of Justice Investigations.* As previously disclosed, on January 7, 2004, we received notification from the Midwest Regional Office of the SEC that it was conducting an inquiry concerning us and requested that we voluntarily provide certain information. On June 22, 2004, the SEC staff notified us that it was conducting a formal investigation. On April 5, 2006, we disclosed that we were advised by the staff of the Midwest Regional Office of the SEC that the staff intends to recommend to the SEC that it terminate its investigation and that no enforcement action be taken against us. Recommendations by the SEC staff do not constitute final action by the SEC, as the SEC thereafter makes its own determination as to whether to follow the recommendations of the SEC staff.

As previously disclosed, we received a letter from the Civil Division of the U.S. Department of Justice ( Justice Department ) in Washington, D.C., dated May 30, 2006, advising us that the Justice Department was reviewing allegations that certain of our schools may have submitted false claims or statements to the ED. The letter requested that we provide documents relating to various subject areas. The Justice Department has indicated that this review is informational in nature. We have voluntarily responded to the Justice Department's requests for information and have cooperated fully with it. We believe this Civil Division informational review is ongoing.

***State Regulatory Matters***

*Katharine Gibbs- New York ( Gibbs-NY ).* In April, 2006, the Office of College and University Evaluation of the New York State Education Department (the Education Department ) conducted a site visit to Gibbs-NY. The purpose of the visit was to examine Gibbs-NY's compliance with the regulations of the Education Department. On June 28, 2006, the Education Department issued a draft report relating to its site visit. The draft report included a number of findings and recommendations and indicated that Gibbs-NY may be out of compliance with Education Department regulations in several areas. Gibbs-NY was given until August 29, 2006, to comment on the draft report, point out factual errors, provide new information, and respond to the recommendations set forth therein. Gibbs-NY submitted a response to the draft report within the prescribed time period.

On January 25, 2007, the Education Department issued a final report stating that, although the school had addressed many of the Education Department's recommendations, additional action was required.

The Education Department stated that, absent a finding of substantial compliance with registration standards resulting from the follow-up review, it would terminate the registration of all degree programs at Gibbs-NY. While the review remains pending, the Education Department has limited enrollments commencing with the April 2007 academic quarter to not more than 50% of entering first-time students enrolled in the comparable academic quarter of the preceding year. The Education Department has also required Gibbs-NY to show that not less than 65% of April 2007 entering first-time, full-time students remain as students into the following term, exhibiting satisfactory academic performance and progress. Gibbs-NY submitted a response addressing the Education Department's remaining concerns on March 23, 2007, and hosted a follow-up visit in July 2007. The final written report of the Education Department's visiting team is pending.

In connection with the Education Department's 2006 site visit, the Accrediting Council for Independent Colleges and Schools (ACICS) conducted a special on-site visit in June 2007 to validate the March 2007 response submitted to the Education Department. The final written report of the visiting team is pending. The ACICS report provided to Gibbs-NY subsequent to the visit by ACICS affirmed that Gibbs-NY has made a significant effort to address the most substantial concerns reflected in the Education Department's report. ACICS requested a response to certain items for which documentation was not provided to the ACICS visiting team. Gibbs-NY submitted a comprehensive response in July 2007 and is awaiting further communication from ACICS.

*Lehigh Valley College (Lehigh)*. As previously disclosed, on July 20, 2005, the Bureau of Consumer Protection of the Office of Attorney General in Pennsylvania (Pennsylvania AG) notified Lehigh that it had begun a review into the business practices of the school. The Pennsylvania AG requested certain documents, including information relating to Lehigh's recruitment practices, student complaints, and financial aid policies and procedures, which we provided in August 2005.

In a May 31, 2006, subpoena, the Pennsylvania AG requested that Lehigh provide additional documents and information and appear to answer certain inquiries. Lehigh has produced documents responsive to the Pennsylvania AG's additional requests and has made a former senior administrator available to answer the Pennsylvania AG's inquiries. In October 2006, the Pennsylvania AG alleged that the school had violated the Pennsylvania Consumer Protection Law. The Pennsylvania AG offered Lehigh and CEC the opportunity to resolve this matter through entering into an assurance of voluntary compliance and payment of a fine and costs. During the period October 2006 through February 2007, Lehigh and CEC engaged in discussions with the Pennsylvania AG regarding the terms of an assurance of voluntary compliance upon which the matter may be resolved. In May 2007, Lehigh received a letter from the Pennsylvania AG setting forth additional requests for information and documents. These latest requests focus on relationships and business dealings between Lehigh and CEC and companies that offer student loans, and, in particular, the use of preferred lender lists. Lehigh and CEC submitted a response to this request in June 2007.

*Brooks Institute*. On April 19, 2007, the California Bureau for Private Postsecondary and Vocational Education issued a full five-year license renewal for Brooks Institute.

We cannot predict the outcome of pending state regulatory matters, and an unfavorable outcome of any one or more of these matters could have a material adverse effect on our business, results of operations, cash flows, and financial position. We have evaluated these matters in connection with our ongoing evaluation of goodwill and indefinite-lived intangible assets for impairment, when applicable.

#### ***Accrediting Body Matters***

*American InterContinental University (AIU)*. As previously disclosed, at SACS' December 11, 2006, meeting, SACS extended AIU's Probation status through December 2007. On January 9, 2007, AIU was notified that seven of the 15 previous recommendations from SACS remained unresolved to the

commission's satisfaction and that another special committee visit to AIU had been authorized. AIU is scheduled to submit a second monitoring report in September 2007 responding to these seven open recommendations, and the special committee visit is scheduled to occur in October 2007. AIU remains accredited during this probationary period and is committed to resolving all issues identified by SACS. Under the SACS' rules, an institution may only remain on Probation status for two consecutive years, after which Probation status must either be lifted or the institution's accredited status must be terminated.

*Brooks College ( Brooks ).* At its June 2007 meeting, the Accrediting Commission for Community and Junior Colleges, Western Association of Schools and Colleges ( ACCJC ) reviewed both the Focused Midterm Report submitted by Brooks and the report of the ACCJC evaluation team that visited the Brooks Long Beach campus in April 2007. The ACCJC placed Brooks on probation and in accord with its directive, the college submitted a Special Report on August 3, 2007. ACCJC has also required that the college submit a Progress Report by October 15, 2007. Brooks is in the process of addressing the concerns expressed by the ACCJC.

We cannot predict the outcome of any pending accreditation matters, and an unfavorable outcome of any one or more of these matters could have a material adverse effect on our business, results of operations, cash flows, and financial position. We have evaluated these matters in connection with our ongoing evaluation of goodwill and indefinite-lived intangible assets for impairment, when applicable.

We periodically evaluate the need to record liabilities in connection with loss contingencies, including, but not limited to, settlement of legal proceedings and regulatory compliance matters. In accordance with SFAS No. 5, *Accounting for Contingencies*, we accrue for costs related to loss contingencies when such costs are probable and reasonably estimable. We believe that we have recorded in our consolidated financial statements adequate liabilities for all material, probable, and reasonably estimable costs associated with loss contingencies existing as of June 30, 2007.

## 8. STOCK REPURCHASE PROGRAM

Prior to the second quarter of 2007, our Board of Directors authorized the use of a total of \$500.2 million to repurchase outstanding shares of our common stock. On May 17, 2007, our Board of Directors authorized us to use an additional \$300.0 million for the repurchase of shares of our common stock. Stock repurchases under this program may be made on the open market or in privately negotiated transactions from time to time, depending on various factors, including market conditions and corporate and regulatory requirements. The stock repurchase program does not have an expiration date and may be suspended or discontinued at any time.

During the three months ended June 30, 2007, we repurchased 2.3 million shares of our common stock for approximately \$75.0 million at an average price of \$32.34 per share. Since the inception of the program, we have repurchased 14.7 million shares of our common stock for approximately \$491.2 million at an average price of \$33.34 per share. As of June 30, 2007, approximately \$308.8 million is available under the program to repurchase outstanding shares of our common stock.

The repurchase of shares of our common stock reduces the amount of cash available to pay cash dividends to our stockholders. We have never paid cash dividends on our common stock.

## 9. SHARE-BASED COMPENSATION

### Overview of Share-Based Compensation Plans

Under our 1998 Employee Incentive Compensation Plan, as amended, (the *Employee Plan*) and our 1998 Non-Employee Directors' Stock Option Plan (the *Directors Plan*), non-employee members of our Board of Directors, officers, and other employees may receive grants of incentive stock options, nonqualified stock options, shares of non-vested stock, stock appreciation rights, and other awards. We are authorized to grant up to approximately 28.5 million shares of common stock under the plans. As of June 30, 2007, we have reserved approximately 5.7 million shares of common stock for the exercise of stock options outstanding as of June 30, 2007, approximately 0.8 million shares for awards of non-vested stock, and approximately 3.7 million additional shares of common stock for future share-based awards under the plans.

*Stock Options.* The exercise price of stock options granted under the plans is equal to the fair market value of our common stock on the date of grant. Employee stock options become exercisable ratably over a four-year service period beginning on the date of grant and expire ten years after the date of grant, unless an earlier expiration date is set at the time of the grant. Non-employee directors' stock options expire ten years after the date of grant and generally become exercisable as follows: one-third on the grant date, one-third on the first anniversary of the grant date, and one-third on the second anniversary of the grant date. Both employee stock options and non-employee director stock options are subject to possible earlier vesting and termination in certain circumstances. If a plan participant terminates his or her employment for any reason other than by death or disability during the vesting period, he or she forfeits the right to unvested stock option awards. Since the inception of the plans, grants of stock options have only been subject to the service conditions discussed previously. No stock option grants have included performance or market conditions that affect stock option vesting or other pertinent factors.

*Non-vested Stock.* Shares of non-vested stock become vested three years after the date of grant. If a plan participant terminates his or her employment for any reason other than by death or disability during the vesting period, he or she forfeits the right to all shares of non-vested stock. The vesting of shares of non-vested stock is subject to possible acceleration in certain circumstances. Certain of the shares of non-vested stock that we have granted to plan participants are subject to performance conditions that may affect the number of shares of non-vested stock that will ultimately vest at the end of the requisite service period. These awards are referred to as *performance-vesting non-vested stock*.

Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Stock option activity during the six months ended June 30, 2007, under all of our share-based compensation plans was as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2006	6,232,895	\$ 33.89		
Granted	618,200	30.86		
Exercised	(564,751 )	28.93		\$ 7,031
Forfeited	(173,947 )	33.06		
Cancelled	(427,302 )	47.55		
Outstanding as of June 30, 2007	5,685,095	\$ 33.87	6.9	\$ 27,946
Exercisable as of June 30, 2007	4,219,442	\$ 34.41	6.2	\$ 24,993

The following table summarizes information with respect to all stock options outstanding under all of our share-based compensation plans as of June 30, 2007:

Exercise Price Ranges	Options Outstanding			Options Exercisable	
	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number Exercisable	Weighted Average Exercise Price
\$2.00 - \$15.57	458,110	\$ 10.92	3.6	458,110	\$ 10.92
\$18.25 - \$28.19	897,625	22.40	5.1	849,450	22.09
\$29.35 - \$33.04	1,862,850	29.87	7.6	1,125,149	29.68
\$33.56 - \$39.47	1,485,172	34.79	8.1	832,646	34.88
\$40.25 - \$68.24	981,338	61.27	6.9	954,087	61.83
	5,685,095	\$ 33.87	6.9	4,219,442	\$ 34.41

Non-vested stock activity during the six months ended June 30, 2007, under the Employee Plan was as follows:

	Number of Shares	Weighted Average Grant-Date Fair Value Per Share
Outstanding as of December 31, 2006	383,100	\$ 29.38
Granted	453,600	\$ 29.79
Forfeited	(56,363 )	\$ 22.81
Outstanding as of June 30, 2007	780,337	\$ 29.45

### Change in Control Provision

Each of the share-based awards granted under the plans, including stock options and shares of non-vested stock, is subject to a change in control provision included in our share-based compensation plans. As defined by the plans, a change in control is deemed to have occurred if, among other things, any corporation, person, or other entity (other than CEC, a majority-owned subsidiary of CEC or any of CEC's subsidiaries, or an employee benefit plan sponsored or maintained by CEC), including a group as defined in Section 13(d)(3) of the Securities Exchange Act of 1934 (the Exchange Act), becomes the beneficial owner of CEC's common stock representing more than 20 percent of the combined voting power of CEC's then outstanding common stock.

Under the Employee Plan, in the event of a change in control:

- Any stock options outstanding as of the date of the change in control and not then exercisable would become fully exercisable to the full extent of the original grant.
- The restrictions applicable to any outstanding shares of non-vested stock awards would lapse, and the shares of non-vested stock would become fully-vested and transferable to the full extent of the original grant.
- The performance goals and other conditions with respect to any performance-vesting non-vested stock or stock options subject to performance vesting conditions would be deemed to have been satisfied in full, and such awards would generally become fully distributable.
- Plan participants holding stock option awards as of the date of the change in control would have the right, by giving notice to us during the 60-day period from and after the date of a change in control, to elect to surrender all or part of a stock option award to us and receive, within 30 days of such notice, cash in an amount equal to the amount by which the per share change of control price, as defined below, exceeds the per share amount that the employee must pay to exercise the stock option award, multiplied by the number of stock options for which the employee has exercised this right.

Under the Director Plan, in the event of a change in control, any stock options outstanding as of the date of such change in control and not then exercisable will become fully exercisable to the full extent of the original grant. In addition, our Board of Directors will have full discretion to do, among other things, any or all of the following with respect to outstanding stock option awards:

- Cause any stock option award to be cancelled, provided notice of at least 15 days thereof is provided before the date of cancellation;
- Grant the director participants, by giving notice during a pre-set period, the right to surrender all or part of a stock option award to us and to receive cash in an amount equal to the amount by which the change in control price per share on the date of such election exceeds the per share amount that the plan participant must pay to exercise the stock option award, multiplied by the number of shares of our common stock for which the director has exercised this right; and
- Take any other action our Board of Directors determines to take.

In the event of a change in control, as described above, the change in control price is defined by the plans as the highest reported sales price of a share of our common stock in any transaction reported on the principal exchange on which our shares are listed during the 60-day period prior to and including the date of the change in control event.

As of June 30, 2007, we are not aware of any person or entity, including a group who beneficially owns 20% or more of the combined voting power of our outstanding common stock, and we do not believe it is probable that the change in control provisions will be triggered.

If any person or entity, including a group, beneficially owned 20% or more of the combined voting power of our then outstanding common stock as of June 30, 2007, triggering the change in control provisions discussed above, we would have recognized additional share-based compensation expense of approximately \$38.8 million during the second quarter of 2007. The estimated additional share-based compensation expense represents, for each outstanding share-based award, the greater of (a) the unrecognized grant date compensation expense for the share-based award as of June 30, 2007, or (b) the fair value of the cash redemption value of the share-based award as of June 30, 2007, less share-based compensation expense previously recorded under SFAS 123R or disclosed as pro forma compensation expense under SFAS 123, based on a change in control price of \$36.68 per share, the highest reported





share price of a share of our common stock in a transaction reported on the NASDAQ Global Select Market during the 60-day period prior to and including June 30, 2007.

Additionally, if the change in control provisions had been triggered as of June 30, 2007, or if we determined that the occurrence of a change in control event was probable, we would have recognized a liability of \$40.2 million as of June 30, 2007, representing the estimated fair value of the obligation that would be due to participants who are eligible to surrender all or part of a stock option award to us in exchange for cash. Our estimation of this cash liability assumes that participants would elect to redeem for cash all stock options outstanding as of June 30, 2007, with an exercise price less than the change in control price.

#### **Balance Sheet Presentation of Share-based Awards Subject to Redemption**

As discussed above, a participant in the plans has the right, or may be granted the right, upon the occurrence of a change in control event, to surrender all or part of his or her stock option awards to us in exchange for cash. As required by SFAS No. 123 (revised), *Share-Based Payment* ( SFAS 123R ), the grant-date cash redemption value of each outstanding stock option award is recorded as Share-based awards subject to redemption on our consolidated balance sheets on a pro rata basis over the requisite service period. Total grant-date cash redemption value for each outstanding stock option award represents the intrinsic value of the award as of the grant date, assuming that a change in control event occurred on the grant date. Share-based awards subject to redemption as of June 30, 2007, recorded as a reduction of retained earnings with no effect on net income, represents the portion of the total grant-date cash redemption value for all stock option awards outstanding as of June 30, 2007, earned by plan participants as a result of services rendered through such date. The adoption of SFAS 123R resulted in the cumulative effect recorded in this manner as of January 1, 2006, of \$11.2 million. The balance increased during 2006 by \$2.3 million, resulting in a balance of \$13.5 million as of December 31, 2006, and increased by \$0.3 million during the first six months of 2007, resulting in a balance of \$13.8 million as of June 30, 2007.

#### **Implementation of SFAS 123R**

On January 1, 2006, we adopted the provisions of SFAS 123R, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* ( SFAS 123 ), and replaces our previous method of accounting for share-based awards under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ( Opinion 25 ) for periods beginning in 2006. SFAS 123R requires that all share-based payments to employees, including grants of stock options, shares of non-vested stock and the compensatory elements of employee stock option plans, be recognized in the financial statements based on the estimated fair value of the equity or liability instrument issued.

We previously accounted for share-based compensation using the intrinsic value method as defined in Opinion 25. Prior to January 1, 2006, no share-based employee compensation cost, other than the insignificant costs associated with infrequent issuances of shares of non-vested stock, was reflected in our consolidated statement of income. SFAS 123R requires that we report the tax benefit from the tax deduction related to share-based compensation that is in excess of recognized compensation costs as a financing cash flow rather than as an operating cash flow in our consolidated statement of cash flows. Prior to January 1, 2006, Opinion 25 required that we report the entire tax benefit related to the exercise of stock options as an operating cash flow.

We adopted SFAS 123R using the modified prospective transition method. Under this method, employee compensation cost recognized during 2006 includes (1) compensation cost for all share-based payments granted prior to, but not yet vested, as of January 1, 2006, based on grant date fair value estimated in accordance with the provisions of SFAS 123 and (2) compensation cost for all share-based awards granted on or subsequent to January 1, 2006, based on the grant date fair value estimated in

accordance with the provisions of SFAS 123R. Under the modified prospective transition method, the provisions of SFAS 123R were not applied to periods prior to adoption, and, thus, prior period financial statements have not been restated.

In accordance with SFAS 123R, the fair value of each stock option award is estimated on the date of grant using the Black-Scholes-Merton option pricing model. Consistent with our approach under the disclosure only provisions of SFAS 123, we will continue to recognize the value of share-based compensation as expense during the vesting periods of the underlying share-based awards using the straight-line method. SFAS 123R requires companies to estimate forfeitures of share-based awards at the time of grant and revise such estimates in subsequent periods if actual forfeitures differ from original projections. Consistent with our approach under the disclosure-only provisions of SFAS 123, we will continue to estimate forfeitures at the time of grant.

The fair value of each stock option award granted during the three and six months ended June 30, 2007 and 2006, was estimated on the date of grant using the Black-Scholes-Merton option pricing model. Our determination of the fair value of each stock option is affected by our stock price on the date of grant, as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the expected life of the awards and actual and projected stock option exercise behavior. The weighted average fair value per share of stock option awards granted during the three and six months ended June 30, 2007 and 2006, and assumptions used to value stock options are as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
Dividend yield				
Risk-free interest rate	4.48	% 5.18	% 4.48	% 5.15
Volatility	51.6	% 53.9	% 51.5	% 53.9
Expected life (in years)	5.1	5.6	5.7	5.6
Weighted average fair value per share of options granted	\$ 15.36	\$ 16.96	\$ 15.78	\$ 16.98

Volatility is calculated based on the actual historical daily prices of our common stock over the expected term of the stock option award.

The expected life of each stock option award is estimated based primarily on our actual historical director and employee exercise behavior.

The fair value of each share of non-vested stock is equal to the fair market value of our common stock as of the date of grant.

All shares of performance-vesting non-vested stock granted during the three and six months ended June 30, 2007, are subject to performance conditions based on the results of school-level independent compliance audits and the compliance of our schools with federal, state, and accrediting body regulations. Share-based compensation expense associated with performance-vesting non-vested stock awards is recognized only to the extent that we believe performance conditions attributable to such awards will ultimately be satisfied. As of June 30, 2007, we believe performance conditions attributable to our performance-vesting non-vested stock awards will be satisfied.

As of June 30, 2007, we estimate that pre-tax compensation expense for all unvested share-based awards, including both stock options and shares of non-vested stock, in the amount of approximately \$26.8 million will be recognized in future periods. We expect to satisfy the exercise of stock options and future distribution of shares of non-vested stock by issuing new shares of common stock.

**10. WEIGHTED AVERAGE COMMON SHARES**

The weighted average numbers of common shares used to compute basic and diluted income per share during the three and six months ended June 30, 2007 and 2006, were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Basic common shares outstanding	93,924	96,989	95,103	97,563
Common stock equivalents	735		612	2,068
Diluted common shares outstanding	94,659	96,989	95,715	99,631

During the three months ended June 30, 2007 and 2006, we issued 170,512 and 236,360 shares, respectively, of our common stock upon the exercise of employee stock options and the purchase of common stock pursuant to our employee stock purchase plan.

During the six months ended June 30, 2007 and 2006, we issued 638,868 and 384,618 shares, respectively, of our common stock upon the exercise of employee stock options and the purchase of common stock pursuant to our employee stock purchase plan.

Included in stock options outstanding as of June 30, 2007 are options to purchase 2.5 million shares of our common stock that were not included in the computation of diluted net income per share during the three months ended June 30, 2007. Included in stock options outstanding as of June 30, 2007, are options to purchase 3.0 million of our common stock that were not included in the computation of diluted net income per share during the six months ended June 30, 2007. The outstanding stock options were excluded from the computation of diluted net income per share during the three months and six months ended June 30, 2007 because the options' exercise prices were greater than the average market price of our common stock during the periods, and, therefore, the effect would have been anti-dilutive.

Total common stock equivalents for the three months ended June 30, 2006, are zero because the impact of such common stock equivalents for the three months ended June 30, 2006 would be anti-dilutive to our earnings per share.

**11. SEGMENT REPORTING**

Based on our interpretation of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* ( SFAS 131 ), we have identified six school reportable segments, including the Academy segment, the Colleges segment, the Culinary Arts segment, the Health Education segment, the International segment, and the University segment.

The Academy segment includes our International Academy of Design and Technology ( IADT ) campuses that collectively offer academic programs primarily in the career-oriented discipline of visual communications and design technologies in a classroom or online setting.

The Colleges segment includes schools that collectively offer academic programs in each of our core career-oriented disciplines of business studies, culinary arts, health education, information technology, and visual communications and design technologies in a classroom or laboratory setting.

The Culinary Arts segment includes our Le Cordon Bleu and Kitchen Academy schools that collectively offer culinary arts academic programs in the career-oriented disciplines of culinary arts, pastry arts, and hotel and restaurant management primarily in a classroom or kitchen setting.

## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

The Health Education segment primarily includes our Sanford-Brown schools that collectively offer academic programs in the career-oriented disciplines of health education, business studies, visual communication and design technologies, and information technology in a classroom or laboratory setting.

The International segment includes our INSEEC Group schools and Istituto Marangoni schools located in France, Italy, and the United Kingdom, which collectively offer academic programs in the career-oriented disciplines of business studies, health education, fashion and design, and visual communication and technologies in a classroom or laboratory setting.

The University segment includes our AIU and CTU universities that collectively offer academic programs in the career-oriented disciplines of business studies, visual communication and design technologies, health education, information technology, criminal justice, and education in an online, classroom, or laboratory setting.

Our chief operating decision maker evaluates segment performance based on pretax segment profit or loss. This measure of profit or loss includes the University segment's share of affiliate earnings and excludes interest income, interest expense, miscellaneous income and expense, and any unallocated corporate expenses. Adjustments to reconcile segment results to consolidated results are included under the caption Corporate and other, which primarily includes unallocated corporate activity and eliminations.

The accounting policies of each segment are consistent with those described in the summary of significant accounting policies in Note 2 Significant Accounting Policies of the notes to our consolidated financial statements in Part IV, Item 15 of our Annual Report on Form 10-K for the year ended December 31, 2006. Transactions between segments, which are not significant, are consummated on a basis intended to reflect the market value of the underlying products or services. A majority of corporate expenses have been charged to the segments as part of a general allocation.

The results of operations of our schools' on-ground campuses fluctuate on a quarterly basis, primarily as a result of changes in the level of student enrollment. Our schools' on-ground campuses typically experience a seasonal increase in student population in the fall, traditionally when the largest number of new high school graduates begin postsecondary education. Furthermore, although our schools encourage year-round attendance at all campuses, certain programs at certain schools include summer breaks. As a result of these factors, total student population and revenue at our schools' on-ground campuses are typically highest in the fourth quarter (October through December) and lowest in the second quarter (April through June). The operating costs of our schools' on-ground campuses do not fluctuate as significantly on a quarterly basis, except for admissions and advertising expenses, which are typically higher during the second quarter and third quarter (April through September) in support of seasonally high enrollment. We anticipate that these seasonal trends will continue.

The results of operations of AIU Online, which is included in our University segment, fluctuate on a quarterly basis, primarily as a result of AIU Online's academic calendar and, more specifically, the number of instructional days in each quarter. Historically, the number of revenue-generating instructional days has been highest during the first and second quarters (January through June), lower in the third quarter (July through September), and lowest in the fourth quarter (October through December). Operating costs for AIU Online do not fluctuate as significantly on a quarterly basis. We anticipate that these seasonal trends will continue.

The results of operations of CTU Online, which is included in our University segment, are not significantly impacted by seasonal trends, as, historically, the number of revenue-generating instructional days during each quarter has not fluctuated significantly.

**Operating Results for the Three Months Ended June 30, 2007 and 2006:**

	Revenues For the Three Months Ended June 30,		Segment Profit (Loss) For the Three Months Ended June 30,	
	2007	2006	2007	2006
<b>Segments:</b>				
University segment(1)	\$ 174,983	\$ 226,322	\$ 21,595	\$ 67,494
Culinary Arts segment	84,574	82,706	7,131	8,384
Colleges segment	42,399	52,286	(8,178 )	6,953
Health Education segment(2)	46,440	41,082	2,408	(85,225 )
Academy segment	40,333	39,418	247	1,720
International segment	16,531	10,626	424	1,179
Corporate and other	11	144	(10,744 )	(21,639 )
	\$ 405,271	\$ 452,584	12,883	(21,134 )
<b>Reconciling items:</b>				
Interest income			4,132	4,679
Interest expense			(209 )	(347 )
Miscellaneous income (expense)			479	(251 )
<b>Earnings before income taxes</b>			\$ 17,285	\$ (17,053 )

(1) University segment profit includes share of affiliate earnings of \$0.9 million and \$0.7 million for the three months ended June 30, 2007 and 2006, respectively.

(2) Health Education segment loss during the three months ended June 30, 2006 includes an \$85.0 million goodwill impairment charge.

	Depreciation and Amortization For the Three Months Ended June 30,		Share of Affiliate Earnings For the Three Months Ended June 30,	
	2007	2006	2007	2006
University segment	\$ 4,603	\$ 4,096	\$ 949	\$ 696
Culinary Arts segment	4,593	5,259		
Colleges segment	2,355	2,677		
Health Education segment	1,828	1,866		
Academy segment	2,258	2,224		
International segment	820	(39 )		
Corporate and other	3,205	3,288		
	\$ 19,662	\$ 19,371	\$ 949	\$ 696

**Operating Results for the Six Months Ended June 30, 2007 and 2006:**

	Revenues For the Six Months Ended June 30,		Segment Profit (Loss) For the Six Months Ended June 30,	
	2007	2006	2007	2006
<b>Segments:</b>				
University segment(1)	\$ 355,558	\$ 469,904	\$ 55,318	\$ 149,884
Culinary Arts segment	173,271	173,334	18,555	22,393
Colleges segment	91,914	109,470	(2,939 )	16,277
Health Education segment(2)	91,311	81,660	5,852	(84,012 )
Academy segment	82,699	82,445	4,252	6,401
International segment	38,431	25,509	6,631	5,041
Corporate and other	136	251	(26,934 )	(38,463 )
	\$ 833,320	\$ 942,573	60,735	77,521
<b>Reconciling items:</b>				
Interest income			8,836	8,973
Interest expense			(563 )	(685 )
Miscellaneous income (expense)			716	(95 )
<b>Earnings before income taxes</b>			\$ 69,724	\$ 85,714

- (1) University segment profit includes share of affiliate earnings of \$2.7 million and \$1.6 million for the six months ended June 30, 2007 and 2006, respectively.
- (2) Health Education segment loss during the six months ended June 30, 2006 includes an \$85.0 million goodwill impairment charge.

	Depreciation and Amortization For the Six Months Ended June 30,		Share of Affiliate Earnings For the Six Months Ended June 30,	
	2007	2006	2007	2006
University segment	\$ 8,984	\$ 8,222	\$ 2,661	\$ 1,599
Culinary Arts segment	9,084	9,670		
Colleges segment	4,537	5,330		
Health Education segment	3,555	3,621		
Academy segment	4,402	4,403		
International segment	1,418	357		
Corporate and other	6,463	6,157		
	\$ 38,443	\$ 37,760	\$ 2,661	\$ 1,599

**Total Assets:**

	<b>Total Assets as of</b>	
	<b>June 30, 2007</b>	<b>December 31, 2006</b>
University segment	\$ 799,735	\$ 752,996
Culinary Arts segment	505,672	494,869
Colleges segment	235,778	210,511
Health Education segment	389,495	383,817
Academy segment	148,394	135,970
International segment	209,202	114,014
Corporate and other	(994,830 )	(729,670 )
Assets held for sale	60,692	63,156
	<b>\$ 1,354,138</b>	<b>\$ 1,425,663</b>

The negative corporate and other segment asset balance as of June 30, 2007, and December 31, 2006, is primarily attributable to the elimination of intercompany receivable activity between corporate and our schools and campuses, which is reflected within Corporate and other.

**Start-up Campuses**

Start-up campuses include our branch campuses that have been instructing students for less than 12 months, including those campuses that have not yet opened for instruction. The following supplemental financial information illustrates the impact of our start-up campuses on segment revenues, operating results, and capital expenditures during the three and six months ended June 30, 2007 and 2006 (in thousands):

**Supplemental Start-up Financial Information for the Three Months Ended June 30, 2007 and 2006:**

	<b>Revenues</b>		<b>Operating Income/(Loss)</b>	
	<b>For the Three Months</b>		<b>For the Three Months</b>	
	<b>Ended June 30,</b>		<b>Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Culinary Arts segment(1)	\$ 790	\$ 1,545	\$ (2,176 )	\$ (1,632 )
Health Education segment(2)		1,634		43
Academy segment(3)	543		(2,406 )	(813 )
	<b>\$ 1,333</b>	<b>\$ 3,179</b>	<b>\$ (4,582 )</b>	<b>\$ (2,402 )</b>

	<b>Capital Expenditures</b>	
	<b>For the Three Months</b>	
	<b>Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Culinary Arts segment(1)	\$ 4,815	\$ 2,668
Health Education segment(2)		371
Academy segment(3)	2,633	1
	<b>\$ 7,448</b>	<b>\$ 3,040</b>

(1) For the three months ended June 30, 2007, Culinary Arts segment start-up campuses include LCB Dallas, TX; LCB Boston, MA; and Kitchen Academy campuses in St. Peters, MO; Seattle, WA; and Sacramento, CA. For the three months ended June 30, 2006, Culinary Arts segment start-up campuses include LCB Dallas, TX; LCB Boston, MA; and Kitchen Academy campuses in St. Peters, MO; Seattle, WA; Hollywood, CA; and Sacramento, CA.

(2) For the three months ended June 30, 2006, Health Education segment start-up campuses includes SBC Milwaukee, WI.

(3) For the three months ended June 30, 2007, Academy segment start-up campuses include IADT Sacramento, CA, San Antonio, TX, and IADT Online Tampa, FL. For the three months ended June 30, 2006, Academy segment start-up campuses include IADT Sacramento, CA and San Antonio, TX.

**Supplemental Start-up Financial Information for the Six Months Ended June 30, 2007 and 2006:**

	Revenues For the Six Months Ended June 30,		Operating Loss For the Six Months Ended June 30,	
	2007	2006	2007	2006
Culinary Arts segment(1)	\$ 969	\$ 2,855	\$ (4,268 )	\$ (4,086 )
Health Education segment(2)		2,907		(70 )
Academy segment(3)	543		(4,254 )	(1,691 )
	\$ 1,512	\$ 5,762	\$ (8,522 )	\$ (5,847 )

	Capital Expenditures For the Six Months Ended June 30,	
	2007	2006
Culinary Arts segment(1)	\$ 9,887	\$ 4,524
Health Education segment(2)		485
Academy segment(3)	2,846	1
	\$ 12,733	\$ 5,010

(1) For the six months ended June 30, 2007, Culinary Arts segment start-up campuses includes LCB Dallas, TX; LCB Boston, MA; and Kitchen Academy campuses in St. Peters, MO; Seattle, WA; and Sacramento, CA. For the six months ended June 30, 2006, Culinary Arts segment start-up campuses includes LCB Dallas, TX; LCB Boston, MA; and Kitchen Academy campuses in St. Peters, MO; Seattle, WA; Hollywood, CA; and Sacramento, CA.

(2) For the six months ended June 30, 2006, Health Education segment start-up campuses includes SBC Milwaukee, WI.

(3) For the six months ended June 30, 2007, Academy segment start-up campuses include IADT Sacramento, CA, San Antonio, TX, and IADT Online Tampa, FL. For the six months ended June 30, 2006, Academy segment start-up campuses includes IADT Sacramento, CA and San Antonio, TX.



**Teach-out Campuses**

Teach-out campus locations include our campuses that have ceased admitting new students and are scheduled to permanently close pending graduation of the remaining students. The following supplemental financial information illustrates the impact of our teach-out campuses on segment revenues and operating results during the three and six months ended June 30, 2007 and 2006:

	For the Three Months Ended June 30, 2007		For the Six Months Ended June 30, 2007	
	(In thousands)	2006	2007	2006
<b>Revenues</b>				
Academy segment(1)	\$ 1,693	\$ 1,673	\$ 3,547	\$ 3,548
Colleges segment(2)	3,393	4,402	7,433	9,750
Health Education segment(3)	85	702	259	1,418
	\$ 5,171	\$ 6,777	\$ 11,239	\$ 14,716

	For the Three Months Ended June 30, 2007		For the Six Months Ended June 30, 2007	
	(In thousands)	2006	2007	2006
<b>Operating Loss</b>				
Academy segment(1)	\$ (792 )	\$ (735 )	\$ (1,115 )	\$ (1,171 )
Colleges segment(2)	(6,437 )	(2,142 )	(8,505 )	(4,070 )
Health Education segment(3)	(281 )	(289 )	(581 )	(406 )
	\$ (7,510 )	\$ (3,166 )	\$ (10,201 )	\$ (5,647 )

(1) For the three and six months ended June 30, 2007 and 2006, the Academy segment teach-out campuses includes IADT Pittsburgh, Pennsylvania. The IADT Pittsburgh teach-out is scheduled to be completed in December of 2008.

(2) For the three and six months ended June 30, 2007 and 2006, the Colleges segment teach-out campuses includes Brooks College, Long Beach and Sunnyvale, California campuses. The Brooks College Long Beach teach-out is scheduled to be completed in March of 2009. The Brooks College Sunnyvale teach-out is scheduled to be completed in December of 2008.

(3) For the three and six months ended June 30, 2007 and 2006, the Health Education segment teach-out campus includes SBI Springfield, Missouri. The SBI Springfield teach-out is scheduled to be completed in September of 2007.

**12. DISCONTINUED OPERATIONS****Schools and Campuses Held For Sale as of June 30, 2007**

In November of 2006, our Board of Directors approved a plan (the Sale Plan) to sell 13 of our schools and campuses, including the nine campuses that comprise the Gibbs division, McIntosh College, the two campuses of Brooks College, and Lehigh Valley College (the Sale Group). Except with respect to the Brooks College campuses, we will continue to operate and invest in the schools and campuses within the Sale Group until the schools and campuses are sold. Continuing investment activities will include the strengthening of educational programming and services offered to the students at each school and campus and the support of local faculty and staff. Each of the schools and campuses within the Sale Group is available for immediate sale in its present condition, and we expect to execute a sales agreement of the campuses and schools in 2007. We will have no significant continuing involvement with the entities after they have been sold. Historically, the Gibbs division campuses have been included in the Gibbs segment,



and the campuses of McIntosh College, Brooks College, and Lehigh Valley College have been included in the Colleges segment.

In June of 2007, we decided to retain the two campuses of Brooks College and teach-out these campuses. We decided to retain and teach out Brooks College because we were not able to identify a suitable buyer that we believed would support the best interests of the campus students and faculty. The two campuses of Brooks College are no longer held for sale and the results of operations of Brooks College are no longer reflected as discontinued operations in our consolidated statements of income for all periods presented. Additionally, the assets and liabilities of our two Brooks College campuses are no longer included in current assets held for sale and current liabilities held for sale on our consolidated balance sheet. All current and prior period financial statements and the related notes included herein have been restated to include the results of operations and financial position of Brooks College in the Colleges segment of our continuing operations.

We believe that the schools and campuses remaining within the Sale Group meet the criteria necessary for such entities to qualify as assets held for sale under the specific provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ). Accordingly, the results of operations of those schools and campuses are reflected as discontinued operations in our consolidated statements of income for all periods presented. Additionally, in accordance with SFAS 144, as we expect to complete the Sale Plan within a year, assets and liabilities of the schools and campuses within the Sale Group are reflected as current assets held for sale and current liabilities held for sale on our consolidated balance sheet as of June 30, 2007, and December 31, 2006.

Under SFAS 144, the net assets of assets held for sale are required to be recorded on the balance sheet at estimated fair value, less costs to sell. Accordingly, during the fourth quarter of 2006, we recorded a charge of approximately \$9.8 million, net of income tax benefit of \$5.2 million, to reduce the carrying value of the net assets of our schools and campuses held for sale to estimated fair value, less costs to sell.

We expect to execute a sales agreement for each of the schools and campuses included in the Sale Plan during 2007. The sales will be subject to approval by the ED and various state regulatory and accrediting agencies, as applicable. We believe that the ultimate sale of our schools and campuses held for sale, including our accounting for lease obligations that may not transfer to the buyer upon sale, will likely result in a loss that is material to our consolidated financial position and results of operations and cash flows.

### Results of Discontinued Operations

Combined summary results of operations for the Sale Group, excluding the Brooks College campuses, which are reflected as discontinued operations in our unaudited condensed consolidated statements of income for the three and six months ended June 30, 2007 and 2006, were as follows:

	For the Three Months Ended June 30, 2007		For the Six Months Ended June 30, 2007	
	2006	2006	2006	2006
	(In thousands)			
Revenues	\$ 29,648	\$ 34,201	\$ 62,016	\$ 72,842
Loss before income tax	(9,106 )	(11,972 )	(14,129 )	(30,554 )
Income tax benefit	(3,233 )	(4,475 )	(5,017 )	(11,425 )
Loss from discontinued operations	\$ (5,873 )	\$ (7,497 )	\$ (9,112 )	\$ (19,129 )

Loss from discontinued operations for the three and six months ended June 30, 2006, includes depreciation expense of \$2.6 million and \$5.2 million, net of income tax benefit of \$1.0 million and \$1.9 million, respectively. Loss from discontinued operations during the three and six months ended June 30, 2007, in accordance with SFAS 144, includes no depreciation expense.

**Assets and Liabilities Held for Sale**

Assets and liabilities classified as held for sale on our unaudited condensed consolidated balance sheets as of June 30, 2007, and December 31, 2006, include the following:

	June 30, 2007 (In thousands)	December 31, 2006
<b>Assets:</b>		
Cash and cash equivalents	\$ 2,457	\$ 1,964
Receivables	5,877	5,181
Prepaid expenses	2,868	2,886
Inventories	449	186
Deferred income tax assets	7,235	7,235
Other current assets	320	857
Total current assets	\$ 19,206	\$ 18,309
Property and equipment, net	36,173	35,414
Goodwill	87	87
Other assets	5,226	9,346
Total assets	\$ 60,692	\$ 63,156
<b>Liabilities:</b>		
Accounts payable	\$ 1,414	\$ 1,982
Accrued payroll and related benefits	1,291	748
Accrued other	15,136	15,108
Deferred tuition revenue	4,711	5,957
Total current liabilities	\$ 22,552	\$ 23,795
Deferred rent obligations	8,694	8,084
Total liabilities	\$ 31,246	\$ 31,879

**13. REGULATION OF THE U.S. POST-SECONDARY EDUCATION INDUSTRY**

Many of our students require assistance in financing their education. For this reason, all of our schools offer financial aid programs and financing options. A majority of students who attend our U.S. accredited schools are eligible to participate in some form of government-sponsored financial aid program. Our schools also participate in a number of state financial aid programs and offer private funding options. Our schools that participate in federal financial aid programs are subject to extensive regulatory requirements imposed by federal and state government agencies, including the ED, and other standards imposed by educational accrediting bodies.

**Nature of Federal Support for Postsecondary Education in the United States**

The U.S. government provides a substantial portion of its support for postsecondary education in the form of Title IV Program grants, loans and work-study programs to students who can use those funds to finance certain expenses at any institution that has been certified as eligible by the ED. These federal programs are authorized by the HEA. Generally, financial aid administered under Title IV Programs is awarded on the basis of financial need, which is generally defined under the HEA as the difference between the cost of attending an institution and the amount a student can reasonably be expected to contribute to that cost. Among other things, recipients of Title IV Program funds must maintain a satisfactory grade point average and progress in a timely manner toward completion of their program of study.

## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Students at our schools may receive grants, loans, and work-study opportunities to fund their education under the following Title IV Programs, although not all of our schools participate in each of these programs:

*Federal Family Education Loan ( FFEL ) Program.* Loans under the FFEL program are made by banks and other lending institutions directly to our students or their parents. If a student or parent defaults on a FFEL program loan, repayment is guaranteed by a federally recognized guaranty agency, which is then reimbursed by the ED. Our schools and students use a wide variety of lenders and guaranty agencies and have not experienced difficulties in identifying lenders and guaranty agencies willing to make and guarantee FFEL program loans. The two primary types of loans obtained by students at our schools under the FFEL program are Stafford loans and PLUS loans for parents.

Stafford loans, which may either be subsidized or unsubsidized, are loans made directly to our students by financial institutions that participate in the FFEL program. Students who have a demonstrated financial need are eligible to receive a subsidized Stafford loan, with the ED paying the interest on this loan while the student is enrolled at least half-time in school and during the first six months after leaving school. Students who do not demonstrate financial need are eligible to receive an unsubsidized Stafford loan. The student is responsible for paying the interest on an unsubsidized Stafford loan while in school and after leaving school, although actual interest payments generally may be deferred by the student until after he or she has left school. Students who are eligible for a subsidized Stafford loan may also receive an unsubsidized Stafford loan.

A student is not required to meet any specific credit scoring criteria to receive a Stafford loan, but any student with a prior Stafford loan default or who has been convicted under federal or state law of selling or possessing drugs while receiving federal aid may not be eligible for a Stafford loan. The ED has established maximum annual borrowing limits with respect to Stafford loans, and these annual limits are generally less than the tuition costs at our U.S. schools.

A PLUS loan is a loan made directly by financial institutions to the parents of our dependent students. Parents who have an acceptable credit history can borrow under a PLUS loan to pay the educational expenses of a child who is a dependent student enrolled at least half-time at our U.S. schools. The amount of a PLUS loan cannot exceed the student's cost of attendance less all other financial aid received.

*Federal Grants.* Title IV Program grants are generally made to our students under the Federal Pell Grant ( Pell ) program and the Federal Supplemental Educational Opportunity Grant ( FSEOG ) program. The ED makes Pell grants up to a maximum amount of \$4,050 per award year to students who demonstrate financial need. This amount will increase to \$4,310 per award year effective with the 2007-2008 award year, which commenced on July 1, 2007. FSEOG program awards are designed to supplement Pell grants up to a maximum amount of \$4,000 per award year for the neediest students. An institution is required to make a 25% matching contribution for all federal funds received under the FSEOG program.

*Federal Work-Study ( FWS ) Program.* Generally, under the FWS program, federal funds are used to pay 75% of the cost of part-time employment of eligible students to perform work for the institution or certain off-campus organizations. The remaining 25% is paid by the institution or the student's employer. In select cases, these federal funds under the FWS program are used to pay 100% of the cost of part-time employment of eligible students.

*Federal Perkins Loan ( Perkins ) Program.* Perkins loans are made from a revolving institutional account, 75% of which is capitalized by the ED and the remainder of which is funded by the institution. Each institution is responsible for collecting payments on Perkins loans from its former students and lending those funds to currently enrolled students. Currently, only one of our schools participates in the Perkins program.

*Academic Competitiveness Grant (ACG.)* The Academic Competitiveness Grant (ACG) is available to students who have successfully completed a rigorous High School program (as defined by the Secretary of Education.) The ACG provides funds for the first and second academic year of undergraduate study. To be eligible, a student must be enrolled full-time, must be a United States citizen, and must be receiving a Federal Pell Grant. Second year students must also have a cumulative grade point average of at least 3.0 on a 4.0 scale.

*The National Science and Mathematics Access to Retain Talent Grant (SMART.)* The Smart Grant will provide funds for each of the third and fourth years of undergraduate study. To be eligible, a student must be enrolled full-time, must be a United States citizen, must be eligible for a Federal Pell Grant, and must be enrolled in a physical, life or computer sciences, mathematics, technology, engineering, or in a foreign language program determined critical to national security, as defined by the Secretary of Education. Students must also maintain a cumulative grade point average of at least 3.0 on a 4.0 scale.

### **ED Regulation of Federal Student Financial Aid Programs**

To participate in the Title IV Programs, an institution must be authorized to offer its programs of instruction by the relevant education agencies of the state in which it is located, accredited by an accrediting agency recognized by the ED, and certified as eligible by the ED. The ED will certify an institution to participate in Title IV Programs only after the institution has demonstrated compliance with the HEA and the ED's extensive regulations regarding institutional eligibility. An institution must also demonstrate its compliance with these requirements to the ED on an ongoing basis. These standards are applied primarily on an institutional basis, with an institution defined as a main campus and its additional campus locations, if any.

*State Authorization for U.S. Institutions.* State licensing agencies are responsible for the oversight of educational institutions, and continued approval by such agencies is necessary for an institution to operate and grant degrees or diplomas to its students. Moreover, under the HEA, approval by such agencies is necessary to maintain eligibility to participate in Title IV Programs. As a result, we are subject to extensive regulation in each of the states in which our schools operate campuses and in other states in which our schools recruit students. Currently, each of our U.S. campuses is authorized by its applicable state licensing agency or agencies.

The level of regulatory oversight varies substantially from state to state. In certain states in which we operate, our campuses are subject to licensure by an agency that regulates proprietary institutions and also by a separate higher education agency. State laws establish standards for, among other things, student instruction, qualifications of faculty, location and nature of facilities, and financial policies. State laws and regulations may limit our campuses' ability to operate or to award degrees or diplomas or offer new degree programs. If any one of our campuses were to lose state authorization, it would be unable to offer educational programs, and students attending the campus would not be eligible to participate in Title IV Programs. Such severe penalties would require us to close a campus if it were to lose state authorization. See Note 7

Commitments and Contingencies State Regulatory Actions of these notes to our consolidated financial statements for a further discussion of selected state regulatory matters currently affecting us and our schools.

*Accreditation for U.S. Institutions.* Accrediting agencies also are responsible for overseeing educational institutions, and, under the HEA, continued approval by an accrediting agency recognized by the ED is necessary for an institution to maintain eligibility to participate in Title IV Programs. Accreditation is a non-governmental process through which an institution submits to a qualitative review by an organization of peer institutions. Accrediting agencies primarily examine the academic quality of the institution's instructional programs, and a grant of accreditation is generally viewed as confirmation that an institution's programs meet generally accepted academic standards. Accrediting agencies also review the

administrative and financial operations of the institutions they accredit to ensure that each institution has sufficient resources to perform its educational mission. Accrediting agencies must adopt specific standards in connection with their review of postsecondary educational institutions to be recognized by the ED. All of our U.S. campuses except Kitchen Academy in Sacramento, California are accredited by one or more accrediting agencies recognized by the ED.

Accrediting agency oversight may occur at several levels. An accrediting agency may place an institution on Reporting status to monitor one or more specified areas of performance. An institution placed on Reporting status is required to report periodically to its accrediting agency on its performance in the specified areas and to continue to submit such periodic reports for a specified period, which is generally one year, after which the institution is re-evaluated. An accrediting agency may place an institution on Warning status if it determines that the institution may be in danger of failing to comply with the accreditation requirement, or it may place an institution on Probation status if it determines that an institution appears to be deficient with regard to such requirement. In either instance, the institution is given a prescribed period to demonstrate that it has rectified the deficiency, which period may subsume two or more years. When accrediting agencies determine that a serious deficiency may exist, it may direct an institution to Show Cause as to why its accreditation should not be terminated. An institution under Show Cause is required to satisfy its accrediting agency within a prescribed period, generally less than one year, that it has satisfactorily resolved the deficiency. See Note 7 Commitments and Contingencies Accrediting Body Actions of these notes to our consolidated financial statements for further discussion of selected accreditation matters currently affecting us and our schools.

*Legislative Action.* The U.S. Congress must periodically reauthorize the HEA and other laws governing Title IV Programs and annually determines the funding level for each Title IV Program. In December 2005, Congress temporarily extended the provisions of the HEA, pending completion of the reauthorization process or further extensions of the HEA. In February 2006, as part of the Deficit Reduction Act of 2005, Congress made certain changes in the HEA that had been reflected in the HEA reauthorization bills. The changes enacted eliminate certain restrictions on online programs, increase, beginning in 2007, student loan limits for the first two academic years of a student's program of study, and other technical changes. In September 2006, Congress temporarily extended the provisions of the HEA, pending completion of the reauthorization process or further extensions of the HEA.

It is possible that Congress will not make further changes to the HEA during 2007 and, instead, extend current law, including the changes made as part of the Deficit Reduction Act of 2005. If Congress does address reauthorization, there may be certain further legislative changes. However, at this time, we cannot determine the scope, content, or effect of such changes. Any action by Congress that significantly reduces Title IV Program funding or the ability of our schools or students to participate in Title IV Programs could have a material adverse effect on our student population, financial condition, results of operations, and cash flows. Legislative action may also require us to modify our practices for our schools to comply fully with applicable requirements. The adoption of any such modifications could result in additional administrative costs, which could have a material adverse effect on our financial condition, results of operations, and cash flows.

*Student Loan Default Rates.* An institution may lose eligibility to participate in some or all Title IV Programs if the rates at which former students default on the repayment of their federally-guaranteed or federally-funded student loans exceed specified percentages. An institution's cohort default rate under the FFEL program is calculated on an annual basis as the rate at which student borrowers scheduled to begin repayment of their loans in one federal fiscal year default on those loans by the end of the next federal fiscal year.

An institution whose cohort default rates equal or exceed 25% for three consecutive years will no longer be eligible to participate in the FFEL or Pell programs for the remainder of the federal fiscal year in

which the ED determines that such institution has lost its eligibility and for the two subsequent federal fiscal years. An institution whose cohort default rate under the FFEL program for any federal fiscal year exceeds 40% will no longer be eligible to participate in the FFEL program for the remainder of the federal fiscal year in which the ED determines that the institution has lost its eligibility and for the two subsequent federal fiscal years. An institution whose cohort default rate under the FFEL program equals or exceeds 25% for any one of the three most recent federal fiscal years, or whose cohort default rate under the Perkins loan program exceeds 15% for any year, may be placed on provisional certification status by the ED for up to four years.

All of our schools have implemented student loan default management programs aimed at reducing the likelihood of our students' failure to repay their loans in a timely manner. Those programs emphasize the importance of students' compliance with loan repayment requirements and provide for extensive loan counseling, methods to increase student persistence and completion rates and graduate employment rates, and proactive borrower contacts after students cease enrollment. If any of our schools were to lose eligibility to participate in Title IV Programs due to student loan default rates being higher than the ED's tolerable thresholds and we could not arrange for adequate alternative student financing sources, we would most likely have to close those schools, which could have a material adverse effect on our student population, financial condition, results of operations, and cash flows.

As of June 30, 2007, four of our schools had student borrowers who entered repayment in the 2003-2004 award year, the most recent year for which we have calculated and reported Perkins loan default rates to the ED. The Perkins loan cohort default rates for these four schools ranged from 11.43% to 66.67%. One of our schools, Brown College, currently participates in Title IV Programs under provisional certification due to the ED's Perkins loan default rate criteria. CTU is our only school that continues to participate in the Federal Perkins Loan program and it had a Perkins loan cohort default rate of 11.43% for students who were scheduled to begin repayment in the 2003-2004 federal award year.

All of our schools participate in the FFEL program, with the exception of our Kitchen Academy campuses, and none of our participating schools had a FFEL cohort default rate of 25% or greater during any of the last three federal fiscal years.

*Financial Responsibility Standards.* To participate in Title IV Programs, an institution must satisfy specific measures of financial responsibility as prescribed by the ED. The ED evaluates institutions for compliance with these standards each year, based on the annual audited financial statements of an institution or its parent corporation, and following a change of control of an institution. With respect to our schools, it has been the ED's practice to measure financial responsibility on the basis of the financial statements of both our individual schools and CEC on a consolidated basis.

To be considered financially responsible, an institution must, among other things, (i) have sufficient cash reserves to make required refunds, (ii) be current on its debt payments, (iii) meet all of its financial obligations, and (iv) achieve a composite score of at least 1.50 based on the institution's annual financial statements. The ED calculates an institution's composite score, which may range from -1.00 to 3.00, based on a combination of financial measures designed to establish the adequacy of an institution's capital resources, its financial viability, its ability to support current operations, and its ability to generate a profit. An institution that does not meet the ED's minimum composite score of 1.0 may demonstrate its financial responsibility in one of several ways, including posting a letter of credit in favor of the ED in an amount equal to at least 50% of Title IV Program funds received by the institution during its prior fiscal year or posting a letter of credit in an amount equal to at least 10% of Title IV Program funds received by the institution during its prior fiscal year and agreeing to certain additional requirements for the receipt of Title IV Program funds, including, in certain circumstances, receipt of Title IV Program funds under an agreement other than the ED's standard advance funding arrangement.



Currently, none of our schools are required to post a letter of credit or accept other conditions on its participation in Title IV Programs due to failure to satisfy the ED's financial responsibility standards.

*Return and Refunds of Title IV Program Funds.* An institution participating in Title IV Programs must correctly calculate the amount of unearned Title IV Program funds that were disbursed to students who withdrew from educational programs before completing the programs, and must return those funds in a timely manner. Institutions have historically been required to return such funds within 30 days of the date the institution determines that the student has withdrawn, but, based upon changes to the HEA in 2006, the deadline to return such funds has been changed to 45 days for any student who withdrew from school on or after July 1, 2006. An institution that is found to be in non-compliance with ED refund requirements for either of the last two completed fiscal years must post a letter of credit in favor of the ED in an amount equal to 25% of the total Title IV Program refunds paid by the institution during its prior fiscal year. Due to non-compliance with ED refund requirements at 14 of our schools, we had posted a total of \$3.9 million in letters of credit in favor of the ED as of June 30, 2007.

*Change of Ownership or Control.* When an institution undergoes a change of ownership resulting in a change of control, as that term is defined by the state in which it is located, its accrediting agency and the ED, it must secure the approval of those agencies to continue to operate and to continue to participate in Title IV Programs. If the institution is unable to re-establish state authorization and accreditation requirements and satisfy other requirements for certification by the ED, the institution may lose its authority to operate and its ability to participate in Title IV Programs. An institution whose change of ownership or control is approved by the appropriate authorities is nonetheless provisionally recertified by the ED for a period of up to three years. Transactions or events that constitute a change of control by one or more of the applicable regulatory agencies, including the ED, applicable state agencies, and accrediting bodies, include the acquisition of an institution from another entity or significant acquisition or disposition of an institution's equity. It is possible that some of these events may occur without our control. Our failure to obtain, or a delay in obtaining, a required approval of any change in control from the ED, applicable state agencies, or accrediting agencies could impair our ability or the ability of the effected schools to participate in Title IV Programs. If we were to undergo a change of control and a material number of our schools failed to obtain the required approvals from applicable regulatory agencies in a timely manner, our student population, financial condition, results of operations, and cash flows could be materially adversely affected.

When we acquire an institution that is eligible to participate in Title IV Programs, that institution undergoes a change of ownership resulting in a change of control as defined by the ED. Each of our acquired schools in the U.S. has undergone a certification review under our ownership and has been certified to participate in Title IV Programs on a provisional basis. Currently, seven of our schools participate in Title IV Programs under provisional certification due to the ED's change of ownership criteria. The potential adverse effects of a change of control under ED regulations may influence future decisions by us and our stockholders regarding the sale, purchase, transfer, issuance, or redemption of our common stock.

*Opening New Schools, Start-up Branch Campuses, and Adding Educational Programs.* The HEA generally requires that proprietary institutions be fully operational for two years before applying to participate in Title IV Programs. However, an institution that is certified to participate in Title IV Programs may establish a start-up branch campus and participate in Title IV Programs at the start-up branch campus without reference to the two-year requirement if the start-up branch campus has received all of the necessary state and accrediting agency approvals, has been reported to the ED, and meets certain other criteria as defined by the ED. Nevertheless, under certain circumstances, such a start-up branch campus may also be required to obtain approval from the ED to be able to participate in Title IV Programs. Similarly, an institution that is eligible to participate in Title IV Programs may generally add a new educational program and disburse Title IV Program funds to students enrolled in that new program



without ED approval if the new program leads to an associate level or more advanced degree and the institution already offers programs at that level, or if the new program prepares students for gainful employment in the same occupation or a related occupation as an educational program that has previously been designated as an eligible program at the institution and meets minimum length requirements. Otherwise, the institution must obtain the ED's approval before it may disburse Title IV Program funds to students enrolled in the new program.

In addition to ED regulation, certain of the state and accrediting agencies with jurisdiction over our schools have requirements that may affect our ability to open a new school, open a start-up branch campus of one of our existing schools, or begin offering a new educational program at one of our schools. If we establish a new school, add a new branch start-up campus, or expand program offerings at any of our schools without obtaining the required approvals, we would likely be liable for repayment of Title IV Program funds provided to students at that school or branch campus or enrolled in that educational program, and we could also be subject to sanctions. Also, if we are unable to obtain the approvals from the ED, applicable state regulatory agencies, and accrediting agencies for any new schools, branch campuses, or program offerings where such approvals are required, or to obtain such approvals in a timely manner, our ability to grow our business would be impaired and our financial condition, results of operations, and cash flows could be materially adversely affected.

As of June 30, 2007, eight of our campuses were in the start-up stage. We define start-up campuses as branch campuses that have been instructing students for less than 12 months, including those campuses that have not yet opened for instruction. Start-up campuses included in our Culinary Arts segment as of June 30, 2007, included LCB Dallas, TX; LCB Boston, MA; and our Kitchen Academy campuses in St. Peters, MO; Seattle, WA; and Sacramento, CA. Start-up campuses included in our Academy segment as of June 30, 2007, include IADT Sacramento, CA, IADT San Antonio, TX, and IADT Online Tampa, FL.

Our LCB Boston, MA and LCB Dallas, TX, campuses and our Kitchen Academy campuses located in St. Peters, MO; and Seattle, WA, will begin enrolling students during 2007. Our Kitchen Academy campus located in Sacramento, CA, has been instructing students since February of 2007. Our IADT San Antonio, TX, campus began instructing students in April of 2007, and our IADT Sacramento, CA, campus began instructing students in May of 2007.

*90-10 Rule.* Under a provision of the HEA commonly referred to as the 90-10 Rule, a proprietary institution would no longer be eligible to participate in Title IV Programs if, on a cash accounting basis, it derived more than 90% of its revenue, as defined pursuant to applicable ED regulations, for any fiscal year from Title IV Programs. An institution that violates this 90-10 Rule becomes ineligible to participate in Title IV Programs as of the first day of the fiscal year following the fiscal year for which it is in violation of the rule and is unable to apply to regain its eligibility until the next fiscal year. 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 ED would require the institution to repay all Title IV Program funds received by the institution after the effective date of the loss of eligibility.

*Administrative Capability.* ED regulations specify extensive criteria that an institution must satisfy to establish that it has the requisite administrative capability to participate in Title IV Programs. These criteria relate to, among other things, institutional staffing, operational standards, timely submission of accurate reports to the ED, and various other procedural matters. If an institution fails to satisfy any of the ED's criteria for administrative capability, the ED may require the repayment of Title IV Program funds disbursed by the institution, require the institution to receive Title IV Program funds under an agreement other than the ED's standard advance funding agreement while being provisionally certified, or commence

a proceeding to impose a fine or limit, suspend, or terminate the participation of the institution in Title IV Programs.

*Restrictions on Payment of Commissions, Bonuses, and Other Incentive Payments.* An institution participating in Title IV Programs may not provide any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any person or entity engaged in any student recruitment or admission activity or in making decisions regarding the awarding of Title IV Program funds. The ED's laws and regulations regarding this rule do not establish clear criteria for compliance in all circumstances. If the ED determined that an institution's compensation practices violated these standards, the ED could subject the institution to monetary fines, penalties or other sanctions.

*Eligibility and Certification Procedures.* Under the provisions of the HEA, an institution must apply to the ED for continued certification to participate in Title IV Programs at least every six years or when it undergoes a change of control, as discussed above. The ED may place an institution on provisional certification status if it finds that the institution does not fully satisfy all required eligibility and certification standards. Provisional certification does not generally limit an institution's access to Title IV Program funds. The ED may withdraw an institution's provisional certification without advance notice if the ED determines that the institution is not fulfilling all material requirements. In addition, an institution must obtain ED approval for certain substantial changes in its operations, including changes in an institution's accrediting agency or state authorizing agency or changes to an institution's structure or certain basic educational features.

Currently, 11 of our schools remain on provisional certification with the ED. Five of our schools are on provisional certification because the initial period of their provisional certification following a change in control has not expired, three schools are on provisional certification due to ongoing ED program reviews, one school is on provisional certification due to administrative capability and unresolved audit liabilities, one school is on provisional certification due to late refunds of Title IV Program funds, and one school is on provisional certification due to its Federal Perkins Loan default rate.

#### **Compliance with Federal Regulatory Standards and Effect of Federal Regulatory Violations**

We and our schools are subject to and have pending audits, compliance reviews, inquiries, investigations, claims of non-compliance, and lawsuits by the ED and federal and state regulatory agencies, accrediting agencies, present and former students and employees, stockholders, and other third parties that may allege violations of statutes, regulations, accreditation standards, or other regulatory requirements applicable to us or our schools. The HEA also requires that an institution's administration of Title IV Program funds be audited annually by an independent accounting firm and that the resulting audit report be submitted to the ED for review.

If the results of any such audits, reviews, investigations, claims, or actions are unfavorable to us, we may be required to pay monetary damages or be subject to fines, operational limitations, loss of federal funding, injunctions, additional oversight and reporting, or other civil or criminal penalties. In addition, if the ED or another regulatory agency determined that one of our schools improperly disbursed Title IV Program funds or violated a provision of the HEA or the ED's regulations, that school could be required to repay such funds, and could be assessed an administrative fine. We have several such matters pending against us or one or more of our schools. See Note 7 Commitments and Contingencies Federal, State, and Accrediting Body Regulatory Actions of these notes to our consolidated financial statements for a detailed discussion of certain of these matters.

#### 14. RECENT ACCOUNTING PRONOUNCEMENTS

##### *FIN 48*

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), which is an interpretation of SFAS No. 109, *Accounting for Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS 109 and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 31, 2006.

We adopted the provisions of FIN 48 on January 1, 2007, the beginning of our 2007 fiscal year. As of January 1, 2007, our consolidated balance sheet included an accrual for uncertain income tax obligations of \$24.9 million. We did not record any cumulative effect adjustment to retained earnings in connection with our adoption of FIN 48. The accrual for uncertain income taxes did not change materially from January 1, 2007, to June 30, 2007. While we expect that the accrual for uncertain income taxes will change during the next six months, we do not believe that the change will have a significant impact on our consolidated financial position or results of operations. As of June 30, 2007, the total amount of unrecognized income tax benefits that, if recognized, would reduce income tax expense is approximately \$25.5 million.

We classify interest expense accrued in connection with unrecognized tax benefits as interest expense in our consolidated statement of income, and we classify income tax penalties incurred as income tax expense in our consolidated statement of income. Such classifications are consistent with classifications reflected in our prior period financial statements. As of June 30, 2007, our consolidated balance sheet included an income tax liability of approximately \$19.6 million and a liability for income tax interest and penalties of approximately \$5.9 million. Our liability for income tax interest and penalties did not change materially from January 1, 2007, to June 30, 2007.

All federal income tax returns of Career Education Corporation and its subsidiaries for periods through 2004 are closed.

State income tax returns are generally subject to examination for a period of three to five years after the filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. Various state income tax returns are currently subject to examination, administrative appeals, or litigation.

##### *SFAS 159*

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 provides guidance with respect to presentation and disclosure requirements for reporting financial assets and liabilities at fair value. SFAS 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), and in SFAS No. 107, *Disclosures about Fair Value of Financial Instruments* ( SFAS 107 ). SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently in the process of assessing the impact of SFAS 159 but do not believe that our adoption of the standard will have a material impact on our consolidated financial statements.

*SFAS 157*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurement and accordingly, does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently in the process of assessing the impact of SFAS 157 but do not believe that our adoption of the standard will have a material impact on our consolidated financial statements.

45

---

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The discussion below contains forward-looking statements, as defined in Section 21E of the Securities Exchange Act of 1934, as amended, that reflect our current expectations regarding our future growth, results of operations, cash flows, performance and business prospects, and opportunities, as well as assumptions made by, and information currently available to, our management. We have used words such as anticipate, believe, plan, expect, intend, will, and similar expressions, but these words are not the exclusive means of identifying these forward-looking statements. These statements are based on information currently available to us and are subject to various risks, uncertainties, and other factors, including, but not limited to, those discussed in Part II, Item 1A Risk Factors in this Quarterly Report on Form 10-Q, that could cause our actual growth, results of operations, cash flows, performance and business prospects, and opportunities to differ materially from those expressed in, or implied by, these statements. Except as expressly required by federal securities laws, we undertake no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances, or for any other reason.*

**INTRODUCTION**

Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is intended to assist the reader in better understanding our business, results of operations, financial condition, changes in financial condition, critical accounting policies and estimates, and significant developments. MD&A is provided as a supplement to, and should be read in conjunction with, our unaudited condensed consolidated financial statements and the accompanying notes thereto appearing elsewhere herein. This section is organized as follows:

- **Our Business** an overview of our business, a discussion of current business and industry opportunities, challenges, business acquisitions, risks, and a discussion of significant developments affecting our business.
- **Results of Operations** an analysis and comparison of our consolidated results of operations for the three and six months ended June 30, 2007 and 2006, as reflected in our unaudited condensed consolidated statements of income.
- **Liquidity, Financial Position, and Capital Resources** a discussion of our primary sources and uses of cash for the three and six months ended June 30, 2007 and 2006, a discussion of selected changes in our financial position, and a summary of our future contractual obligations.

**OUR BUSINESS**

**Overview**

We are a dynamic educational services company committed to quality, career-focused learning and led by passionate professionals who inspire individual worth and lifelong achievement. Since our founding in 1994, we have progressed rapidly toward our goal of becoming the world's leading provider of quality educational services. We are one of the world's leading on-ground providers of private, for-profit, postsecondary education and have a substantial presence in online education. Our schools and universities prepare students for professionally and personally rewarding careers through the continuing operation of 76 on-ground campuses located throughout the United States and in France, Canada, Italy, and the United Kingdom and three fully-online academic platforms.

We evaluate our business based on our operating segments, which we define as our operating divisions. Each of our school and university operating divisions represents a group of for-profit, postsecondary schools that offer a variety of degree and non-degree academic programs and are differentiated based on a variety of criteria including, but not limited to, brand name, academic offerings, and geographic location. We have six reportable segments, including the Academy segment, the Colleges

## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

segment, the Culinary Arts segment, the Health Education segment, the International segment, and the University segment.

The Academy segment includes our International Academy of Design and Technology ( IADT ) campuses that collectively offer academic programs primarily in the career-oriented discipline of visual communications and design technologies in a classroom or online setting.

The Colleges segment includes schools that collectively offer academic programs in our core career-oriented disciplines of business studies, health education, information technology, and visual communications and design technologies in a classroom or laboratory setting.

The Culinary Arts segment includes our Le Cordon Bleu and Kitchen Academy schools that collectively offer culinary arts programs in the career-oriented disciplines of culinary arts, baking and pastry arts, and hotel and restaurant management primarily in a classroom or kitchen setting.

The Health Education segment primarily includes our Sanford-Brown schools that collectively offer academic programs in the career-oriented disciplines of health education, business studies, visual communications and design technologies, and information technology in a classroom or laboratory setting.

The International segment includes our INSEEC Group schools and Istituto Marangoni schools located in France, Italy, and the United Kingdom, which collectively offer academic programs in the career-oriented disciplines of business studies, health education, fashion and design, and visual communication and technologies in a classroom or laboratory setting.

The University segment includes our American Intercontinental University ( AIU ) and Colorado Technical University ( CTU ) universities that collectively offer academic programs in the career-oriented disciplines of business studies, visual communication and design technologies, health education, information technology, criminal justice, and education in an online, classroom, or laboratory setting.

The student population of each of our reportable segments as of July 31, 2007 and 2006, was as follows:

	<b>Student Population as of July 31,</b>	
	<b>2007</b>	<b>2006</b>
University segment	39,500	37,700
Health Education segment(1)	11,800	10,400
Culinary Arts segment	11,000	10,600
Academy segment(1)	8,600	8,100
Colleges segment(1)	6,900	7,900
International segment	1,000	700
<b>Total CEC</b>	<b>78,800</b>	<b>75,400</b>

The student population of our fully-online online platforms as of July 31, 2007 and 2006, was as follows:

	<b>Student Population as of July 31,</b>	
	<b>2007</b>	<b>2006</b>
AIU Online	15,700	17,600
CTU Online	15,100	10,900
IADT Online	80	
<b>Total online</b>	<b>30,880</b>	<b>28,500</b>

(1) Excludes schools in the process of a teach-out.



## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Student starts for each of our reportable segments for the three months ended June 30, 2007 and 2006, was as follows:

	<b>Student Starts For the Three Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
University segment	12,250	10,510
Health Education segment(1)	3,660	3,010
Culinary Arts segment	2,090	1,690
Academy segment(1)	1,230	1,080
Colleges segment(1)	620	780
International segment	330	330
<b>Total CEC</b>	<b>20,180</b>	<b>17,400</b>

Student starts for our fully-online platforms for the three months ended June 30, 2007 and 2006, was as follows:

	<b>Student Starts For the Three Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
AIU Online	4,800	4,440
CTU Online	5,880	4,540
<b>Total online</b>	<b>10,680</b>	<b>8,980</b>

(1) Excludes schools in the process of a teach-out.

For a detailed discussion of the seasonality of the results of operations for our schools' campuses, see Note 11 Segment Reporting of the notes to our unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

*Second Quarter 2007 Overview.* In June 2007, we decided to retain the two campuses of Brooks College and collectively teach-out these campuses. We decided to retain and teach-out Brooks College because we were not able to identify a suitable buyer that would support the best interests of the campus' students and faculty. The two campuses of Brooks College are no longer held for sale and the results of operations of Brooks College are no longer reflected as discontinued operations in our consolidated statements of income for all periods presented. Additionally, their assets and liabilities are no longer included in current assets held for sale and current liabilities held for sale on our consolidated balance sheet. All current and prior period financial statements and the related notes included herein have been restated to include the results of operations and financial position of Brooks College in the Colleges segment of our continuing operations.

In June 2007, we also decided to teach-out our IADT Pittsburgh, Pennsylvania campus. We made the decision to teach-out our IADT Pittsburgh campus due primarily to poor historical and forecasted future operating results. We believe that this is the most responsible and appropriate course of action at this time.

During the teach-out period, our Brooks College campuses and our IADT Pittsburgh campus will continue to operate and honor commitments to their current students, who will be allowed to complete their programs at their current locations. Student services, including externships, career services, and financial aid, will remain available until the last student graduates. After the final graduation date, student services will remain available to graduates at designated locations.

During the second quarter of 2007, we recorded expenses of approximately \$13.1 million in connection with the probable settlement of certain legal matters, which effectively reduced our second quarter 2007 operating profit margin percentage by 3.2 percentage points.

Total revenue from continuing operations during the second quarter of 2007 was \$405.3 million, a decrease of \$47.3 million, or 10.5%, from total revenue during the second quarter of 2006 of \$452.6 million. The decrease in revenue was primarily due to a decrease in average revenue per student. The decrease in average revenue per student was primarily driven by a population mix change that included an increase in students in our University segment's fully-online associate degree programs, which offer lower tuition rates than those of our University segment's fully-online bachelor's degree and master's degree programs, and more part-time students at CTU Stonecliffe, the associate degree division of CTU Online. The increase in online associate degree-seeking students was primarily a result of a pricing decline in our AIU Online associate programs and strong student population growth at CTU Stonecliffe.

Consolidated income from operations increased to \$11.9 million during the second quarter of 2007, from consolidated loss from operations of \$21.8 million during the second quarter of 2006. Operating profit margin percentage was 2.9% during the second quarter of 2007, compared to operating loss margin percentage of 4.8% during the second quarter of 2006. Second quarter 2006 consolidated loss from operations of \$21.8 million included a pre-tax goodwill impairment charge of approximately \$85.0 million. Excluding the impact of the goodwill impairment charge, income from operations and operating profit margin percentage during the second quarter of 2006 were \$63.2 million and 14.0%, respectively.

Declines in student starts, student population, and revenue experienced by many of our campuses during 2006 have been influenced by a number of factors, including, but not limited to, (1) the continued Probation status of our AIU schools, (2) general competitive pressures for student leads and enrollments experienced by some of our schools, (3) the ED's general restrictions on our ability to open new branch campuses during 2005 and 2006, (4) the continued negative impact of legal and regulatory matters, and (5) the related negative publicity and negative press coverage regarding us and certain of our schools. We believe that these factors have adversely impacted the rate at which our leads for prospective students convert into enrolled students (conversion rate) and the rate at which our enrolled students start school (show rate).

However, notwithstanding the continuing impact on student population and revenue of the factors discussed above, we believe that student population at many of our campuses has begun to stabilize, due primarily to strengthening of recent student start performance and improvement in student retention, and certain key operating metrics that we believe will drive future performance, including student conversion rates, shows rates, and retention rate, have continued to improve.

Loss from continuing operations as a percentage of total revenue for the quarter ended June 30, 2006, which reflects the impact of the \$85.0 million Health Education segment goodwill impairment charge, was 4.8%. Income from continuing operations as a percentage of total revenue for the quarter ended June 30, 2007 was 2.9%. The following factors adversely affected our profit margins for the quarter ended June 30, 2007, relative to our profit margins during the quarter ended June 30, 2006:

- An unfavorable segment revenue mix change resulting in disproportionately larger revenue declines in our University segment, which has historically produced the highest operating profit margin percentages;
- An unfavorable student mix change within our University segment's fully-online programs, as discussed above;
- A decrease in operating profit margin percentage generated by our University segment, driven primarily by (1) a decline in revenue, caused, in part, by the Probation status of AIU and reductions of the prices of our AIU Online associate degree programs and (2) an increase in administrative expenses;
- An increase in occupancy expense and other fixed costs as a percentage of revenue due to declines in revenue.

The adverse impact on continuing operating profit margin percentage during the second quarter of 2007 of the factors noted above was offset, in part, by a decrease in bad debt expense as a percentage of revenue.

*Full-Year 2007 Outlook.* We expect 2007 to be a period of transition and development. While our results continue to be negatively affected by a number of near-term factors, we have taken steps during the first six months of 2007 to address these issues and better position the company to achieve its long-term potential. While we are in the process of finalizing a plan that will allow us to sustain positive operating trends, address existing issues, and better position the company for profitable, long-term growth, to date we have made significant progress with respect to a number of key initiatives designed to better focus our business, increase efficiency and profitability, and ensure that the company's priorities align with those of our students. These initiatives include the following:

- We are completing a corporate realignment conceived to facilitate more consistent customer-focused decision making by reducing redundancies and streamlining the decision making process.
- We have developed an Online Service Center to leverage significant online and on-ground capabilities to provide students at certain of our schools with more flexible educational delivery options. Through the service center, the technology that AIU Online, CTU Online, and IADT Online currently use will enable us to make online and flexible education available at our schools. As a service provider, the service center will offer customization to meet the varying needs of our students and the varying curricula of our individual schools. The ability to offer flexible educational delivery combined with a large number of and variety of our brick-and-mortar campuses further distinguishes us in the marketplace, enabling us to provide students with more choices to learn in ways that fit their particular lifestyles.
- We have introduced measures that we believe will have a positive impact on admissions productivity, including a supplemental compensation program for admission representatives, extended payment plans for students, a process for better qualification of leads, and a greater focus on referrals.
- We continue to focus on building our strengths in careers of passion. By focusing on areas where we have the greatest competitive advantages and proven success, we believe we can more effectively prepare students for careers they are passionate about through our high-quality boutique schools, gold-standard brands, and flexible student-centered product offerings.
- We are continuing to open start-up campuses.
- We will continue to evaluate individually the pricing of each of our programs at each of our schools to ensure that the prices of our academic offerings are properly aligned with perceived value, identified price sensitivities, and competitive forces.
- We will continue to evaluate the alternative financing options that we and student lenders make available to prospective students. We will strive to provide greater flexibility in alternative financing options to give prospective students diverse and affordable options to finance the cost of their education.

#### **Current Business and Industry Opportunities, Challenges and Risks**

In addition to the risk factors discussed in Part I, Item 1A of our Annual Report on Form 10-K for our fiscal year ended December 31, 2006, we have identified a number of key factors and trends related to our business and industry that represent opportunities, challenges, and risks.

*SACS Probation Status of AIU.* As previously disclosed, on December 6, 2005, the Commission on Colleges of the Southern Associations of Colleges and Schools ( SACS ) placed AIU on Probation



status for one year pending AIU's satisfactory remediation of certain accreditation deficiencies with regard to SACS Principles of Accreditation. This action followed a July 2005 SACS special committee visit of AIU that resulted in a report identifying specific recommendations. In October 2006, a SACS special committee completed site visits of selected AIU campuses. At SACS' December 11, 2006, meeting, SACS extended AIU's Probation status through December 2007. Under SACS's rules, an institution may remain on Probation status only for two consecutive years, after which SACS must either lift the Probation or remove the institution from membership.

This action has had, and will continue to have, a disruptive effect on operations of AIU and our business generally, including, the diversion of significant time and attention of AIU's senior management, which adversely affected our results of operations for 2006 and the results of operations for the first six months of 2007. We expect this action to also have an adverse impact on our results of operations for the second half of 2007.

AIU remains accredited during this probationary period and is committed to resolving all issues identified by SACS. We cannot predict SACS future accreditation actions, and unfavorable outcomes would have a material adverse effect on our growth prospects, student population, financial condition, results of operations, and cash flows.

*Sale Plan for Certain of Our Schools and Campuses.* Our Board of Directors approved a plan to sell 11 of our schools and campuses (the Sale Plan). The Sale Plan includes the anticipated sale of our nine Gibbs campuses, which collectively comprised our entire Gibbs reportable segment, McIntosh College, and Lehigh Valley College. McIntosh College and Lehigh Valley College were previously components of our Colleges reportable segment.

While we believe that each of the campuses included in the Sale Plan is a valuable asset with effective academic programs, we do not believe that our continued operation of these campuses is consistent with our near-term and long-term strategic goals. We will continue to reasonably invest in the campuses included in the Sale Plan in preparation for a sale. We believe that the Sale Plan is a critical component of our overall strategy to strengthen operational results and provide more effective focus on preparing students for careers they are passionate about through high-quality boutique schools, gold-standard brands, and flexible student-centered program offerings. Also, upon selling the campuses in the Sale Plan, we believe that we will be better positioned to target our business strategy and leverage resources to maximize value for our students, employees, and stockholders.

We have not yet secured a buyer for any of the schools or campuses included in the Sale Plan, but we have retained an investment banking firm to assist our management in identifying potential buyers and evaluating any proposals put forth by any such potential buyers. We expect to execute a sale agreement for each of the schools and campuses included in the Sale Plan during 2007. The sales will be subject to approval by the ED and various state regulatory and accrediting agencies, as applicable. We believe that the ultimate sale of our schools and campuses held for sale, including our accounting for lease obligations that may not transfer to the buyer upon sale, will likely result in a loss that is material to our consolidated financial position and results of operations and cash flows.

See Note 12 *Discontinued Operations* of the notes to our unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for further discussion of our accounting for discontinued operations.

*Decline in University Segment Profitability.* The operating margin percentage of our University segment, excluding share of affiliate earnings, declined to 11.8% during the second quarter of 2007, from 29.5% during the second quarter of 2006, due primarily to a decline in average revenue per student. The overall decline in University segment operating profit margin percentage during the second quarter of 2007 was impacted most significantly by the decline during the second quarter of 2007 in the combined

operating profit margin percentage of our University segment's fully-online academic platforms, which include AIU Online, CTU Online, and Stonecliffe College Online (an academic division of CTU).

A significant portion of the total student population, revenue, and operating profits of our University segment are attributable to AIU Online. However, AIU Online student population, revenue, and operating profit declined during the second quarter of 2007. The decreases in AIU Online's student population, revenue, and operating profits are primarily attributable to the maturation of AIU Online's academic offerings and the adverse impact of negative publicity related to AIU's Probation status with its accrediting body, SACS. These factors have adversely impacted AIU Online's show rate during the second quarter of 2007, relative to its show rate during the second quarter of 2006. Due to the accelerated nature of AIU Online academic programs, AIU Online revenue per student is generally greater than revenue per student generated by our other schools. Thus, given the relatively quick turnover of AIU Online students, when AIU Online experiences student start declines, the impact on student revenue, and, ultimately, operating profits, is significant and immediate, because new revenue-generating student starts are insufficient to replace graduating students.

The decline in AIU Online student population, revenue, and operating profits is also attributable to greater competition and greater consumer price sensitivity within the online, postsecondary education market. In response to such emerging market forces, AIU continually evaluates its online programs to ensure that the programs are market relevant and competitively priced. AIU has historically marketed AIU Online's programs as premium academic product due to the quality of educational content and the technology used to deliver the program. However, market research conducted by AIU during 2006 revealed the significant price sensitivity among prospective students for AIU Online's associate degree programs. Based on this information, AIU Online reduced the pricing of its associate degree programs beginning in July 2006. AIU did not identify similar price sensitivities among prospective students for AIU Online's bachelor's and master's degree programs and, thus, it has not reduced the pricing of its bachelor's and master's degree programs. We believe there remains a high level of interest in AIU Online's accelerated programs, and AIU expects to further expand AIU Online's program offerings to include part-time offerings for bachelor's and master's degrees.

Also, as previously discussed, we expect that the combined operating margin percentage achieved by our University segment and our University segment's online platforms will continue to decline from prior period levels primarily as a result of the continued disproportionate operating profit growth of CTU Online and Stonecliffe College Online (an academic division of CTU). CTU Online has historically operated at a lower operating margin percentage than that of AIU Online. Thus, the disproportionate growth of CTU Online operations is effectively lowering the operating margin percentage of the University segment as a whole. Additionally, as a result of the disproportionate growth of CTU Online and the introduction of Stonecliffe College Online, both of which offer longer-termed programs than does AIU Online, we expect average revenue per online student to continue to decrease in the future. However, we believe that by providing our students with a flexible array of online program options, we will enhance our University segment schools' ability to expand their presence in the online, postsecondary education market.

The results of operations and operating margin percentage of our University segment during the second quarter of 2007 were positively impacted by a decrease in bad debt expense as a percentage of revenue. The decrease in University segment bad debt expense as a percentage of revenue was primarily attributable to an increased focus on the collection of amounts due from students who have left school and improvements in student retention.

*Impact of Changes in Credit Standards.* We believe that student population, revenue, and operating profits at certain of our schools were negatively impacted during the second quarter of 2007 as a result of (1) the implementation by Sallie Mae in March 2006 of stricter credit standards at all of our schools for certain prospective students seeking to fund a portion of their education through Sallie Mae's non-

recourse loan program (2) our decision to stop offering loans made under the Stillwater Bank Purchase Agreement to new students, and (3) the continued application of strict credit standards by all of our schools. We believe these stricter credit standards have reduced bad debt expense from previous levels but also have limited the number of prospective students who qualify for certain private financing options.

During August and September of 2006, we reevaluated the impact of stricter credit standards and implemented certain changes in the credit standards for students at all of our schools. We also began offering our students extended payment plans to finance the portion of their tuition not covered by Title IV Program funds, private loans, and other available sources of financial aid that most of our students qualify for. These extended payment plans allow students to make an affordable monthly payment while they attend school and pay their remaining balance after they graduate or leave school. Under our extended payment plans, students may be granted up to 10 years to repay their extended payment plan balances, which is generally the same amount of time that students are granted to repay their Stafford Loans. See Note 5 Recourse Loan Agreements of the notes to our unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information regarding tuition funding sources.

*International Expansion.* We believe that the international market for our services represents a significant growth opportunity. We believe that international students are increasingly utilizing online U.S. educational programs as a means of obtaining a U.S. education without incurring the related significant travel and living costs and facing stringent visa requirements associated with studying abroad. Additionally, we continue to pursue opportunities to expand our on-ground presence internationally. On January 25, 2007, we acquired Istituto Marangoni. Istituto Marangoni is a world-renowned private, for-profit, post-secondary fashion and design school with locations in Milan, Italy; London, England; and Paris, France. We acquired Istituto Marangoni primarily because of its potential for market leadership, the economic attractiveness of the educational markets that it serves, and its potential for strong returns on invested capital. The acquisition of Istituto Marangoni also provides us with a platform for additional expansion in Europe and represents our entry into the Italian educational market.

*Hybrid Learning.* We have made significant advances in the development of our unique hybrid learning model, which capitalizes on the strength of our highly regarded learning platform and extensive library of interactive and multimedia content and now enables students at a growing number of on-ground campuses to pursue their academic programs on-ground or online. AIU, which now offers 23 hybrid programs, and CTU, which now offers 18 hybrid programs, were our first on-ground schools to offer hybrid educational programs as a complement to those schools existing online campuses. We expect to provide hybrid programs at our IADT campuses in August of 2007, and we expect to further expand our hybrid learning offerings to other selected schools during the remainder of 2007.

*Increased Competition.* We have experienced increased competition for our universities fully-online platforms and in certain of the markets served by our campuses. While we believe that each of our schools possess strong competitive advantages, such increased competition has adversely affected our schools ability to recruit new students.

#### **Litigation and Regulatory Matters**

See Note 7 Commitments and Contingencies of the notes to our unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of selected litigation and regulatory matters.

#### **RECENT ACCOUNTING PRONOUNCEMENTS**

See Note 14 Recent Accounting Pronouncements of the notes to our unaudited condensed consolidated financial statements in Part I, Item 1 Financial Statements of this Quarterly Report on Form 10-Q for a discussion of recent accounting pronouncements that may affect us.

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES**

A detailed discussion of the accounting policies and estimates that we believe are most critical to our financial condition and results of operations and that require management's most subjective and complex judgments in estimating the effect of inherent uncertainties is included under the caption "Summary of Significant Accounting Policies and Estimates" included in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2006. Note 2

"Significant Accounting Policies" of the notes to our consolidated financial statements in Part IV, Item 15 of our Annual Report on Form 10-K, for the year ended December 31, 2006, also includes a discussion of these and other significant accounting policies.

**RESULTS OF CONTINUING OPERATIONS**

*Three Months Ended June 30, 2007, Compared to Three Months Ended June 30, 2006*

The summary of selected financial data table below should be referenced in connection with a review of the following discussion of our results of continuing operations for the three months ended June 30, 2007, compared to the three months ended June 30, 2006.

	For the Three Months Ended June 30,		% of Total Revenue	% of Total Revenue	% Change 2007 vs. 2006
	2007 (Dollars in thousands)	% of Total Revenue			
<b>TOTAL REVENUE</b>	\$ 405,271			\$ 452,584	-10.5 %
<b>OPERATING EXPENSES</b>					
Educational services and facilities expense	143,958	35.5 %		136,663	5.3 %
General and administrative:					
Advertising	63,899	15.8 %		62,293	2.6 %
Admissions	55,809	13.8 %		61,346	-9.0 %
Administrative expense	99,015	24.4 %		93,176	6.3 %
Bad debt expense	10,994	2.7 %		16,950	-35.1 %
Total general and administrative expense	229,717	56.7 %		233,405	-1.6 %
Depreciation and amortization	19,662	4.9 %		19,371	1.5 %
Goodwill and intangible asset impairment charge		0.0 %		84,975	-100.0 %
<b>INCOME (LOSS) FROM OPERATIONS</b>	11,934	2.9 %		(21,830 )	154.7 %
<b>INTEREST INCOME</b>	4,132	1.0 %		4,679	-11.7 %
<b>PROVISION FOR INCOME TAXES</b>	6,287	1.6 %		22,959	-72.6 %
Effective tax rate	36.37 %			63.68 %	
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>	10,998	2.7 %		(40,012 )	127.5 %
LOSS FROM DISCONTINUED OPERATIONS, net of tax	(5,873 )	-1.4 %		(7,497 )	21.7 %
<b>NET INCOME (LOSS)</b>	\$ 5,125	1.3 %		\$ (47,509 )	110.8 %

Educational services and facilities expense includes costs directly attributable to the educational activity of our schools, including, among other things, (1) salaries and benefits of faculty, academic administrators, and student support personnel, (2) costs of educational supplies and facilities, including rents on school leases, certain costs of establishing and maintaining computer laboratories, costs of student housing, and owned and leased facility costs, (3) royalty fees paid to Le Cordon Bleu, and (4) certain student financing costs. Also included in educational services and facilities expense are costs of other goods



Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

and services provided by our schools, including, among other things, costs of textbooks, laptop computers, dormitory services, restaurant services, contract training, and cafeteria services.

General and administrative expense includes salaries and benefits of personnel in corporate and school administration, marketing, admissions, accounting, human resources, legal, and compliance. Costs of promotion and development, advertising and production of marketing materials, occupancy of the corporate offices, and bad debt expense are also included in this expense category.

**Revenue**

Revenue and student starts for the three months ended June 30, 2007 and 2006, and student population as of April 30, 2007 and 2006, are as follows (dollars in thousands). We believe that student population totals as of April 30, 2007 and 2006, serve as reasonable approximations of the revenue-generating population during the second quarter ended June 30, 2007 and 2006.

	For the Three Months Ended June 30,			% Change	
	2007	% of Total CEC	2006	% of Total CEC	2007 vs. 2006
<b>REVENUE:</b>					
University segment	\$ 174,983	43 %	\$ 226,322	50 %	-23 %
Culinary Arts segment	84,574	21 %	82,706	18 %	2 %
Colleges segment	42,399	11 %	52,286	12 %	-19 %
Health Education segment	46,440	11 %	41,082	9 %	13 %
Academy segment	40,333	10 %	39,418	9 %	2 %
International segment	16,531	4 %	10,626	2 %	56 %
Corporate and other	11	0 %	144	0 %	-92 %
Total revenue	\$ 405,271		\$ 452,584		-10 %

<b>STUDENT STARTS</b>					
	2007	% of Total CEC	2006	% of Total CEC	% Change 2007 vs. 2006
University segment	12,250	61 %	10,510	61 %	17 %
Culinary Arts segment	2,090	10 %	1,690	10 %	24 %
Colleges segment	620	3 %	780	4 %	-21 %
Health Education segment	3,660	18 %	3,010	17 %	22 %
Academy segment	1,230	6 %	1,080	6 %	14 %
International segment	330	2 %	330	2 %	0 %
Total student starts	20,180		17,400		16 %

	As of April 30,			% Change	
	2007	% of Total CEC	2006	% of Total CEC	2007 vs. 2006
<b>STUDENT POPULATION:</b>					
University segment	42,200	48 %	44,000	51 %	-4 %
Culinary Arts segment	10,500	12 %	10,600	12 %	-1 %
Colleges segment	7,500	9 %	9,000	10 %	-17 %
Health Education segment	12,200	14 %	10,900	12 %	12 %
Academy segment	8,500	10 %	8,600	10 %	-1 %
International segment	6,200	7 %	4,300	5 %	44 %
Total student population	87,100		87,400		0 %

## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Total revenue decreased \$47.3 million, or 10.5%, from \$452.6 million during the second quarter of 2006 to \$405.3 million during the second quarter of 2007. The overall decrease in revenue is primarily attributable to a decrease in revenue generated by our University and Colleges segments, offset, in part, by increases in revenue generated by our Health Education and International segments.

*University Segment Revenue.* University segment revenue decreased \$51.3 million, or 22.7%, from \$226.3 million during the second quarter of 2006 to \$175.0 million during the second quarter of 2007. The University segment revenue decrease is primarily attributable to a decrease in average revenue per student. The decrease in average revenue per student was primarily due to a population mix change that included an increase in students in our University segment's fully-online associate degree programs, which offer lower tuition rates than those of our University segment's fully-online bachelor's degree and master's degree programs, and more part-time students at CTU Stonecliffe, the associate degree division of CTU Online. The increase in online associate degree-seeking students was a result of a pricing decline in our AIU Online associate programs and strong student population growth at CTU Stonecliffe. The University segment revenue decrease is also attributable to a decline in average student population during the second quarter of 2007 compared to average student population during the second quarter of 2006. We believe that the declines in the University segment student population and student starts are primarily attributable to the continuing effects of the ongoing SACS Probation status of our AIU universities, which was announced on December 6, 2005, and is negatively impacting those schools' ability to recruit new students. The adverse effects of the SACS Probation status have resulted in a decrease in student population and revenue at each of our AIU universities and has most dramatically impacted the operating results of AIU Online.

*Colleges Segment Revenue.* Colleges segment revenue decreased \$9.9 million, or 18.9%, from \$52.3 million during the second quarter of 2006 to \$42.4 million during the second quarter of 2007. The Colleges segment revenue decrease is primarily attributable to declines in average student population and student starts during the second quarter of 2007, relative to average student population and student starts during the second quarter of 2006, and represents a continuation of weak operating performance experienced in recent periods by many of our Colleges segment schools. We believe that the continuing weak operating performance experienced by many of our Colleges segment schools is primarily attributable to the continued negative impact of certain legal and regulatory matters and the related negative publicity, negative press coverage regarding certain of our Colleges segment schools, and ongoing general competitive pressures for student leads and enrollments experienced by certain of our Colleges segment schools.

*Health Education Segment Revenue.* Health Education segment revenue increased \$5.4 million, or 13.0%, from \$41.1 million during the second quarter of 2006 to \$46.4 million during the second quarter of 2007. The Health Education segment revenue increase is primarily attributable to (1) tuition price increases implemented during 2006, (2) an increase in average student population and student starts during the second quarter of 2007, relative to average student population and student starts during the second quarter of 2006, and (3) a shift in student enrollment mix that resulted in higher average revenue per student.

*Academy Segment Revenue.* Academy segment revenue increased \$0.9 million, or 2.3%, from \$39.4 million during the second quarter of 2006 to \$40.3 million during the second quarter of 2007. The Academy segment revenue increase is primarily attributable to an increase in student starts during the second quarter of 2007, relative to student starts during the second quarter of 2006.

*International Segment Revenue.* International segment revenue increased \$5.9 million, or 55.6%, from \$10.6 million during the second quarter of 2006 to \$16.5 million during the second quarter of 2007. The International segment revenue increase is primarily attributable to second quarter incremental revenues of \$4.2 million generated by Istituto Marangoni, which we acquired in January of 2007.



Additionally, revenue generated by our INSEEC schools during the second quarter of 2007 increased by approximately \$1.7 million as a result of an increase in average student population during the second quarter of 2007, relative to average student population during the second quarter of 2006.

#### *Educational Services and Facilities Expense*

Educational services and facilities expense increased \$7.3 million, or 5.3%, from \$136.7 million during the second quarter of 2006 to \$144.0 million during the second quarter of 2007. The \$7.3 million increase is primarily attributable to a \$4.0 million increase in academics expense and a \$3.4 million increase in occupancy expense. The increase in academics expense is primarily attributable to incremental costs incurred by new campus locations, including our start-ups campuses and our Istituto Marangoni schools. The increase in occupancy expense is primarily attributable to incremental costs associated with 2006 expansions of certain existing campuses, 2006 and 2007 start-up activity, and our January 2007 acquisition of Istituto Marangoni.

#### *General and Administrative Expense*

General and administrative expense decreased \$3.7 million, or 1.6%, from \$233.4 million during the second quarter of 2006 to \$229.7 million during the second quarter of 2007. This decrease is primarily attributable to a \$5.5 million decrease in admissions expense associated with admissions headcount reductions and a \$5.6 million decrease in bad debt expense, offset, in part, by a \$5.3 million increase in administration expenses. During the second quarter of 2007, we recorded expenses of approximately \$13.1 million in connection with the probable settlement of certain legal matters. The overall decrease in general and administrative expense during the second quarter of 2007 reflects the impact of cost cutting measures enacted in response to declines in student population at a majority of our campuses and the effect of our corporate realignment, which we believe has eliminated certain redundancies and improved operational efficiency.

University segment general and administrative expense decreased \$6.3 million, or 5.6%, from \$112.8 million during the second quarter of 2006, to \$106.5 million during the second quarter of 2007, due primarily to a \$6.0 million decrease in bad debt expense and a \$4.5 million decrease in admissions expense, offset, in part, by a \$5.2 million increase in administration expense. The decrease in admissions expense is primarily attributable to an approximate 25% reduction in average admissions advisor headcount during the first quarter of 2007.

As noted above, bad debt expense decreased by \$5.6 million, from \$16.6 million during the second quarter of 2006 to \$11.0 million during the second quarter of 2007. Bad debt expense and bad debt expense as a percentage of revenue incurred by each of our reportable segments during the three months ended June 30, 2007 and 2006, was as follows (dollars in thousands):

	For the Three Months Ended June 30,		As a	
	2007	As a Percentage of Segment Revenue	2006	As a Percentage of Segment Revenue
<b>Bad debt expense by segment:</b>				
University segment	\$ 4,878	2.8 %	\$ 10,846	4.8 %
Culinary Arts segment	2,462	2.9 %	1,486	1.8 %
Colleges segment	587	1.4 %	280	0.5 %
Health Education segment	2,214	4.8 %	1,563	3.8 %
Academy segment	677	1.7 %	862	2.2 %
International segment	296	1.8 %	343	3.2 %
Corporate and other	\$ (120 )	N/A	1,210	N/A
Total bad debt expense	\$ 10,994	2.7 %	\$ 16,590	3.7 %

The overall decrease in bad debt expense and bad debt expense as a percentage of revenue during the period is primarily attributable to (1) a decrease in overall student receivable exposure at a majority of our schools, primarily as a result of declines in student population and improved cash collections experience, and (2) overall improvement in student retention.

The decrease in University segment bad debt expense and bad debt expense as a percentage of revenue is attributable to (1) a decrease in student receivable exposure as a result of declines in student population and revenue per student and improved cash collections experience, (2) price reductions that have reduced the difference between program costs and available financial aid, and (3) improvements in student retention.

***Income (Loss) From Continuing Operations and Continuing Operating Margin Percentage***

Income (loss) from continuing operations and continuing operating margin percentage for the three months ended June 30, 2007 and 2006, by segment, were as follows:

	For the Three Months Ended June 30,			% of Total CEC	% Change 2007 vs. 2006
	2007 (Dollars in thousands)	% of Total CEC	2006		
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS:</b>					
University segment (excluding share of affiliate earnings)	\$ 20,646	173 %	\$ 66,798	-306 %	-69 %
Culinary Arts segment	7,131	60 %	8,384	-38 %	-15 %
Colleges segment	(8,178 )	-69 %	6,953	-32 %	-218 %
Health Education segment	2,408	20 %	(85,225 )	390 %	103 %
Academy segment	247	2 %	1,720	-8 %	-86 %
International segment	424	4 %	1,179	-5 %	-64 %
Corporate and other	(10,744 )	-90 %	(21,639 )	99 %	50 %
Total income (loss) from operations	\$ 11,934		\$ (21,830 )		155 %
Operating profit (loss) margin percentage:					
University segment (excluding share of affiliate earnings)	11.8	%	29.5	%	
Culinary Arts segment	8.4	%	10.1	%	
Colleges segment	-19.3	%	13.3	%	
Health Education segment	5.2	%	-207.5	%	
Academy segment	0.6	%	4.4	%	
International segment	2.6	%	11.1	%	
CEC consolidated	2.9	%	-4.8	%	

Income from operations increased \$33.8 million, or 154.6%, from a loss of \$21.8 million during the second quarter of 2006, to income during the second quarter of 2007 of \$11.9 million. Excluding the Health Education segment goodwill impairment charge of \$85.0 million recorded during the second quarter of 2006, income from operations decreased \$51.3 million, or 81.2%, from \$63.2 million during the second quarter of 2006, to \$11.9 million during the second quarter of 2007. This decrease is primarily attributable to the decline in University segment operating profit and operating profit margin percentage.

As discussed above, we believe that the declines in University segment operating profit and operating profit margin are primarily attributable to the negative effects of the ongoing Probation status of the University segment's AIU universities, which has had a significant adverse impact on student starts, student population, and revenue.

## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

AIU Online's operating profit margin percentage declined from 45.0% during the second quarter of 2006 to 27.1% during the second quarter of 2007, due primarily to the continuing effects of the ongoing SACS Probation status, price reductions of associate degree programs, and a student mix change that resulted in a decrease in revenue per student. As discussed above, declines in AIU Online student starts, student population, and operating results have a disproportionate negative impact on University segment and CEC consolidated operating profits and operating profit margin percentages.

Income from operations generated by our Academy segment decreased \$1.5 million, from \$1.7 million during the second quarter of 2006, to \$0.2 million during the second quarter of 2007. Academy segment income from operations during the second quarter of 2007 includes Academy segment start-up campus operating losses totaling \$2.4 million, compared to Academy segment start-up campus operating losses of 2006 of \$0.8 million incurred during the second quarter of 2006.

Income from operations generated by our International segment decreased \$0.8 million, from \$1.2 million during the second quarter of 2006, to \$0.4 million during the second quarter of 2007. International segment income from operation during the second quarter of 2007 includes an operating loss of \$0.8 million incurred by our Istituto Marangoni schools, which we acquired in January of 2007.

Income from operations and operating profit margin percentage for the three months ended June 30, 2007 and 2006, for our University segment universities, including the universities' online platforms, are as follows:

	<b>For the Three Months Ended June 30,</b>			
	<b>2007</b>		<b>2006</b>	
	<b>(In thousands)</b>			
<b>Operating Profit (Loss):</b>				
On-ground universities	\$	(10,267 )	\$	(844 )
Online platforms (AIU Online, CTU Online, and Stonecliffe College Online combined)	30,913		67,642	
Total University segment operating profit	\$	20,646	\$	66,798
<b>Operating Profit (Loss) Margin Percentage:</b>				
On-ground universities	-26.5	%	-1.8	%
Online platforms (AIU Online, CTU Online, and Stonecliffe College Online combined)	22.7	%	37.5	%
Total University segment operating profit margin percentage	11.8	%	29.5	%
AIU Online	27.1	%	45.0	%
CTU Online and Stonecliffe College Online	15.4	%	20.0	%

### ***Interest Income***

Interest income decreased \$0.5 million, or 11.7%, from \$4.7 million during the second quarter of 2006 to \$4.1 million during the second quarter of 2007, primarily as a result of a decrease in average invested cash balances.

### ***Provision for Income Taxes***

Provision for income taxes decreased \$16.7 million, or 72.6%, from \$23.0 million during the second quarter of 2006 to \$6.3 million during the second quarter of 2007. The decrease is primarily attributable to a decrease of \$51.3 million in continuing income before provision for income taxes during the second quarter of 2007, excluding the \$85.0 million Health Education segment goodwill impairment charge, recorded during the three months ended June 30, 2006, and a decrease in our effective tax rate for continuing operations from 37.4% during the second quarter of 2006 to 36.5% during the second quarter

of 2007. Of the \$85.0 million Health Education segment goodwill impairment charge included in operating expenses during the three months ended June 30, 2006, only \$6.5 million was deductible for income tax reporting purposes. The decrease in our effective tax rate is attributable primarily to the impact of various tax planning strategies, and favorable changes in the proportionate distribution of our total pretax income among the tax jurisdictions in which we operate.

***Loss from Discontinued Operations***

Loss from discontinued operations decreased \$1.6 million, or 21.7%, from \$7.5 million during the second quarter of 2006 to \$5.9 million during the second quarter of 2007. Loss from discontinued operations during the second quarter of 2007 includes no goodwill impairment charge and, in accordance with SFAS 144, no depreciation expense.

***Net Income***

Net income increased \$52.6 million, or 110.7%, from a net loss of \$47.5 million generated during the second quarter of 2006, to net income of \$5.1 million during the second quarter of 2007. Excluding the Health Education segment goodwill impairment charge of \$78.5 million, net of income tax benefit of \$6.5 million, net income decreased \$25.9 million, or 83.5%, from a net income of \$31.0 million during the second quarter of 2006, to \$5.1 million during the second quarter of 2007. The decrease in net income is the result of the cumulative effect of the factors discussed above.

**RESULTS OF CONTINUING OPERATIONS**

*Six Months Ended June 30, 2007, Compared to Six Months Ended June 30, 2006*

The summary of selected financial data table below should be referenced in connection with a review of the following discussion of our results of continuing operations for the six months ended June 30, 2007, compared to the six months ended June 30, 2006.

	For the Six Months Ended June 30,		2006	% of Total Revenue	% Change 2007 vs. 2006
	2007 (Dollars in thousands)	% of Total Revenue			
<b>TOTAL REVENUE</b>	\$ 833,320		\$ 942,573		-11.6 %
<b>OPERATING EXPENSES</b>					
Educational services and facilities expense	288,263	34.6 %	278,462	29.5 %	3.5 %
General and administrative:					
Advertising	126,510	15.2 %	126,862	13.5 %	-0.3 %
Admissions	115,041	13.8 %	127,443	13.5 %	-9.7 %
Administrative expense	188,281	22.6 %	181,182	19.2 %	3.9 %
Bad debt expense	18,708	2.2 %	29,967	3.2 %	-37.6 %
Total general and administrative expense	448,540	53.8 %	465,454	49.4 %	-3.6 %
Depreciation and amortization	38,443	4.6 %	37,760	4.0 %	1.8 %
Goodwill and intangible asset impairment charge		0.0 %	84,975	9.0 %	-100.0 %
<b>INCOME FROM OPERATIONS</b>	58,074	7.0 %	75,922	8.1 %	-23.5 %
<b>INTEREST INCOME</b>	8,836	1.1 %	8,973	1.0 %	-1.5 %
<b>PROVISION FOR INCOME TAXES</b>	25,449	3.1 %	61,395	6.5 %	-58.5 %
Effective tax rate	36.50	%	90.59	%	
<b>INCOME FROM CONTINUING OPERATIONS</b>	44,275	5.3 %	24,319	2.6 %	82.1 %
LOSS FROM DISCONTINUED OPERATIONS, net of tax	(9,112 )	-1.1 %	(19,129 )	-2.0 %	52.4 %
<b>NET INCOME</b>	\$ 35,163	4.2 %	\$ 5,190	0.6 %	577.5 %

Educational services and facilities expense includes costs directly attributable to the educational activity of our schools, including, among other things, (1) salaries and benefits of faculty, academic administrators, and student support personnel, (2) costs of educational supplies and facilities, including rents on school leases, certain costs of establishing and maintaining computer laboratories, costs of student housing, and owned and leased facility costs, (3) royalty fees paid to Le Cordon Bleu, and (4) certain student financing costs. Also included in educational services and facilities expense are costs of other goods and services provided by our schools, including, among other things, costs of textbooks, laptop computers, dormitory services, restaurant services, contract training, and cafeteria services.

General and administrative expense includes salaries and benefits of personnel in corporate and school administration, marketing, admissions, accounting, human resources, legal, and compliance. Costs of promotion and development, advertising and production of marketing materials, occupancy of the corporate offices, and bad debt expense are also included in this expense category.



**Revenue**

Revenue and student starts for the six months ended June 30, 2007 and 2006, and student population as of January 31, 2007 and 2006, are as follows (dollars in thousands). We believe that student population totals as of January 31, 2007 and 2006, which are reported below, serve as reasonable approximations of the revenue-generating population for the three months ended March 31, 2007 and 2006. We believe that student population totals as of April, 2007 and 2006, serve as reasonable approximations of the revenue-generating population for the three months ended June 30, 2007 and 2006.

	For the Six Months Ended June 30,				% Change 2007 vs. 2006
	2007	% of Total CEC	2006	% of Total CEC	
<b>REVENUE:</b>					
University segment	\$ 355,558	42 %	\$ 469,904	50 %	-24 %
Culinary Arts segment	173,271	21 %	173,334	18 %	0 %
Colleges segment	91,914	11 %	109,470	11 %	-16 %
Health Education segment	91,311	11 %	81,660	9 %	12 %
Academy segment	82,699	10 %	82,445	9 %	0 %
International segment	38,431	5 %	25,509	3 %	51 %
Corporate and other	136	0 %	251	0 %	-46 %
Total revenue	\$ 833,320		\$ 942,573		-12 %
<b>STUDENT STARTS</b>					
University segment	26,420	60 %	27,230	62 %	-3 %
Culinary Arts segment	4,810	11 %	4,200	10 %	15 %
Colleges segment	1,700	4 %	2,120	5 %	-20 %
Health Education segment	7,700	18 %	6,720	15 %	15 %
Academy segment	2,380	5 %	2,530	6 %	-6 %
International segment	730	2 %	790	2 %	-8 %
Total student starts	43,740		43,590		0 %

	As of January 31,				% Change 2007 vs. 2006
	2007	% of Total CEC	2006	% of Total CEC	
<b>STUDENT POPULATION:</b>					
University segment	41,000	46 %	46,400	50 %	-12 %
Culinary Arts segment	10,900	12 %	11,500	12 %	-5 %
Colleges segment	8,700	10 %	10,200	11 %	-15 %
Health Education segment	11,600	13 %	10,700	11 %	8 %
Academy segment	9,000	10 %	9,300	10 %	-3 %
International segment	7,600	9 %	5,500	6 %	38 %
Total student population	88,800		93,600		-5 %

## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Total revenue decreased \$109.3 million, or 11.6%, from \$942.6 million during the six months ended June 30, 2006, to \$833.3 million during the six months ended June 30, 2007. The overall decrease in revenue is primarily attributable to a decrease in revenue generated by our University and Colleges segment, offset, in part, by increases in revenue generated by our Health Education and International segments.

*University Segment Revenue.* University segment revenue decreased \$114.3 million, or 24.3%, from \$469.9 million during the six months ended June 30, 2006, to \$355.6 million during the six months ended June 30, 2007. The University segment revenue decrease is primarily attributable to a decrease in average revenue per student. The decrease in average revenue per student was primarily due to a population mix change that included an increase in students in our University segment's fully-online associate degree programs, which offer lower tuition rates than those of our University segment's fully-online bachelor's degree and master's degree programs, and more part-time students at CTU Stonecliffe, the associate degree division of CTU Online. The increase in online associate degree-seeking students was a result of a pricing decline in our AIU Online associate programs and strong student population growth at CTU Stonecliffe. The University segment revenue decrease is also attributable to a decline in average student population and student starts during the six months ended June 30, 2007 compared to average student population and student starts during the six months ended June 30, 2006. We believe that the declines in the University segment student population and student starts are primarily attributable to the continuing effects of the ongoing SACS Probation status of our AIU universities, which was announced on December 6, 2005, and is negatively impacting those schools' ability to recruit new students. The adverse effects of the SACS Probation status have resulted in a decrease in student population and revenue at each of our AIU universities and has most dramatically impacted the operating results of AIU Online.

*Colleges Segment Revenue.* Colleges segment revenue decreased \$17.6 million, or 16.0%, from \$109.5 million during the six months ended June 30, 2006, to \$91.9 million during the six months ended June 30, 2007. The Colleges segment revenue decrease is primarily attributable to declines in average student population and student starts during the six months ended June 30, 2007, relative to average student population and student starts during the six months ended June 30, 2006, and represents continuation of weak operating performance experienced in recent periods by a many of our Colleges segment schools. We believe that the continuing weak operating performance experienced by many of our Colleges segment schools is primarily attributable to the continued negative impact of certain legal and regulatory matters and the related negative publicity, negative press coverage regarding certain of our Colleges segment schools, and ongoing general competitive pressures for student leads and enrollments experienced by certain of our Colleges segment schools.

*Health Education Segment Revenue.* Health Education segment revenue increased \$9.7 million, or 11.8%, from \$81.7 million during the six months ended June 30, 2006, to \$91.3 million during the six months ended June 30, 2007. The Health Education segment revenue increase is primarily attributable to (1) tuition price increases affected during 2006, (2) an increase in average student population and student starts during the six months ended June 30, 2007, relative to average student population and student starts during the six months ended June 30, 2006, and (3) a shift in student enrollment mix that resulted in an increase in average revenue per student.

*International Segment Revenue.* International segment revenue increased \$12.9 million, or 50.7%, from \$25.5 million during the six months ended June 30, 2006, to \$38.4 million during the six months ended June 30, 2007. The International segment revenue increase is primarily attributable to revenue of \$7.9 million generated by Istituto Marangoni for the six months ended June 30, 2007, which we acquired in January of 2007. Additionally, revenue generated by our INSEEC schools during the six months ended June 30, 2007, increased by approximately \$5.0 million as a result of an increase in average student population during the six months ended June 30, 2007, relative to average student population during the six months ended June 30, 2006.



***Educational Services and Facilities Expense***

Educational services and facilities expense increased \$9.8 million, or 3.5%, from \$278.5 million during the six months ended June 30, 2006, to \$288.3 million during the six months ended June 30, 2007. Approximately \$3.9 million, or 39.7%, of the total increase is attributable to educational services and facilities expense incurred by Istituto Marangoni, which we acquired in January of 2007. Educational services and facilities expense incurred by our existing schools increased by approximately \$5.9 million. The \$5.9 million increase is attributable to a \$4.4 million increase in occupancy costs associated with the expansion of certain facilities in 2006 and a \$5.2 million increase in academics expenses, offset, in part, by a \$3.7 million decrease in other student-related expenses, including the costs of laptops, books, and other program materials, attributable to decreases in student population at most of our schools.

University segment educational services and facilities expense decreased \$1.6 million, from \$86.9 million during the six months ended June 30, 2006, to \$85.3 million during the six months ended June 30, 2007. The decrease is primarily attributable to a \$2.3 million decrease in other student-related expense associated with the decreases in student population, offset, in part, by a \$0.7 million increase in occupancy costs.

***General and Administrative Expense***

General and administrative expense decreased \$16.9 million, or 3.6%, from \$465.5 million during the six months ended June 30, 2006, to \$448.5 million during the six months ended June 30, 2007. Excluding general and administrative expense of approximately \$3.7 million incurred during the six months ended June 30, 2007 by Istituto Marangoni, which we acquired in January of 2007, general and administrative expense incurred by our existing schools during the six months ended June 30, 2007, decreased by approximately \$20.6 million. This decrease is primarily attributable to a \$13.5 million decrease in admissions expense associated with admissions headcount reductions and a \$11.3 million decrease in bad debt expense, offset, in part, by an increase of \$4.0 million in administration expense. During the second quarter of 2007, we recorded expenses of approximately \$13.1 million in connection with the probable settlement of certain legal matters. The overall decrease in general and administrative expense during the six months ended June 30, 2007, reflects the impact of cost cutting measures enacted in response to declines in student population at a majority of our campuses and the effect of our corporate realignment, which we believe has eliminated certain redundancies and improved operational efficiency.

University segment general and administrative expense decreased \$17.9 million, or 7.9%, from \$226.5 million during the six months ended June 30, 2006, to \$208.7 million during the six months ended June 30, 2007, due primarily to a \$12.5 million decrease in bad debt expense and a \$9.9 million decrease in admissions expense. The decrease in admissions expense is primarily attributable to an approximate 25% reduction in average admissions advisor headcount during the six months ended June 30, 2007, relative to average admissions advisor headcount during the six months ended June 30, 2006.

Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

As noted above, bad debt expense decreased by \$11.3 million, from \$30.0 million during the six months ended June 30, 2006, to \$18.7 million during the six months ended June 30, 2007. Bad debt expense and bad debt expense as a percentage of revenue incurred by each of our reportable segments during the six months ended June 30, 2007 and 2006, was as follows (dollars in thousands):

	For the Six Months Ended June 30,		2006	As a Percentage of Segment Revenue	
	2007	As a Percentage of Segment Revenue		2006	As a Percentage of Segment Revenue
<b>Bad debt expense by segment:</b>					
University segment	\$ 8,100	2.3 %	\$ 20,575	4.4 %	
Culinary Arts segment	4,052	2.3 %	2,470	1.4 %	
Colleges segment	741	0.8 %	761	0.7 %	
Health Education segment	3,939	4.3 %	2,746	3.4 %	
Academy segment	1,245	1.5 %	1,682	2.0 %	
International segment	347	0.9 %	523	2.1 %	
Corporate and other	284	N/A	1,210	N/A	
Total bad debt expense	\$ 18,708	2.2 %	\$ 29,967	3.2 %	

The overall decrease in bad debt expense and bad debt expense as a percentage of revenue during the period is primarily attributable to (1) a decrease in overall student receivable exposure at a majority of our schools, primarily as a result of declines in student population and revenue per student and improved cash collections experience, and (2) overall improvement in student retention.

The decrease in University segment bad debt expense and bad debt expense as a percentage of revenue is attributable to (1) a decrease in student receivable exposure as a result of declines in student population and revenue per student and improved cash collections experience, (2) price reductions that have reduced the difference between program costs and available financial aid, and (3) improvements in student retention.

**Income (Loss) From Continuing Operations and Continuing Operating Margin Percentage**

Income (loss) from continuing operations and continuing operating margin percentage for the six months ended June 30, 2007 and 2006, by segment, was as follows:

	For the Six Months Ended June 30,		2006	% of Total CEC	% Change 2007 vs. 2006
	2007	% of Total CEC			
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS:</b>					
University segment (excluding share of affiliate earnings)	\$ 52,657	91 %	\$ 148,285	195 %	-65 %
Culinary Arts segment	18,555	32 %	22,393	30 %	-17 %
Colleges segment	(2,939 )	-5 %	16,277	21 %	-118 %
Health Education segment	5,852	10 %	(84,012 )	-111 %	107 %
Academy segment	4,252	7 %	6,401	8 %	-34 %
International segment	6,631	11 %	5,041	7 %	32 %
Corporate and other	(26,934 )	-46 %	(38,463 )	-50 %	30 %
Total income from operations	\$ 58,074		\$ 75,922		-24 %
Operating profit (loss) margin percentage:					
University segment (excluding share of affiliate earnings)	14.8	%	31.6	%	
Culinary Arts segment	10.7	%	12.9	%	
Colleges segment	-3.2	%	14.9	%	
Health Education segment	6.4	%	-102.9	%	
Academy segment	5.1	%	7.8	%	
International segment	17.3	%	19.8	%	
CEC consolidated	7.0	%	8.1	%	

Income from operations decreased \$17.8 million, or 23.5%, from \$75.9 million during the six months ended June 30, 2006, to \$58.1 million during the six months ended June 30, 2007. Excluding the Health Education segment goodwill impairment charge of \$85.0 million recorded during the six months ended June 30, 2006, income from operations decreased \$102.8 million, or 63.8%, from \$160.9 million during the six months ended June 30, 2006, to \$58.1 million during the six months ended June 30, 2007. This decrease is primarily attributable to the decline in University segment operating profit and operating profit margin percentage.

As discussed above, we believe that the declines in University segment operating profit and operating profit margin are primarily attributable to the negative effects of the ongoing Probation status of the University segment's AIU universities, which has had a significant adverse impact on student starts, student population, and revenue.

AIU Online's operating profit margin percentage declined from 45.3% during the six months ended June 30, 2006, to 28.9% during the six months ended June 30, 2007, due primarily to the continuing effects of the ongoing SACS Probation status and price reductions of associate degree programs.

Income from operations generated by our Academy segment decreased \$2.1 million, from \$6.4 million during the six months ended June 30, 2006, to \$4.3 million during the six months ended June 30, 2007. Academy segment income from operations during the six months ended June 30, 2007, includes Academy segment start-up campus operating losses totaling \$4.3 million, compared to Academy segment start-up campus operating losses of \$1.7 million incurred during the six months ended June 30, 2006.

## Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Income from operations generated by our International segment increased \$1.6 million, from \$5.0 million during the six months ended June 30, 2006, to \$6.6 million during the six months ended June 30, 2007. International segment income from operation during the six months ended June 30, 2007 includes an operating loss of \$0.4 million incurred by our Istituto Marangoni schools, which we acquired in January of 2007.

Income from operations and operating profit margin percentage for the six months ended June 30, 2007 and 2006, for our University segment universities, including the universities' online platforms, are as follows:

	<b>For the Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
<b>Operating Profit (Loss):</b>		
On-ground universities	\$ (12,682 )	\$ 3,525
Online platforms (AIU Online, CTU Online, and Stonecliffe College Online combined)	65,339	144,760
Total University segment operating profit	\$ 52,657	\$ 148,285
<b>Operating Profit (Loss) Margin Percentage:</b>		
On-ground universities	-15.5	% 3.7
Online platforms (AIU Online, CTU Online, and Stonecliffe College Online combined)	23.9	% 38.8
Total University segment operating profit margin percentage	14.8	% 31.6
AIU Online	28.9	% 45.3
CTU Online and Stonecliffe College Online	15.3	% 22.7

### ***Interest Income***

Interest income decreased \$0.2 million, or 1.5%, from \$9.0 million during the six months ended June 30, 2006, to \$8.8 million during the six months ended June 30, 2007, primarily as a result of an decrease in average invested cash balances.

### ***Provision for Income Taxes***

Provision for income taxes decreased \$35.9 million, or 58.5%, from \$61.4 million during the six months ended June 30, 2006, to \$25.4 million during the six months ended June 30, 2007. The decrease is primarily attributable to a decrease in continuing income before provision for income taxes during the six months ended June 30, 2007 of approximately \$16.0 million and a decrease in our effective tax rate for continuing operations from 37.4% during the six months ended June 30, 2006 to 36.5% during the six months ended June 30, 2007. The decrease in our effective tax rate is attributable primarily to the impact of various tax planning strategies, favorable changes in the proportionate distribution of our total pretax income among the tax jurisdictions in which we operate. During the six months ended June 30, 2006, only \$6.5 million of our total \$85.0 million Health Education segment goodwill impairment charge, which was included in operating expenses, was deductible for income tax purposes.

### ***Loss from Discontinued Operations***

Loss from discontinued operations decreased \$10.0 million, or 52.4%, from \$19.1 million during the six months ended June 30, 2006, to \$9.1 million during the six months ended June 30, 2007. Loss from discontinued operations during the six months ended June 30, 2007, includes no goodwill impairment charge and, in accordance with SFAS 144, no depreciation expense.

***Net Income***

Net income increased \$30.0 million, or 577.5%, from \$5.2 million generated during the six months ended June 30, 2006, to \$35.2 million generated during the six months ended June 30, 2007. Excluding the Health Education segment goodwill impairment charge recorded during the six months ended June 30, 2006, of \$78.5 million, net of income tax benefit of \$6.5 million, net income decreased \$48.5 million, or 57.9%, from \$83.7 million during the six months ended June 30, 2006, to \$35.2 million during the six months ended June 30, 2007. The decrease in net income is the result of the cumulative effect of the factors discussed above.

**LIQUIDITY, FINANCIAL POSITION, AND CAPITAL RESOURCES**

As of June 30, 2007, cash and cash equivalents and investments totaled \$363.3 million. Our cash flows from operations have historically been adequate to fulfill our liquidity requirements. We finance our operating activities and our organic growth primarily through cash generated from operations. We finance acquisitions primarily through funding from a combination of equity issuances, credit facility borrowings, and cash generated from operations. We anticipate that we will be able to satisfy the cash requirements associated with, among other things, our working capital needs, capital expenditures, and lease commitments through at least the next 12 months primarily with cash generated by operations, existing cash balances, and, if necessary, borrowings under our existing credit agreements.

The ED requires that Title IV Program funds collected in advance of student billings be kept in a separate cash account until students are billed for the portion of their program related to those Title IV Program funds collected. As of June 30, 2007 and 2006, the amount of restricted cash balances held in separate cash accounts was not significant. Restrictions on these cash balances have not affected, nor do we believe that such restrictions will affect, our ability to fund our daily operations.

**Sources and Uses of Cash**

Cash flows from discontinued operations are combined with cash flows from continuing operations in the operating, investing, and financing sections of our consolidated statements of cash flows.

***Operating Cash Flows***

During the second quarter of 2007, net cash flows used in operating activities totaled \$0.9 million, compared to net cash flows provided by operating activities during the second quarter of 2006 of \$8.8 million. The decrease in operating cash flows was primarily attributable to a decrease in net income, excluding the impact on second quarter 2006 net income of the \$85.0 million Health Education segment goodwill impairment charge, and deferred tuition revenues during the second quarter of 2007. During the six months ended June 30, 2007 and 2006, net cash flows provided by operating activities totaled \$88.3 million and \$131.5 million, respectively.



Edgar Filing: CAREER EDUCATION CORP - Form 10-Q

Our primary source of cash flows from operating activities is tuition collected from our students. Our students finance tuition costs through the use of a variety of funding sources, including, among others, federal loan and grant programs, state grant programs, private loans and grants, private and institutional scholarships, and cash payments. The following table summarizes our U.S. schools' cash receipts from tuition payments by fund source as a percentage of total tuition payments received for the three and six months ended June 30, 2007 and 2006. The percentages reflected therein were determined based upon each U.S. school's cash receipts for the three and six months ended June 30, 2007 and 2006.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2007	2006	2007	2006
<b>Title IV Program funding</b>				
Stafford loans	43.4 %	42.2 %	43.1 %	42.1 %
Grants	9.9 %	8.0 %	10.7 %	9.2 %
PLUS loans	6.6 %	7.2 %	7.1 %	7.2 %
Total Title IV Program funding	59.9 %	57.4 %	60.9 %	58.5 %
<b>Private loans</b>				
Non-recourse loans	15.7 %	20.0 %	16.0 %	20.3 %
Sallie Mae loans	2.6 %	2.1 %	2.5 %	1.8 %
Stillwater recourse loans	0.1 %	0.4 %	0.1 %	0.4 %
Total private loans	18.4 %	22.5 %	18.6 %	22.5 %
<b>Scholarships, grants and other</b>	3.9 %	3.0 %	3.8 %	3.5 %
<b>Cash payments</b>	17.8 %	17.1 %	16.7 %	15.5 %
<b>Total tuition receipts</b>	100.0 %	100.0 %	100.0 %	100.0 %

The total Title IV Program funding as a percentage of total tuition receipts reflected above was not computed on the same basis on which our 90-10 Rule ratios are computed. In accordance with applicable regulations, certain tuition receipts included in the totals above are excluded from our 90-10 Rule ratio calculations.

For a detailed discussion of Title IV Program funding and alternative private loan funding sources for our students, see "Student Financial Aid and the Regulation of the Postsecondary Education Industry" and "Alternative Student Financial Aid Sources" in Item 1 "Business" in Part I of our Annual Report on Form 10-K for the year ended December 31, 2006.

Our primary uses of cash to support our operating activities include, among other things, cash paid to employees for services, to vendors for products and services, to lessors for rents and operating costs related to leased facilities, to suppliers for textbooks and other school supplies, and to federal, state, and provincial governments for income and other taxes.

Although we anticipate that we will be able to satisfy the cash requirements for our working capital needs, capital expenditures, and commitments through at least the next 12 months primarily with cash generated by our operations, existing cash balances, and, if necessary, borrowings under our existing credit agreements, we are not able to reasonably assess the effect of loss contingencies on future cash requirements and liquidity. See Note 7 "Commitments and Contingencies" of the notes to our unaudited condensed consolidated financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional discussion of such loss contingencies.

**Investing Cash Flows**

*Acquisition of Istituto Marangoni.* On January 25, 2007, we acquired 100% of the issued and outstanding stock of Istituto Marangoni for approximately \$37.2 million, excluding acquired cash balances totaling approximately \$6.9 million. The purchase price was funded with cash generated from operating activities.

*Sales and Purchases of Investments.* Net sales of available-for-sale investments were \$20.1 million during the second quarter of 2007, compared to net sales of available-for-sale investments of \$102.7 million during the second quarter of 2006. During the six months ended June 30, 2007 and 2006, net purchases of available-for-sale investments were \$2.4 million and \$15.2 million, respectively.

*Capital Expenditures.* Capital expenditures decreased \$11.1 million, or 43.3%, from \$25.6 million during the second quarter of 2006 to \$14.5 million during the second quarter of 2007. Capital expenditures during the second quarter of 2007 represented approximately 3.5% of second quarter 2007 total revenue, including revenue generated by our schools and campuses held for sale. During the six months ended June 30, 2007 and 2006, capital expenditures were \$31.3 million and \$43.2 million, respectively.

**Financing Cash Flows**

During the second quarter of 2007, net cash used in financing activities totaled \$71.8 million, a \$22.4 million decrease relative to net cash used in financing activities during the second quarter of 2006 of \$94.2 million. The decrease in net cash used for financing activities was primarily attributable to a decrease in cash used for repurchases of our common stock. During the second quarter of 2007, we repurchased 2.3 million shares of our common stock for approximately \$75.0 million, relative to 3.2 million shares of our common stock repurchased for approximately \$99.9 million during the second quarter of 2006. During the six months ended June 30, 2007, we repurchased 4.0 million shares for approximately \$124.9 million.

*Credit Agreements.* As of June 30, 2007, we had outstanding under our \$200.0 million U.S. Credit Agreement revolving loans totaling approximately \$10.4 million and letters of credit totaling approximately \$15.6 million. The availability under our U.S. Credit Agreement as of June 30, 2007, was \$174.0 million. As of June 30, 2007, we had no outstanding borrowings under our \$10.0 million (USD) Canadian Credit Agreement.

**Contractual Obligations**

As of June 30, 2007, minimum future cash payments, including interest, due under contractual obligations, including, among others, our credit agreements, non-cancelable operating and capital lease agreements, and other long-term arrangements, were as follows (in thousands):

	2007	2008	2009	2010	2011	2012 & Thereafter	Total
Revolving loans	\$ 10,588	\$	\$	\$	\$	\$	\$ 10,588
Operating lease obligations	66,579	125,117	118,643	112,184	108,567	533,604	1,064,694
Capital lease obligations	605	798	443	443	443	665	3,397
Other long-term debt							
Total contractual cash obligations	\$ 77,772	\$ 125,915	\$ 119,086	\$ 112,627	\$ 109,010	\$ 534,269	\$ 1,078,679

*Revolving Loans.* We have entered into an unsecured credit agreement (the U.S. Credit Agreement ) with a syndicate of financial institutions. Under our U.S. Credit Agreement, we may borrow up to the U.S. dollar equivalent of \$200.0 million in U.S. dollars and various foreign currencies under a revolving credit facility and obtain up to the U.S. dollar equivalent of \$100.0 million in standby letters of credit in U.S. dollars and various foreign currencies. Outstanding letters of credit were approximately \$15.6 million as of June 30, 2007, and reduced the availability of borrowings under the revolving credit facility but are not included in the table above. Subject to the satisfaction of certain conditions precedent under the U.S. Credit Agreement, we may prepay outstanding loans under the U.S. Credit Agreement at any time without penalty. The stated maturity of our U.S. Credit Agreement is December 19, 2007.

Our domestic subsidiaries have jointly and severally guaranteed repayment of our obligations under the U.S. Credit Agreement. Under the U.S. Credit Agreement, we are limited in our ability to take certain actions, including, among other things, consummating certain acquisitions or mergers, paying cash dividends, selling or disposing of certain assets or subsidiaries, incurring other debt in excess of specified amounts, prepaying other debt, and making certain investments. We are also required to satisfy certain financial covenants on a periodic basis, including the maintenance of a maximum consolidated leverage ratio of 1.75:1, a minimum fixed charge coverage ratio of 1.50:1, a minimum level of consolidated net worth, and a minimum annual consolidated ED financial responsibility composite score of 1.50. As of June 30, 2007, we were in compliance with the covenants of our U.S. Credit Agreement.

Our Canadian subsidiary has entered into an unsecured credit agreement (the Canadian Credit Agreement ) with a syndicate of financial institutions. Under our Canadian Credit Agreement, our Canadian subsidiary may borrow up to the U.S. dollar equivalent of 10.0 million in Canadian dollars under a revolving credit facility. Subject to the satisfaction of certain conditions precedent under the Canadian Credit Agreement, we may prepay outstanding loans under the Canadian Credit Agreement at any time without penalty. The stated maturity of our Canadian Credit Agreement is December 19, 2007.

*Operating Lease Obligations.* We lease most of our administrative and educational facilities and certain equipment under non-cancelable operating leases expiring at various dates through 2028. Lease terms generally range from five to 10 years with one to two renewal options for extended terms. The amounts included in the table above represent future minimum lease payments for non-cancelable operating leases.

*Capital Lease Obligations.* We finance the acquisition of certain equipment through capital lease agreements and have assumed capital lease obligations in connection with certain acquisitions. As of June 30, 2007, the principal balance of outstanding capital lease obligations was approximately \$2.9 million, and scheduled future interest payments on our outstanding capital lease obligations totaled \$0.5 million.

*Off-Balance Sheet Arrangements.* As of June 30, 2007, we were not a party to any off-balance sheet financing or contingent payment arrangements, nor do we have any unconsolidated subsidiaries.

**Changes in Financial Position June 30, 2007 compared to December 31, 2006**

Selected consolidated balance sheet account changes from December 31, 2006, to June 30, 2007, are as follows:

	As of June 30, 2007 (Dollars in thousands)	As of December 31, 2006	% Change
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ 99,161	\$ 187,853	-47 %
Investments	264,095	259,766	2 %
Total cash and cash equivalents and investments	363,256	447,619	-19 %
Student receivables, gross	74,534	77,273	-4 %
Allowance for doubtful accounts	(29,504 )	(28,709 )	3 %
Student receivables, net	45,030	48,564	-7 %
Discontinued assets held for sale	60,692	63,156	-4 %
Other current assets	18,725	32,064	-42 %
Goodwill	380,450	349,760	9 %
<b>Liabilities</b>			
Current liabilities:			
Accounts payable	26,665	30,095	-11 %
Accrued payroll and related benefits	26,636	27,012	-1 %
Deferred tuition revenue	114,598	132,186	-13 %
Long-term liabilities			
Deferred rent obligations	91,660	90,360	1 %
Stockholders' equity			
Treasury stock	\$ (491,240 )	\$ (366,319 )	34 %

*Cash and Cash Equivalents and Investments.* The decrease in total cash and cash equivalents and investments is primarily attributable to cash of \$124.9 million used during the six months ended June 30, 2007 to repurchase approximately 4.0 million shares of our common stock and cash of \$37.2 million, excluding acquired cash balances of approximately \$6.9 million, used to purchase Instituto Marangoni, offset, in part by cash flows generated from operations during the six months ended June 30, 2007 of approximately \$88.3 million.

*Student Receivables.* The decrease in net student receivables is primarily attributable to a decrease in revenue per student and improvements in our financial aid packaging and cash collections processing during the period. Our allowance for doubtful accounts as a percentage of gross student receivables and quarterly days sales outstanding ( DSO ) were as follows as of the dates indicated:

	As of June 30, 2007		December 31, 2006		June 30, 2006	
Allowance for doubtful accounts as a percentage of gross student receivables	39.6	%	37.2	%	42.7	%
Quarterly DSO (in days) (1)	12		12		11	

(1) We calculate DSO by dividing net receivables, including both student receivables and other receivables, by quarterly average daily revenue. Quarterly average daily revenue is computed by dividing total quarterly revenue by the total number of days in the quarter.

*Other Current Assets.* The decrease in other current assets is primarily attributable to the remission during the first quarter of 2007 of taxes of approximately \$15.4 million withheld as of December 31, 2007, in connection with December 2006 stock option exercises.

*Goodwill.* The increase in goodwill is primarily attributable to goodwill of approximately \$28.8 million recorded in connection with our January 2007 acquisition of Istituto Marangoni.

*Accounts Payable.* The decrease in accounts payable is primarily attributable to the implementation of an automated voucher approval and payment process at certain of our schools and the corporate office during 2005, which has resulted in a continued reduction in our outstanding payable balances.

*Accrued Income Taxes.* The increase in accrued income taxes is primarily attributable to current income tax liabilities associated with pretax income generated during the six months ended June 30, 2007, offset, in part, by income tax payments made during the first six months of 2007. As of December 31, 2006, we were in a prepaid position with respect to income taxes, and accordingly, our accrued income tax balance was zero as of such date.

*Deferred Tuition Revenue.* The decrease in deferred tuition revenue is primarily attributable to a decline in revenue per student and a decline in student population from December 31, 2006, to June 30, 2007, which is consistent with historical cyclical trends.

*Treasury Stock.* As discussed above, during the six months ended June 30, 2007, we repurchased approximately 4.0 million shares of our common stock for approximately \$124.9 million at an average price of approximately \$31.54 per share.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. We use various techniques to manage our market risk, including, from time to time, the use of derivative financial instruments. We do not use derivative financial instruments for speculative purposes.

#### Interest Rate Exposure

Our borrowings under our credit agreements bear annual interest at variable rates tied to the prime rate and the Eurocurrency rate. Total outstanding borrowings under these credit agreements were \$10.4 million and \$11.5 million as of June 30, 2007, and December 31, 2006, respectively.



The weighted average interest rate of borrowings under our credit agreements was 4.66% as of June 30, 2007, and December 31, 2006, respectively.

In addition, we had capital lease obligations totaling \$2.9 million as of June 30, 2007, and December 31, 2006, respectively.

We estimate that the book value of our investments, debt instruments, and any related derivative financial instruments approximated their fair values as of June 30, 2007, and December 31, 2006. We believe that the exposure of our consolidated financial position and results of operations and cash flows to adverse changes in interest rates is not significant.

#### **Foreign Currency Exposure**

We are subject to foreign currency exchange exposures arising from current and anticipated transactions denominated in currencies other than the U.S. dollar and the translation of foreign currency balance sheet accounts into U.S. dollar balance sheet accounts. Specifically, we are subject to risks associated with fluctuations in the value of the Euro, the Canadian dollar, and the British pound vis-à-vis the U.S. dollar. Our investment in our foreign operations as of June 30, 2007, was not significant to our consolidated financial position, and the book values of the assets and liabilities of such foreign operations as of June 30, 2007, approximated their fair values.

In addition, as of June 30, 2007, we had borrowings outstanding under our U.S. Credit Agreement of \$10.4 million denominated in 7.7 million.

We believe that the exposure of our consolidated financial position and results of operations and cash flows to adverse changes in foreign currency exchange rates is not significant.

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

We completed an evaluation as of the end of the period covered by this Report under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934 ( Exchange Act ), as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2007, our disclosure controls and procedures were effective to provide reasonable assurance that (i) the information required to be disclosed by us in this Report was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

##### **Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Inherent Limitations on the Effectiveness of Controls**

Our management does not expect that our disclosure controls and procedures or our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our company have been detected.

These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

75

---



**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

Note 7 Commitments and Contingencies to our unaudited condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by reference.

**Item 1A. Risk Factors**

Our operations and financial results are subject to various risks and uncertainties that could adversely affect our business, financial condition, and results of operations and the market price of our common stock. Item 1A of our Annual Report on Form 10-K for year ended December 31, 2006, includes a detailed discussion of these risk factors.

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

The following table sets forth information regarding purchases made by us of shares of our common stock on a monthly basis during the six months ended June 30, 2007:

**Issuer Purchases of Equity Securities**

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
January 1, 2007 - January 31, 2007		\$		\$ 133,761,949
February 1, 2007 - February 28, 2007				133,761,949
March 1, 2007 - March 31, 2007	1,642,687	30.42	1,642,687	83,794,797
April 1, 2007 - April 30, 2007	918,600	30.29	918,600	55,968,815
May 1, 2007 - May 31, 2007	481,436	33.37	481,436	339,903,915
June 1, 2007 - June 30, 2007	917,756	33.85	917,756	\$ 308,841,173
<b>Total</b>	<b>3,960,479</b>	<b>\$ 31.54</b>	<b>3,960,479</b>	

(1) Our Board of Directors had authorized us to use up to approximately \$500.2 million for the repurchase of shares of our outstanding common stock. Pursuant to this stock repurchase program, we may repurchase shares of our outstanding common stock on the open market or in private transactions from time to time, depending on factors including market conditions and corporate and regulatory requirements. The stock repurchase program does not have an expiration date and may be suspended or discontinued at any time. On May 17, 2007, the Board of Directors authorized us to use an additional \$300.0 million for the repurchase of shares of our common stock. This amount is in addition to the \$500.2 million previously authorized by the Board of Directors since the inception of the stock repurchase program.

**Item 4.** Submission of Matters to a Vote of Security Holders

- (a) Our annual meeting of shareholders was held on May 17, 2007.
- (b) Our stockholders voted as follows to elect six directors to our board of directors:

<b>Directors:</b>	<b>Votes For:</b>	<b>Authority Withheld:</b>
Patrick W. Gross	84,246,241	4,286,679
Thomas B. Lally	80,431,744	8,501,176
Steven H. Lesnik	87,652,041	1,280,879
Gary E. McCullough	88,683,982	248,938
Keith K. Ogata	88,739,945	192,975
Leslie T. Thornton	88,688,429	244,491

Directors whose terms continued after the meeting were Dennis H. Chookaszian, Robert E. Dowdell, and Patrick K. Pesch.

Article V of CEC's Certificate of Incorporation was amended and restated in May of 2006 to provide, among other things, that those directors previously elected for three-year terms of office by CEC's stockholders will complete their three-year terms and will be eligible for re-election to one-year terms at each annual meeting of stockholders thereafter. Beginning with the 2008 Annual Meeting of Stockholders, the declassification of the Board of Directors will be complete, and all directors will be subject to annual elections to one-year terms. The six directors elected at the 2007 CEC's Annual Meeting of Stockholders will each serve for a one-year term expiring at CEC's 2008 Annual Meeting of Stockholders.

- (c) Our stockholders voted as follows to ratify the appointment of Ernst & Young LLP as an independent registered public accounting firm of our financial statements for the year ended December 31, 2007.

For: 88,839,557      Against: 84,021      Abstentions: 9,342      Broker Non Votes: N/A

**Item 6.** Exhibits*(a)* Exhibits

31.1	Certification of CEO pursuant to Section 302 of Sarbanes-Oxley Act of 2002
31.2	Certification of CFO pursuant to Section 302 of Sarbanes-Oxley Act of 2002
32.1	Certification of CEO pursuant to Section 906 of Sarbanes-Oxley Act of 2002
32.2	Certification of CFO pursuant to Section 906 of Sarbanes-Oxley Act of 2002

**SIGNATURES**

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

Date: August 8, 2007

CAREER EDUCATION CORPORATION  
By: /s/ GARY E. MCCULLOUGH  
Gary E. McCullough  
*President and Chief Executive Officer*  
*(Principal Executive Officer)*

Date: August 8, 2007

By: /s/ PATRICK K. PESCH  
Patrick K. Pesch  
*Executive Vice President,*  
*Chief Financial Officer, Treasurer*  
*and Assistant Secretary*  
*(Principal Financial and Accounting Officer)*