

CORINTHIAN COLLEGES INC  
Form 10-Q  
May 12, 2005  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2005

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 0-25283

**CORINTHIAN COLLEGES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of

Incorporation or organization)

**33-0717312**  
(I.R.S. Employer

Identification No.)

6 Hutton Centre Drive, Suite 400, Santa Ana, California

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(Address of principal executive offices)

92707

(Zip Code)

(714) 427-3000

(Registrant's telephone number, including area code)

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 an accelerated filer (as defined in Rule 12b-2 of the Act.) Yes  No

At May 2, 2005, there were 90,977,379 shares of Common Stock of the Registrant outstanding.

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CORINTHIAN COLLEGES, INC. AND SUBSIDIARIES

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## CORINTHIAN COLLEGES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

|   | <b>June 30,<br/>2004</b> | <b>March 31,<br/>2005</b> |
|---|--------------------------|---------------------------|
|   | <b>(Unaudited)</b>       |                           |
|   | <b>(In thousands)</b>    |                           |
| <b>ASSETS</b>   |                          |                           |
| <b>CURRENT ASSETS:</b>  |                          |                           |
| Cash and cash equivalents   | \$ 46,699                | \$ 29,640                 |
| Restricted cash   | 10                       | 10                        |
| Short-term investments  |                          | 53,725                    |
| Accounts receivable, net of allowance for doubtful accounts of \$19,308 and \$21,217 at June 30, 2004 and March 31, 2005, respectively  | 66,232                   | 71,612                    |
| Student notes receivable, net of allowance for doubtful accounts of \$769 and \$377 at June 30, 2004 and March 31, 2005, respectively   | 1,853                    | 2,569                     |
| Deferred income taxes   | 14,874                   | 14,874                    |
| Prepaid expenses and other current assets   | 34,671                   | 33,132                    |
| <b>Total current assets</b>   | <b>164,339</b>           | <b>205,562</b>            |
| <b>PROPERTY AND EQUIPMENT, net</b>  | <b>146,020</b>           | <b>185,957</b>            |
| <b>OTHER ASSETS:</b>  |                          |                           |
| Goodwill, net   | 197,547                  | 206,924                   |
| Other intangibles, net  | 52,761                   | 54,541                    |
| Student notes receivable, net of allowance for doubtful accounts of \$742 and \$1,410 at June 30, 2004 and March 31, 2005, respectively | 1,934                    | 3,474                     |
| Deposits and other assets   | 5,447                    | 6,337                     |
| <b>TOTAL ASSETS</b>   | <b>\$ 568,048</b>        | <b>\$ 662,795</b>         |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                          |                           |
| <b>CURRENT LIABILITIES:</b>   |                          |                           |
| Accounts payable  | \$ 22,830                | \$ 23,946                 |
| Accrued compensation and related liabilities  | 28,462                   | 25,619                    |
| Accrued expenses  | 12,579                   | 23,079                    |
| Prepaid tuition   | 37,614                   | 47,146                    |
| Current portion of capital lease obligations  | 614                      | 237                       |
| Current portion of long-term debt   | 146                      | 160                       |
| <b>Total current liabilities</b>  | <b>102,245</b>           | <b>120,187</b>            |
| <b>LONG-TERM CAPITAL LEASE OBLIGATIONS, net of current portion</b>  | <b>12,406</b>            | <b>12,251</b>             |
| <b>LONG-TERM DEBT, net of current portion</b>   | <b>46,366</b>            | <b>48,206</b>             |
| <b>DEFERRED INCOME TAXES</b>  | <b>27,150</b>            | <b>27,150</b>             |
| <b>OTHER LIABILITIES</b>  | <b>21,926</b>            | <b>26,679</b>             |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                          |                           |

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|   |                   |                   |
|---|-------------------|-------------------|
| <b>STOCKHOLDERS EQUITY:</b>   |                   |                   |
| Common Stock, \$0.0001 par value:   |                   |                   |
| Common Stock, 120,000 shares authorized and 90,305 shares and 90,976 shares issued and outstanding at June 30, 2004 and March 31, 2005, respectively respectively |                   |                   |
|   | 9                 | 9                 |
| Additional paid-in capital  | 126,339           | 137,893           |
| Deferred compensation   |                   | (2,506)           |
| Retained earnings   | 231,603           | 292,891           |
| Accumulated other comprehensive income (loss)   | 4                 | 35                |
|   | <u>          </u> | <u>          </u> |
| <b>TOTAL STOCKHOLDERS EQUITY</b>  | <b>357,955</b>    | <b>428,322</b>    |
|   | <u>          </u> | <u>          </u> |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>  | <b>\$ 568,048</b> | <b>\$ 662,795</b> |
|   | <u>          </u> | <u>          </u> |

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

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## CORINTHIAN COLLEGES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

|   | Three Months Ended<br>March 31,                      |            | Nine Months Ended<br>March 31, |            |
|---|--|------------|--------------------------------|------------|
|   | 2004   | 2005       | 2004                           | 2005       |
|   | (In thousands, except per share data)<br>(Unaudited) |            |                                |            |
| NET REVENUES  | \$ 217,331   | \$ 254,032 | \$ 587,142                     | \$ 731,869 |
| OPERATING EXPENSES:                                   |  |            |                                |            |
| Educational services                                  | 110,346  | 134,256    | 298,862                        | 390,992    |
| General and administrative                            | 19,328   | 21,310     | 50,938                         | 64,152     |
| Marketing and advertising                             | 48,945   | 61,082     | 128,868                        | 174,608    |
| Impairment charge                                     | 3,154  |            | 3,154                          |            |
| Total operating expenses                              | 181,773  | 216,648    | 481,822                        | 629,752    |
| INCOME FROM OPERATIONS                                | 35,558   | 37,384     | 105,320                        | 102,117    |
| Interest (income)                                     | (383)  | (1,127)    | (1,005)                        | (2,321)    |
| Interest expense                                      | 852  | 1,280      | 2,221                          | 3,192      |
| Other (income) expense, net                           | (105)  | 274        | (186)                          | (58)       |
| INCOME BEFORE PROVISION FOR INCOME TAXES              | 35,194   | 36,957     | 104,290                        | 101,304    |
| Provision for income taxes                            | 13,947   | 14,598     | 41,723                         | 40,016     |
| NET INCOME  | \$ 21,247  | \$ 22,359  | \$ 62,567                      | \$ 61,288  |
| Income per common share:                              |  |            |                                |            |
| Basic   | \$ 0.24  | \$ 0.25    | \$ 0.70                        | \$ 0.68    |
| Diluted   | \$ 0.23  | \$ 0.24    | \$ 0.67                        | \$ 0.66    |
| Weighted average number of common shares outstanding: |  |            |                                |            |
| Basic   | 89,883   | 90,860     | 88,868                         | 90,569     |
| Diluted   | 94,321   | 93,131     | 93,935                         | 92,668     |

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

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## CORINTHIAN COLLEGES, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Nine Months Ended<br>March 31, |                  |
|---|--------------------------------|------------------|
|   | 2004                           | 2005             |
|   | (In thousands)<br>(Unaudited)  |                  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                                |                  |
| Net income  | \$ 62,567                      | \$ 61,288        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                |                  |
| Depreciation and amortization   | 17,177                         | 26,031           |
| Impairment charge   | 3,154                          |                  |
| Tax benefit of stock options exercised  | 21,688                         | 1,995            |
| Stock-based compensation  |                                | 307              |
| Changes in assets and liabilities, net of effects from acquisitions:              |                                |                  |
| Accounts receivable, net  | (3,671)                        | (2,078)          |
| Student notes receivable, net   | (606)                          | (2,256)          |
| Prepaid expenses and other assets   | (2,861)                        | 358              |
| Accounts payable  | (232)                          | 474              |
| Accrued expenses, compensation and related benefits                               | 8,748                          | 3,662            |
| Income taxes payable  | 2,328                          | 3                |
| Prepaid tuition   | 1,637                          | 7,725            |
| Other long-term liabilities   | 3,535                          | 5,731            |
| Net cash provided by operating activities   | <u>113,464</u>                 | <u>103,240</u>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                                |                  |
| Acquisitions of schools, colleges, and training centers, net of cash acquired     | (101,392)                      | (9,060)          |
| Capital expenditures, net of disposals  | (52,918)                       | (60,947)         |
| Sales of (investments in) marketable securities, net                              | 3,897                          | (53,725)         |
| Net cash (used in) investing activities   | <u>(150,413)</u>               | <u>(123,732)</u> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                                |                  |
| Proceeds from borrowings  | 51,631                         |                  |
| Principal repayments on capital lease obligations and long-term debt              | (9,404)                        | (3,714)          |
| Proceeds from exercise of stock options and Employee Stock Purchase Plan          | 17,755                         | 6,746            |
| Net cash provided by financing activities   | <u>59,982</u>                  | <u>3,032</u>     |
| EFFECTS OF EXCHANGE RATE CHANGES ON CASH  | <u>51</u>                      | <u>401</u>       |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS                              | 23,084                         | (17,059)         |
| CASH AND CASH EQUIVALENTS, beginning of period                                    | 35,901                         | 46,699           |
| CASH AND CASH EQUIVALENTS, end of period  | <u>\$ 58,985</u>               | <u>\$ 29,640</u> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>                          |                                |                  |

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Cash paid during the period for:

|              |                   |                   |
|--------------|-------------------|-------------------|
| Income taxes | \$ 18,886         | \$ 34,678         |
|              | <u>          </u> | <u>          </u> |
| Interest     | \$ 2,221          | \$ 3,203          |
|              | <u>          </u> | <u>          </u> |

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

Acquisitions of various schools, colleges, and training centers

|                                 |                   |                   |
|---------------------------------|-------------------|-------------------|
| Fair value of assets acquired   | \$ 140,171        | \$ 11,704         |
| Net cash used in acquisitions   | (101,392)         | (9,060)           |
|                                 | <u>          </u> | <u>          </u> |
| Liabilities assumed or incurred | \$ 38,779         | \$ 2,644          |
|                                 | <u>          </u> | <u>          </u> |

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



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CORINTHIAN COLLEGES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2005

**Note 1 - The Company and Basis of Presentation**

As of March 31, 2005, Corinthian Colleges, Inc. (the Company) operated 94 schools and colleges in the for profit, post-secondary education industry in the United States, and 41 colleges (including 6 colleges scheduled to close in fiscal 2005) and 14 training centers in 7 Canadian provinces. All of the Company's schools grant either diplomas or degrees (associate's, bachelor's and master's) and offer educational opportunities from an extensive and diverse curricula library with an emphasis on four primary concentrations: allied health, business, technology, and criminal justice. Additionally, the Company has an online learning alternative available to students pursuing education exclusively online and is approved to offer 14 accredited degrees to exclusively online students.

Effective August 2, 2004, the Company acquired substantially all of the assets of A.M.I., Inc. (AMI). AMI operates one campus in Daytona Beach, Florida that offers programs in the motorcycle, marine, and personal watercraft technician fields. The acquisition of AMI was accounted for using the purchase method of accounting and its results of operations are included in the Company's consolidated results of operations since its acquisition date.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission and in accordance with U.S. generally accepted accounting principles. Certain information and footnote disclosures normally included in annual financial statements have been omitted or condensed pursuant to such regulations. The Company believes the disclosures included in the unaudited condensed consolidated financial statements, when read in conjunction with the June 30, 2004 consolidated financial statements of the Company included in the Company's 2004 Annual Report on Form 10-K and notes thereto, are adequate to make the information presented not materially misleading. In management's opinion, the unaudited condensed consolidated financial statements reflect all adjustments, consisting solely of normal recurring adjustments, necessary to summarize fairly the consolidated financial position, results of operations, and cash flows for such periods. The results of operations for the three and nine months ended March 31, 2005 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2005.

The unaudited condensed consolidated financial statements as of March 31, 2005 and June 30, 2004 and for the three and nine months ended March 31, 2005 and 2004 include the accounts of the Company and its subsidiaries that it directly or indirectly controls through majority ownership. All significant intercompany balances and transactions have been eliminated in consolidation.

The financial position and results of operations of the Company's direct and indirect Canadian subsidiaries are measured using the local currency as the functional currency. Assets and liabilities of the Canadian subsidiaries are translated to U.S. dollars using exchange rates in effect at the balance sheet dates. Income and expense items are translated at monthly average rates of exchange. The resultant translation adjustments are included as a component of Stockholders' Equity designated as accumulated other comprehensive income. Exchange gains and losses arising from transactions denominated in a currency other than the functional currency are immediately included in earnings.

Certain amounts for the prior periods have been reclassified to conform to fiscal 2005 financial statement presentation.



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*Leases*

The Company currently leases almost all of its administrative and educational facilities under operating lease agreements. On February 7, 2005, the Office of the Chief Accountant of the Securities and Exchange Commission ( OCASEC ) issued a letter to the American Institute of Certified Public Accountants expressing its views regarding certain operating lease accounting issues and their application under generally accepted accounting principles in the United States of America. In light of this letter, the Company initiated a review of its lease-related accounting and determined that its previous method of accounting for leasehold improvements funded by landlord incentives or allowances under operating leases ( tenant improvement allowances ) was not in accordance with the guidance provided by OCASEC.

The Company has historically accounted for tenant improvement allowances as reductions to the related leasehold improvement asset on the condensed consolidated balance sheets and capital expenditures in investing activities on the condensed consolidated statements of cash flows. Management determined that the appropriate interpretation of Financial Accounting Standards Board ( FASB ) Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*, requires these allowances to be recorded as a deferred rent liability on the condensed consolidated balance sheets and as a component of operating activities on the condensed consolidated statements of cash flows. As a result of these reclassifications, the purchases of leasehold improvements and related amortization expense will increase and will be offset by a corresponding increase in the deferred rent liability and a reduction in rent expense for all periods presented. There is no impact on the condensed consolidated statements of operations as a result of this reclassification. In the third quarter of 2005, the Company reclassified \$15.1 million and \$22.0 million of unamortized tenant improvement allowances from leasehold improvements to a long-term deferred rent liability in its condensed consolidated balance sheets as of June 30, 2004 and March 31, 2005, respectively. In addition, for the nine-months ended March 31, 2004 and 2005, the Company reclassified \$6.4 million and \$9.1 million, respectively in the condensed consolidated statements of cash flows from purchases of property and equipment included in investing activities to depreciation and amortization expense and other liabilities included in operating activities. These reclassifications did not have a material effect on the prior periods.

**Note 2 - Stock Split**

On February 18, 2004, the Company authorized a two-for-one stock split of its common stock effected in the form of a stock dividend. The additional shares were distributed on March 23, 2004 to shareholders of record on March 4, 2004. All share and per share information has been retroactively restated to reflect the stock split.

**Note 3 - Stock Based Compensation**

*Restricted Stock*

In November 2003, the Company's stockholders approved the Company's 2003 Performance Award Plan (the 2003 Plan ), which authorized the issuance of restricted stock awards to executive officers and other employees of the Company. The restricted stock awards vest over a period of four years. The Company has awarded a total of 202,228 restricted stock units to employees in accordance with provisions of the 2003 plan. The shares were valued based on the market price on the date of grant. The Company recognized compensation expense related to such stock units of \$307,000 during the nine month period ended March 31, 2005. The deferred portion of the awards is reflected as a component of Stockholders Equity entitled Deferred Compensation.

*Stock Options*

The Company accounts for stock-based compensation using the intrinsic value method of APB Opinion No. 25, Accounting for Stock Issued to Employees, and has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, related to options issued to employees and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation. There

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were 588,474 shares issued through the exercising of stock options and 82,487 shares issued through the employee stock purchase plan for the period ended March 31, 2005.

|  | Three Months Ended<br>March 31, |           | Nine Months Ended<br>March 31, |           |
|--|---------------------------------|-----------|--------------------------------|-----------|
|  | 2004                            | 2005      | 2004                           | 2005      |
| (In thousands, except per share data)<br>(Unaudited)   |                                 |           |                                |           |
| Net income, as reported  | \$ 21,247                       | \$ 22,359 | \$ 62,567                      | \$ 61,288 |
| Stock-based compensation included in net income above  |                                 | 162       |                                | 307       |
| Deduct: Total stock-based employee compensation cost determined under fair value method for all awards, net of related tax effects | (3,752)                         | (4,440)   | (9,810)                        | (12,980)  |
| Pro forma net income   | \$ 17,495                       | \$ 18,081 | \$ 52,757                      | \$ 48,615 |
| Basic earnings per share:  |                                 |           |                                |           |
| As reported  | \$ 0.24                         | \$ 0.25   | \$ 0.70                        | \$ 0.68   |
| Pro forma  | \$ 0.19                         | \$ 0.20   | \$ 0.59                        | \$ 0.54   |
| Diluted earnings per share:  |                                 |           |                                |           |
| As reported  | \$ 0.23                         | \$ 0.24   | \$ 0.67                        | \$ 0.66   |
| Pro forma  | \$ 0.19                         | \$ 0.19   | \$ 0.56                        | \$ 0.52   |

The effects of applying SFAS No. 123 in the above pro forma disclosures are not necessarily indicative of future amounts. The fair value of each option and other common stock-based securities were estimated on the date of grant using the Black-Scholes method with the following weighted-average assumptions:

|                               | Three Months Ended<br>March 31, |         | Nine Months Ended<br>March 31, |         |
|-------------------------------|---------------------------------|---------|--------------------------------|---------|
|                               | 2004                            | 2005    | 2004                           | 2005    |
| Risk-free rate                | 3.73%                           | 3.90%   | 3.75%                          | 3.90%   |
| Expected years until exercise | 7 years                         | 7 years | 7 years                        | 7 years |
| Expected stock volatility     | 35%                             | 50%     | 38%                            | 107%    |
| Expected dividends            | \$                              | \$      | \$                             | \$      |

**Note 4 - Weighted Average Number of Common Shares Outstanding**

Basic net income per share is calculated by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the assumed conversion of all dilutive securities, consisting of stock options and restricted stock units.

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The table below reflects the calculation of the weighted average number of common shares outstanding used in computing basic and diluted net income per common share (in thousands):

|  | Three Months Ended<br>March 31, |        | Nine Months<br>Ended<br>March 31, |        |
|--|---------------------------------|--------|-----------------------------------|--------|
|  | 2004                            | 2005   | 2004                              | 2005   |
| Basic common shares outstanding          | 89,883                          | 90,860 | 88,868                            | 90,569 |
| Effects of dilutive securities:          |                                 |        |                                   |        |
| Stock options and restricted stock units | 4,438                           | 2,271  | 5,067                             | 2,099  |
| Diluted common shares outstanding        | 94,321                          | 93,131 | 93,935                            | 92,668 |

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### **Note 5 - Common Stock**

Effective November 20, 2003, the Company amended and restated its certificate of incorporation to increase the number of authorized shares of common stock with a par value of \$0.0001 per share to a total of 120,000,000 shares.

### **Note 6 - Marketable Securities**

Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting For Certain Debt and Equity Securities* requires that all applicable investments be classified as trading securities, available-for-sale securities or held-to-maturity securities. The Company does not currently have any trading securities or held-to-maturity securities.

Securities classified as available-for-sale may be sold in response to changes in interest rates, liquidity needs and for other purposes. Available-for-sale securities are carried at fair value and include all debt and equity securities not classified as held-to-maturity or trading. Unrealized holding gains and losses for available-for-sale securities are excluded from earnings and reported, net of any income tax effect, as a separate component of stockholders' equity. Realized gains and losses for securities classified as available-for-sale are reported in earnings based on the adjusted cost of the specific security sold. At March 31, 2005 and June 30, 2004, the unrealized loss on available-for-sale securities was immaterial.

### **Note 7 - Acquisitions**

#### *Fiscal 2004*

During the fiscal year ended June 30, 2004, the Company acquired all of the outstanding stock of Career Choices, Inc. ( *Career Choices* ). Career Choices operated 10 campuses in California, Washington, and Oregon, which offer diplomas and degrees in the applied science, automotive technology, HVAC technology and allied health fields. The cash purchase price was approximately \$56.3 million, subject to certain balance sheet adjustments. The Company purchased Career Choices to expand its presence and strength in the Pacific Northwest and expects to benefit from increased marketing power and operational leverage. The 10 schools operated under the Sequoia Institute ( *Sequoia* ), Ashmead College, and Eton Technical Institute ( *Eton* ) trade names. Sequoia focuses on programs in the growing automotive technology field that will expand Corinthian's presence in the high demand technology programs. Sequoia also introduces heating/ventilation/air-conditioning (HVAC) training to the Company's technology programs. The Ashmead and Eton schools include the fields of massage therapy, dental and medical assisting. The acquisition is a strategic fit to the Company's allied health program and the Company expects to gain outstanding automotive curriculum that complements the Company's Wyo-Tech curricula. The acquisition was accounted for using the purchase method of accounting and Career Choices' results of operations are included in the consolidated results of operations of the Company since August 1, 2003, its acquisition date.

During the fiscal year ended June 30, 2004, the Company acquired substantially all of the assets of East Coast Aero Tech, LLC ( *ECAT* ). ECAT operated one campus in Massachusetts, which offers programs in the aviation maintenance technology field. The cash purchase price was approximately \$3.2 million, subject to certain balance sheet adjustments. ECAT marks the Company's entry into the growing field of aviation maintenance technology training, providing Corinthian with an additional platform for growth and enhancement of its technology programs. It offers accredited programs in airframe and powerplant technology, which prepare students to become Federal Aviation Administration (FAA) certified Aviation Maintenance Technicians. The acquisition was accounted for using the purchase method of accounting and ECAT's results of

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operations are included in the consolidated results of operations of the Company since August 6, 2003, its acquisition date.

During the fiscal year ended June 30, 2004, the Company acquired approximately 89% of the outstanding shares of common stock of CDI Education Corporation ( CDI ) through a tender offer to acquire all of the



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outstanding shares of common stock. As of October 7, 2003, the Company had acquired all shares of CDI for approximately \$42.1 million and the assumption of approximately \$10 million of debt and other liabilities. CDI is a wholly-owned subsidiary of Corinthian Colleges, Inc. In October 2003, the Company completed the acquisition of CMA Careers, Inc. located in Kitchener, Ontario, Canada. The intent to acquire this campus by CDI had been agreed to prior to the Company's acquisition of CDI. The cash purchase price was funded with available cash and borrowings from the Company's amended credit facility. CDI operated 45 post-secondary colleges offering diploma-granting programs in the allied health, business and information technology fields. CDI's corporate education division, which has 15 training centers, serves as both an outsourced and e-learning provider focused on skills development specialties such as leadership, innovation and business analysis. This acquisition expands the Company into the international arena with a significant presence in the Canadian post-secondary and corporate education markets, adding new programs that either extend or enhance the Company's portfolio. The acquisition was accounted for using the purchase method of accounting and CDI's results of operations are included in the consolidated results of operations of the Company since August 19, 2003, its acquisition date.

The following table provides unaudited pro forma financial data for the Company reflecting the completion of the fiscal year 2004 acquisitions as if they had occurred July 1, 2003. These unaudited pro forma results have been prepared for comparative purposes only and include certain pro forma adjustments. Such pro forma amounts are not necessarily indicative of what actual results of operations might have been or will be in the future. Pro forma results of operations for the prior period reflect an increase in interest expense related to debt used to fund the acquisitions.

|                              | Three Months Ended                    |            | Nine Months Ended |            |
|------------------------------|---------------------------------------|------------|-------------------|------------|
|                              | March 31,                             |            | March 31,         |            |
|                              | 2004                                  | 2005       | 2004              | 2005       |
|                              | (In thousands, except per share data) |            |                   |            |
|                              | (Unaudited)                           |            |                   |            |
| Net revenue                  | \$ 217,331                            | \$ 254,032 | \$ 599,262        | \$ 731,869 |
| Net income                   | \$ 21,247                             | \$ 22,359  | \$ 60,406         | \$ 61,288  |
| Earnings per share - basic   | \$ 0.24                               | \$ 0.25    | \$ 0.68           | \$ 0.68    |
| Earnings per share - diluted | \$ 0.23                               | \$ 0.24    | \$ 0.64           | \$ 0.66    |

*Fiscal 2005*

Effective August 2, 2004, the Company acquired substantially all of the assets of AMI Inc. (AMI). AMI operates one campus in Daytona Beach, Florida, which offers accredited diploma programs in the motorcycle, marine and personal watercraft technician fields. The purchase price was approximately \$11.7 million. The Company has assigned value to other intangible assets, such as accreditation, trade names, curriculum and other under SFAS No. 141. The Company purchased AMI to enter into the growing field of motorcycle, marine and personal watercraft technician fields and adds to the Company's growing transportation-related technical curricula, providing the Company with an additional platform for growth and enhancement of its technology programs. AMI also offers specialized motorcycle technician and dealership management programs. The acquisition was accounted for using the purchase method of accounting and AMI's results of operations are included in the consolidated results of operations of the Company since August 2, 2004, its acquisition date.

**Table of Contents****Note 8 - Comprehensive Income (Loss)**

Comprehensive income (loss) is defined as the total of net income (loss) and all changes that impact stockholders' equity other than transactions involving stockholders' ownership interests. The following table details the components of comprehensive income (loss) for the three and nine month periods ended March 31, 2005 and 2004:

|  | Three Months Ended<br>March 31, |                  | Nine Months Ended<br>March 31, |                  |
|--|---------------------------------|------------------|--------------------------------|------------------|
|  | 2004                            | 2005             | 2004                           | 2005             |
| (In thousands)                           |                                 |                  |                                |                  |
| (Unaudited)                              |                                 |                  |                                |                  |
| Net income                               | \$ 21,247                       | \$ 22,359        | \$ 62,567                      | \$ 61,288        |
| Foreign currency translation adjustments | 39                              | 1                | (45)                           | 31               |
| <b>Comprehensive income</b>              | <b>\$ 21,286</b>                | <b>\$ 22,360</b> | <b>\$ 62,522</b>               | <b>\$ 61,319</b> |

**Note 9 - Impairment, Facility Closing, and Severance Charges**

During fiscal 2004, the Company implemented a plan to streamline operations at several of its divisions, including the recently acquired CDI. The plan primarily included closing 2 LTU campuses and 10 CDI campuses. In addition, the Company reviewed the long-lived assets and goodwill related to these closures for possible impairment in accordance with SFAS 142 and SFAS 144. Based on the results of the review, the Company recognized a pre-tax impairment, facility closing, and severance charge of \$6.4 million in fiscal 2004 (\$3.2 million in the quarter ended March 31, 2004 and \$3.2 million in the quarter ended June 30, 2004). The fair value of the remaining goodwill was based on the Company's estimate of discounted future cash flows.

The table below summarizes the liability and activity for the nine months ended March 31, 2005, relating to the impairment, facility closing and severance charges:

|                          | Fixed Asset<br>Write-offs | Severance<br>and<br>Benefits | Facility<br>Related | Total    |
|--------------------------|---------------------------|------------------------------|---------------------|----------|
| (In thousands)           |                           |                              |                     |          |
| (Unaudited)              |                           |                              |                     |          |
| Balance at June 30, 2004 | \$                        | \$ 919                       | \$ 6,975            | \$ 7,894 |
| Charges/adjustments      | 482                       | 670                          | (2,062)             | (910)    |
| Cash payments            |                           | (1,299)                      | (1,143)             | (2,442)  |
| Asset writedowns         | (482)                     |                              |                     | (482)    |

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|                           |    |        |          |          |
|---------------------------|----|--------|----------|----------|
| Balance at March 31, 2005 | \$ | \$ 290 | \$ 3,770 | \$ 4,060 |
|---------------------------|----|--------|----------|----------|

The accrual for severance and benefits is reflected in accounts payable. The accrual for lease payments on vacated facilities is reflected in accounts payable and other long-term liabilities and is expected to be paid out over the lease terms, the latest of which expires in 2012.

**Table of Contents****Note 10 - Segment Information**

The Company's operations are aggregated into a single reportable operating segment based upon similar economic and operating characteristics as well as similar markets. The Company's operations are also subject to similar regulatory environments. The Company conducts its operations in the U.S. and Canada. Revenues and long-lived assets by geographic area are as follows:

|                                      | <b>Three Months Ended</b> |                   | <b>Nine Months Ended</b> |                   |
|--------------------------------------|---------------------------|-------------------|--------------------------|-------------------|
|                                      | <b>March 31,</b>          |                   | <b>March 31,</b>         |                   |
|                                      | <b>2004</b>               | <b>2005</b>       | <b>2004</b>              | <b>2005</b>       |
| (In thousands)                       |                           |                   |                          |                   |
| (Unaudited)                          |                           |                   |                          |                   |
| Revenues from unaffiliated customers |                           |                   |                          |                   |
| U.S. operations                      | \$ 193,314                | \$ 224,537        | \$ 532,594               | \$ 645,583        |
| Canadian operations                  | \$ 24,017                 | \$ 29,495         | \$ 54,548                | \$ 86,286         |
| Consolidated                         | <u>\$ 217,331</u>         | <u>\$ 254,032</u> | <u>\$ 587,142</u>        | <u>\$ 731,869</u> |
|                                      |                           |                   | <b>June 30,</b>          | <b>March 31,</b>  |
|                                      |                           |                   | <b>2004</b>              | <b>2005</b>       |
| (In thousands)                       |                           |                   |                          |                   |
| (Unaudited)                          |                           |                   |                          |                   |
| Long-lived assets                    |                           |                   |                          |                   |
| U.S. operations                      |                           |                   | \$ 344,956               | \$ 395,464        |
| Canadian operations                  |                           |                   | \$ 58,753                | \$ 61,769         |
| Consolidated                         |                           |                   | <u>\$ 403,709</u>        | <u>\$ 457,233</u> |

No one customer accounted for more than 10% of the Company's consolidated revenues. Revenues are attributed to regions based on the location of customers.

**Note 11 - New Accounting Pronouncements**

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)), which amends SFAS No. 123, Accounting for Stock-Based Compensation, supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. SFAS No. 123(R) requires companies to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. In addition, the adoption of SFAS No. 123(R) requires additional accounting and disclosure related to the income tax and cash flow effects resulting from share-based payment arrangements. SFAS No. 123(R) is effective beginning as of the first interim or annual reporting period beginning after June 15, 2005. As permitted by Statement No. 123, the

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Company currently accounts for share-based payments to employees using Opinion No. 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of Statement No. 123(R)'s fair value method will have a significant impact on our result of operations, although it will have no impact on our overall financial position. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, if we had adopted Statement 123(R) in prior periods, the impact of that standard would have approximated the impact of Statement 123 as described in the disclosure of pro forma net income and earnings per share in Note 3 to our unaudited consolidated financial statements. Statement 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption.

**Table of Contents****Note 12 - Commitments and Contingencies**

In the ordinary conduct of the business, the Company and its colleges are subject to occasional lawsuits, investigations and claims, including, but not limited to, claims involving students and graduates and routine employment matters. When the Company is aware of a claim or potential claim, it assesses the likelihood of any loss or exposure. If it is probable that a loss will result and the amount of the loss can be reasonably estimated, the Company records a liability for the loss. If the loss is not probable or the amount of the loss cannot be reasonably estimated, the Company discloses the nature of the specific claim if the likelihood of a potential loss is reasonably possible and the amount involved is material. There can be no assurance that the ultimate outcome of any of the matters disclosed below will not have a material adverse effect on the Company's financial condition or results of operations.

On March 8, 2004, the Company was served with two virtually identical putative class action complaints entitled *Travis v. Rhodes Colleges, Inc., Corinthian Colleges, Inc., and Florida Metropolitan University*, and *Satz v. Rhodes Colleges, Inc., Corinthian Colleges, Inc., and Florida Metropolitan University*. Additionally, on May 7, 2004, the Company received another putative class action complaint entitled *Jennifer Baker, et al. v. Corinthian Colleges, Inc. and Florida Metropolitan University, Inc.* and on April 15, 2005, the Company received a complaint entitled *Alan Alvarez, et al. v. Rhodes Colleges, Inc., Corinthian Colleges, Inc., and Florida Metropolitan University, Inc.* The *Baker* complaint names nine plaintiffs while the *Alvarez* first amended and supplemental complaint names ninety-nine plaintiffs. The named plaintiffs in these lawsuits are current and former students in the Company's Florida Metropolitan University ( FMU ) campuses in Florida and online. The plaintiffs allege that FMU concealed the fact that it is not accredited by the Commission on Colleges of the Southern Association of Colleges and Schools and that FMU credits are not transferable to other institutions. The *Baker*, *Satz* and *Travis* plaintiffs seek certification of the lawsuits as class actions and seek recovery of compensatory damages and attorney's fees under common law and Florida's Deceptive and Unfair Trade Practices Act for themselves and all similarly situated people. The *Alvarez* plaintiffs seek damages on behalf of themselves under common law and Florida's Deceptive and Unfair Trade Practices Act. The Company believes the complaints are without merit and will vigorously defend itself, Rhodes Colleges, Inc., and FMU against these allegations. The Company has filed motions to compel arbitration in *Satz* and *Travis*, and the court has granted the Company's motion in the *Satz* case. Similar motions are anticipated to be filed in *Baker* and *Alvarez*.

Since July 8, 2004, various putative class action lawsuits have been filed in the United States District Court for the Central District of California by certain alleged purchasers of our common stock against the Company and certain of its current and former executive officers, David Moore, Dennis Beal, Paul St. Pierre and Anthony Digiovanni. The cases purportedly are brought on behalf of all persons who acquired shares of the Company's common stock during a specified class period from August 27, 2003 through either June 23, 2004 or July 30, 2004, depending on the complaint. The complaints allege that, in violation of Section 10(b) of the Securities Exchange Act of 1934 (the Act) and Rule 10b-5 promulgated thereunder by the SEC, the defendants made certain material misrepresentations and failed to disclose certain material facts about the condition of the Company's business and prospects during the putative class period, causing the respective plaintiffs to purchase the Company's common stock at artificially inflated prices. The plaintiffs further claim that Messrs. Moore, Beal, St. Pierre and Digiovanni are liable under Section 20(a) of the Act. The plaintiffs seek unspecified amounts in damages, interest, and costs, as well as other relief. On November 5, 2004, a lead plaintiff was chosen and these cases are now consolidated into one action. A consolidated and amended complaint was filed in February 2005. The Company believes the amended consolidated complaint is without merit and intends to vigorously defend the Company and its current and former executive officers against the allegations.

Between July 21, 2004 and July 23, 2004, two derivative actions captioned *Collet, Derivatively on behalf of Corinthian Colleges, Inc., v. David Moore, et al.* and *Davila, Derivatively on behalf of Corinthian Colleges, Inc., v. David Moore, et al.* were filed in the Orange County California Superior Court against David Moore, Dennis Beal, Dennis Devereux, Beth Wilson, Mary Barry, Stan Mortensen, Bruce Deyong, Loyal Wilson, Jack Massimino, Linda Skladany, Paul St. Pierre, Michael Berry, and Anthony Digiovanni and the Company as a

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nominal defendant. Each individual defendant is one of the Company's current or former officers and/or directors. The lawsuits allege breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment, and violations of the California corporations' code, essentially based on the same allegations of conduct complained of in the foregoing securities class action complaints. The *Collet* and *Davila* cases have now been consolidated into one action, and a consolidated complaint has been filed. The Company believes the consolidated complaint is without merit and intends to vigorously defend the Company's directors and current and former executive officers against the allegations. This consolidated action has been stayed by the court pending a decision on the Company's anticipated motion to dismiss in the federal securities action.

The California Attorney General's Office has requested that the Company provide documentation regarding three of its California Bryman Colleges and certain other general Company policies and procedures. The Attorney General's office has not asserted any claims against the Company and the Company is cooperating with the inquiry.

In February 2005, the Company received a putative class action demand in arbitration entitled *Michelle Sanchez v. Corinthian Colleges, Inc.*, filed by a former diagnostic medical sonography student from the Company's Bryman College campus in West Los Angeles, alleging violations of the state education code and of California's Business and Professions Code Section 17200. The Company believes the complaint is without merit and intends to vigorously defend itself against these allegations.

In February 2005, the Company was served with a lawsuit entitled *Nancy Tsai v. Corinthian Colleges, Inc., et al.*, filed by twenty-four current or former medical assisting students from the Company's National Institute of Technology campus in Long Beach, California, alleging fraud in the inducement, breach of contract, breach of the implied covenant of good faith and fair dealing, and violation of California Business and Professions Code Section 17200, regarding alleged misrepresentations about the eligibility of such students to take the Certified Medical Assistant examination. The complaint does not seek certification as a class action. The Company has filed demands in arbitration against each of the individual plaintiffs for breach of their contractual obligation to arbitrate rather than litigate disputes with the Company and has also filed a motion with the California Superior Court to compel the plaintiffs to binding arbitration. The Company intends to vigorously defend itself in this matter.

On April 6, 2005, the Company was served with a lawsuit entitled *Jaclyn Fisher, et al. v. Corinthian Colleges, Inc.*, filed by forty-one current or former medical assisting students from the Company's Bryman College campus in Tacoma, Washington, alleging negligent/intentional misrepresentations and violations of the state consumer protection act regarding alleged misrepresentations about the eligibility of such students to take the Certified Medical Assistant exam. The complaint does not seek certification as a class action. The Company anticipates filing a motion to compel binding arbitration and intends to vigorously defend itself in this matter.

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

This Quarterly Report on Form 10-Q contains statements that may constitute forward-looking statements as defined by the U.S. Private Securities Litigation Reform Act of 1995. Such forward-looking statements can be identified by the use of forward-looking terminology such as believes, estimates, anticipates, continues, contemplates, expects, may, will, could, should or would, or the negatives thereof, and are based on the intent, belief or expectation of the Company as of the date of this Quarterly Report. Any such forward-looking statements are not guarantees of future performance and may involve risks and uncertainties that are outside the control of the Company. Results may differ materially from the forward-looking statements contained herein as a result of changes in governmental regulations, including those governing student financial aid, the effect of competitive pressures on the Company's tuition pricing, integration risks associated with acquired campuses and other factors, including those discussed under the headings entitled Governmental Regulation and Financial Aid and Risks Related to Our Business in the Company's Annual Report on Form





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10-K (File No. 0-25283) and other documents periodically filed with the Securities and Exchange Commission. The Company expressly disclaims any obligation to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The following discussion of the Company's results of operations and financial condition should be read in conjunction with the interim unaudited condensed financial statements of the Company and the notes thereto included herein and in conjunction with the information contained in the Annual Report on Form 10-K.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts on those financial statements. On an on-going basis, we evaluate our estimates, including, but not limited to, those related to our allowance for doubtful accounts, intangible assets, deferred taxes, and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different conditions or if our assumptions change.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements:

*Revenue Recognition.* Revenues consist primarily of tuition and fees derived from courses taught in our colleges, schools, and training centers. Revenue from tuition and fees are recognized pro-rata (on a straight-line basis) over the relevant period attended by the student of the applicable course or program. If a student withdraws from a course or program, the paid but unearned portion of the student tuition is refunded. Textbook sales and other revenues are recognized as sales occur or services are performed and represent less than 10% of total revenues. Prepaid tuition is the portion of payments received but not earned and is reflected as a current liability in the accompanying unaudited condensed consolidated balance sheets as this amount is expected to be earned within the next year. Revenue is recognized for the CDI Corporate Education division using the percentage of completion method for long duration service contracts and as services are provided for short duration programs.

Students attending our post-secondary institutions enroll in either (i) diploma programs, which cover a specific area of training over a discrete length of time (averaging nine months for such programs) or (ii) courses leading to an associate, bachelor or master degree. Costs of programs or credit hours for courses are clearly identified in our enrollment agreements. At the start of each student's respective program or course of study leading to a degree, the student executes an enrollment agreement which specifies the field of study, the expected length of study, and the cost of the program or course. We recognize revenue from tuition and fees on a straight-line basis over the relevant period attended by the student of the applicable course or program of study. If a student withdraws from an institution, we cease the recognition of revenue and the paid but unearned portion of the student tuition is refunded. Additionally, to ensure the delivery of education has occurred, either attendance is taken or academic events are conducted at appropriate intervals to ensure that the student is completing his or her field of study within the acceptable time period.

*Allowance for Doubtful Accounts.* We maintain an allowance for doubtful accounts for estimated losses resulting from the inability, failure or refusal of our students to make required payments. We determine the adequacy of this allowance by regularly reviewing the accounts receivable aging and applying various expected loss percentages to certain student accounts receivable categories based upon historical bad debt experience. We generally write off accounts receivable balances deemed uncollectible as they are sent to collection agencies. We offer a variety of payment plans to help students pay that portion of their education expense not covered by financial aid programs. These balances are unsecured and not guaranteed. We



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believe our reserves are adequate; however, losses related to unpaid student balances could exceed the amounts we have reserved for bad debts.

Many of our students in the U.S. participate in federally guaranteed student loan programs. The federally guaranteed student loans are authorized by the Higher Education Act ( HEA ) of 1965 and are guaranteed by an agency of the federal government, not us. The guaranteed loans are neither guaranteed by us, nor can the student guaranteed loans become an obligation of ours. Accordingly, we do not record an obligation to repay any of the guaranteed loans that are not repaid by our former students and we do not record either a contingent obligation or an allowance for future obligations as a result of student defaults on federally guaranteed student loans.

The guarantee of student loans is provided by an agency of the federal government, not by us. If an institution's former students' default rate on guaranteed loans (Cohort Default Rate) equals or exceeds 25% for three consecutive years, the institution may lose participation eligibility in the guaranteed loan program and its students would be denied access to the guaranteed loan program. Our institutions' Cohort Default Rates act as a gatekeeper to the institutions' eligibility to participate in the federal student financial aid programs. We have no obligation to repay any of the federally guaranteed loans that our former students default upon, even if the Cohort Default Rates of our students exceed permitted levels. Rather, if the Cohort Default Rates at a particular institution exceed 25% for three consecutive years, the institution's students may lose eligibility to receive federal student financial aid.

*Goodwill and Other Intangible Assets.* We have significant goodwill and other intangible assets. Goodwill represents the excess of the cost over the fair market value of net assets acquired, including identified intangible assets. We consider a number of factors, including valuations and appraisals from independent valuation firms in determining the amounts that are assignable to other intangible assets, such as curriculum, accreditation, and trade names. The Company, however, is ultimately responsible for the valuations. The fair value of identified intangible assets is derived using accepted valuation methodologies, including cost, market, and income approaches, as appropriate, following consultations with valuation firms, and in accordance with SFAS No. 141 and requirements set forth by the Uniform Standards of Professional Appraisal Practice.

Effective July 1, 2002, we adopted SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). This standard changed the accounting for goodwill and other indefinite-lived intangible assets from an amortization method to an impairment-only approach. As of July 1, 2002, we ceased amortization of goodwill recorded in conjunction with past business combinations. In addition, we conducted a review of our other identifiable intangible assets and determined that accreditation and trade names met the indefinite life criteria outlined in SFAS No. 142. Our review considered analysis of all pertinent factors, including the expected use of the asset, any legal, regulatory, or contractual provisions that may limit the useful life, the effects of obsolescence, demand, competition, and other economic factors, and the level of maintenance expenditures required to obtain the expected future cash flows from the asset. Accordingly, we also ceased amortization of the accreditation and trade names as of July 1, 2002. Curricula continue to be amortized over their useful lives ranging generally from three to ten years and the amortization is included in general and administrative expenses in the accompanying statements of operations.

Under SFAS No. 142, goodwill is tested annually or more frequently if circumstances indicate potential impairment, by comparing its fair values to its carrying amounts at the reporting unit level as defined by SFAS 142. We determine fair value of our reporting units using the income approach of valuation that includes discounted cash flow as well as other generally accepted valuation methodologies. To the extent the fair value of a reporting unit is less than the carrying amount of its assets, we record an impairment charge in the statements of operations.

Also, under SFAS No. 142, indefinite-lived assets are tested annually or more frequently if circumstances indicate potential impairment, by comparing their fair values to their carrying amounts. To the extent the fair value of an intangible asset is less than its carrying amount, we record an impairment charge in the statements of operations. For instance, if we were to discontinue the use of a trade name or



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lose accreditation at one or more of our acquired schools to which we have ascribed value for trade names and accreditation, we would test the amounts we have allocated to such assets for impairment. Such testing would include estimating the future cash flows expected to be received from the trade names and accreditation and comparing them to their carrying values. If our estimate of the present value of these future cash flows were below the carrying values of the related assets, we would consider the assets to be impaired and take a charge against the amounts we had allocated to trade names and accreditation.

The determination of related estimated useful lives of intangible assets and whether or not these intangible assets are impaired involves significant judgment. Although we believe our goodwill and intangible assets are fairly stated, changes in strategy or market conditions could significantly impact these judgments and require adjustments to asset balances.

*Litigation.* In the ordinary conduct of the business, the Company and its colleges are subject to occasional lawsuits, investigations and claims, including, but not limited to, claims involving students and graduates and routine employment matters. When the Company is aware of a claim or potential claim, it assesses the likelihood of any loss or exposure. If it is probable that a loss will result and the amount of the loss can be reasonably estimated, the Company records a liability for the loss. If the loss is not probable or the amount of the loss cannot be reasonably estimated, the Company discloses the nature of the specific claim if the likelihood of a potential loss is reasonably possible and the amount involved is material. There can be no assurance that the ultimate outcome of any of the matters disclosed will not have a material adverse effect on the Company's financial condition or results of operations.

*Deferred Taxes.* We currently have deferred income tax assets which are subject to periodic recoverability assessments. Realization of our deferred income tax assets is principally dependent upon achievement of projected future taxable income offset by deferred income tax liabilities. We evaluate the realizability of our deferred income tax assets annually.

*Stock-based Compensation.* We account for stock-based compensation using the intrinsic value method of APB Opinion No. 25, Accounting for Stock Issued to Employees, and have adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation, related to options issued to employees and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Stock-based employee compensation cost reflected in net income relates to grants of restricted stock awards to certain officers and other executives. We recognize compensation cost on these restricted stock awards over the vesting period of the award (generally four years). The compensation expense related to the deferred portion of the awards is reflected as Deferred Compensation and included as a component of Stockholders Equity. All common stock options are accounted for using the fixed accounting method and have an exercise price equal to the market value of the underlying common stock on the date of grant.

**Table of Contents****Results of Operations**

Comparisons of results of operations between the first nine months of fiscal 2005 and the first nine months of fiscal 2004 are affected by the acquisition of AMI and its campus on August 2, 2004, as well as the opening of eight branch campuses since the end of the third quarter of fiscal 2004. Additionally, we acquired CDI and its 45 campuses and 15 training centers on August 19, 2003, Career Choices and its 10 campuses on August 1, 2003 and ECAT and its 1 campus on August 6, 2003, and their results of operations are included in the consolidated results of operations since their respective acquisition dates. At March 31, 2005, we operated 135 campuses (including 6 colleges scheduled to close by the end of fiscal 2005) and 14 training centers, compared to 132 campuses and 17 training centers at March 31, 2004. The following table summarizes our operating results as a percentage of net revenue for the periods indicated:

|  | Three Months Ended |             | Nine Months Ended |             |
|--|--------------------|-------------|-------------------|-------------|
|  | March 31,          |             | March 31,         |             |
|  | 2004               | 2005        | 2004              | 2005        |
| <b>Statement of Operations Data (Unaudited):</b> |                    |             |                   |             |
| Net revenues                                     | 100.0%             | 100.0%      | 100.0%            | 100.0%      |
| <b>Operating expenses:</b>                       |                    |             |                   |             |
| Educational services                             | 50.8               | 52.9        | 50.9              | 53.4        |
| General and administrative                       | 8.9                | 8.4         | 8.7               | 8.8         |
| Marketing and advertising                        | 22.5               | 24.0        | 22.0              | 23.9        |
| Impairment charge                                | 1.4                |             | 0.5               |             |
| <b>Total operating expenses</b>                  | <b>83.6</b>        | <b>85.3</b> | <b>82.1</b>       | <b>86.1</b> |
| Income from operations                           | 16.4               | 14.7        | 17.9              | 13.9        |
| Interest (income)                                | (0.2)              | (0.4)       | (0.2)             | (0.3)       |
| Interest expense                                 | 0.4                | 0.5         | 0.4               | 0.4         |
| Other (income) expense                           |                    | 0.1         | (0.1)             |             |
| Minority interest in income (loss) of subsidiary |                    |             |                   |             |
| <b>Income before provision for income taxes</b>  | <b>16.2</b>        | <b>14.5</b> | <b>17.8</b>       | <b>13.8</b> |
| Provision for income taxes                       | 6.4                | 5.7         | 7.1               | 5.4         |
| <b>Net income</b>                                | <b>9.8%</b>        | <b>8.8%</b> | <b>10.7%</b>      | <b>8.4%</b> |

**Three Months Ended March 31, 2005 Compared to Three Months Ended March 31, 2004**

*Net Revenues.* Net revenues increased \$36.7 million, or 16.9%, from \$217.3 million in the third quarter of fiscal 2004 to \$254.0 million in the third quarter of fiscal 2005, due primarily to a 9.3% increase in total student population and a 5.3% increase in the average tuition rate per student. At March 31, 2005, student population was 72,383, compared with 66,239 at March 31, 2004. Revenues in same schools increased 12.4% for the third quarter of fiscal 2005 and reflect a 7.3% increase in same school student population and a 4.3% increase in the average tuition rate per student in same schools. We define same schools as those colleges, schools, and training centers that have been owned and operated by us for four full quarters. Core growth in revenues increased 16.1% in the third quarter of fiscal 2005 ended March 31, 2005. We define core growth in revenues as the increase in revenues, including revenues from branches opened during the last four full quarters, but excluding revenues attributable to colleges, schools, and training centers acquired within the last four full quarters. Total student starts increased

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3.8% to 25,985 for the third quarter of fiscal 2005 when compared to the third quarter of last year. Total student starts, excluding the 10 scheduled closed campuses in Canada and the 1 U.S. closed campus, increased 5.6% when compared to the third quarter of last year. Same school student starts increased 0.1% for the quarter ended March 31, 2005 when compared to third quarter of fiscal 2004. Net revenues also increased as a result of opening 8 branch campuses and acquiring 1 campus since March 31, 2004.

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*Educational Services.* Educational services expenses include direct operating expenses of the schools consisting primarily of payroll and payroll related expenses, rents, occupancy costs, supply expenses, bad debt expense and other educational related expenses. As a percentage of net revenues, educational services expenses increased from 50.8% of revenues in the third quarter of fiscal 2004 to 52.9% of revenues in the third quarter of fiscal 2005. The increase, as a percent of revenues, was due primarily to increases in bad debt expense as well as an increase in facility costs as we seek to absorb the increase in capacity we added in fiscal 2004. Bad debt expense for the third quarter of fiscal 2005 amounted to \$12.1 million or 4.8% of net revenues, compared to \$7.7 million or 3.5% of net revenues for the third quarter of fiscal 2004. Educational services expenses increased \$23.9 million, or 21.7%, from \$110.3 million in the third quarter of fiscal 2004 to \$134.3 million in the third quarter of fiscal 2005. Overall, the increase in educational services expenses was primarily due to expenses required to support the 16.9% increase in revenue and costs related to the 8 new branch campuses and 1 acquired campus opened since March 31, 2004. Additionally, during the third quarter, 29 new programs were adopted into existing schools, including 19 program adoptions into our campuses in the U.S. and 10 program adoptions into our campuses in Canada.

*General and Administrative.* General and administrative expenses include incentive bonuses, corporate payroll related expenses, headquarters office rents and occupancy expenses, professional fees and other support related expenses. As a percentage of net revenues, general and administrative expenses decreased from 8.9% of revenues in the third quarter of fiscal 2004 to 8.4% of revenues in the third quarter of fiscal 2005. The decrease, as a percentage of revenues, was due primarily to a decrease in compensation costs offset by increases in public company compliance expenses. General and administrative expenses increased \$2.0 million, or 10.3%, from \$19.3 million in the third quarter of fiscal 2004 to \$21.3 million in the third quarter of fiscal 2005. The overall increase was also due to additional headquarters staff required to support the 16.9% increase in revenues, 9.3% increase in student population and to support the 8 new branch campus openings and 1 acquired campus since March 31, 2004.

*Marketing and Advertising.* Marketing and advertising expenses consist primarily of direct-response and other advertising expenses, payroll and payroll related expenses, promotional materials and other related marketing costs. As a percentage of net revenues, marketing and advertising expenses increased from 22.5% of revenues in the third quarter of fiscal 2004 to 24.0% of revenues for the third quarter of fiscal 2005 primarily as a result of increases in costs of television, radio, and Internet advertising. Marketing and advertising expenses increased \$12.1 million, or 24.8%, from \$48.9 million in the third quarter of fiscal 2004 to \$61.1 million in the third quarter of fiscal 2005. The increase in marketing and advertising expenses resulted in a 3.8% increase in total student starts and a 0.1% increase in same school student starts during the third quarter of fiscal 2005.

*Impairment Charge.* As a result of the decision to close two LTU campuses, the Company reviewed the long-lived assets and goodwill of LTU for possible impairment in accordance with SFAS 142 and SFAS 144. Based on the results of the review, the Company recognized a non-cash impairment loss and related charge of \$3.2 million (pre-tax) in the quarter ended March 31, 2004. The charge included \$2.8 million of intangible asset impairment and \$0.4 million of fixed asset write-offs. The fair value of the goodwill was based on the Company's estimate of discounted future cash flows.

*Income from Operations.* Income from operations increased 5.1% from \$35.6 million in the third quarter of fiscal 2004 to \$37.4 million in the third quarter of fiscal 2005. As a percentage of net revenues, income from operations decreased from 16.4% of revenues in the third quarter of fiscal 2004 to 14.7% of revenues for the third quarter of fiscal 2005.

*Interest (Income) Expense, net.* Interest expense (net of interest income of \$1.1 million) amounted to \$0.2 million in the third quarter of fiscal 2005. In the same period of the prior year, interest expense (net of interest income of \$0.4 million) amounted to \$0.5 million. The decrease in net interest expense compared to the prior year is primarily due to an increase in interest income due to an increase in interest earning investments.



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*Provision for Income Taxes.* The effective income tax rate was 39.5% of income before taxes in the third quarter of fiscal 2005 compared to 39.6% in the third quarter of fiscal 2004.

*Net Income.* Net income increased \$1.1 million from \$21.2 million in the third quarter of fiscal 2004 to \$22.4 million in the third quarter of fiscal 2005. As a percentage of net revenues, net income decreased from 9.8% of revenues in the third quarter of fiscal 2004 to 8.8% of revenues for the third quarter of fiscal 2005.

*Income per Share.* Diluted earnings per common share for the third quarter of fiscal 2005 increased 4.4% to \$0.24 per diluted common share compared to \$0.23 per diluted common share for the third quarter of fiscal 2004. On February 18, 2004, we authorized a two-for-one stock split of our common stock effected in the form of a stock dividend. The additional shares were distributed on March 23, 2004 to shareholders of record on March 4, 2004. All share and per share information has been retroactively restated to reflect the stock split.

### **Nine Months Ended March 31, 2005 Compared to Nine Months Ended March 31, 2004**

*Net Revenues.* Net revenues increased \$144.7 million, or 24.7%, from \$587.1 million in the first nine months of fiscal 2004 to \$731.9 million in the first nine months of fiscal 2005, due primarily to a 9.3% increase in total student population and a 3.7% increase in the average tuition rate per student. At March 31, 2005, student population was 72,383, compared with 66,239 at March 31, 2004. Revenues in same schools increased 16.4% for the first nine months of fiscal 2005 and reflect a 7.3% increase in same school student population and a 3.7% increase in the average tuition rate per student in same schools. We define same schools as those colleges, schools, and training centers that have been owned and operated by us for four full quarters. Core growth in revenues increased 20.4% in the first nine months of fiscal 2005 ended March 31, 2005. We define core growth in revenues as the increase in revenues, including revenues from branches opened during the last four full quarters, but excluding revenues attributable to colleges, schools, and training centers acquired within the last four full quarters. Total student starts increased 13.5% to 76,063 for the first nine months of fiscal 2005 when compared to the first nine months of last year. Same school student starts increased 6.1% as of March 31, 2005 when compared to the first nine months of fiscal 2004. Net revenues also increased as a result of opening 8 branch campuses and acquiring 1 campus since March 31, 2004, as well as the acquisitions of 71 campuses and training centers in August 2003.

*Educational Services.* Educational services expenses include direct operating expenses of the schools consisting primarily of payroll and payroll related expenses, rents, occupancy costs, supply expenses, bad debt expense and other educational related expenses. As a percentage of net revenues, educational services expenses increased from 50.9% of revenues in the first nine months of fiscal 2004 to 53.4% of revenues in the first nine months of fiscal 2005. The increase, as a percent of revenues, was due primarily to increases in facility leases and depreciation as we seek to absorb the increase in capacity we added in fiscal 2004. Additionally, bad debt expense for the first nine months of fiscal 2005 amounted to \$35.8 million or 4.9% of net revenues, compared to \$21.6 million or 3.7% of net revenues for the first nine months of fiscal 2004. Educational services expenses increased \$92.1 million, or 30.8%, from \$298.9 million in the first nine months of fiscal 2004 to \$391.0 million in the first nine months of fiscal 2005. Overall, educational services expenses increased primarily due to expenses required to support the 24.7% increase in revenue and costs related to the 8 new branch campuses and 1 acquired campus opened since March 31, 2004. Additionally, the increase in educational services expenses was attributable, in part, to the acquisitions made in August 2003. Accordingly, the results of operations for the first nine months of fiscal 2004 included these campuses since their respective dates of acquisition. During the first nine months of fiscal 2005, 89 new programs were adopted into existing schools, including 64 program adoptions into our campuses in the U.S. and 25 program adoptions into our campuses in Canada.

*General and Administrative.* General and administrative expenses include incentive bonuses, corporate payroll related expenses, headquarters office rents and occupancy expenses, professional fees and other support related expenses. As a percentage of net revenues, general and administrative expenses increased from 8.7% of revenues in the first nine months of fiscal 2004 to 8.8% of revenues in the first nine months of fiscal 2005. The



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increase, as a percentage of revenues, was due primarily to the increase in public company compliance expenses and legal costs associated with previously disclosed matters. General and administrative expenses increased \$13.2 million, or 25.9%, from \$50.9 million in the first nine months of fiscal 2004 to \$64.2 million in the first nine months of fiscal 2005. The overall increase was primarily due to additional headquarters staff required to support the 24.7% increase in revenues, 9.3% increase in student population and to support the 8 new branch campus openings and 1 acquired campus since March 31, 2004. In addition, the increase was due to higher public company compliance expenses, including accounting, legal and other professional fees.

*Marketing and Advertising.* Marketing and advertising expenses consist primarily of direct-response and other advertising expenses, payroll and payroll related expenses, promotional materials and other related marketing costs. As a percentage of net revenues, marketing and advertising expenses increased from 22.0% of revenues in the first nine months of fiscal 2004 to 23.9% of revenues for the first nine months of fiscal 2005 primarily as a result of increases in costs of television, radio and Internet advertising and an increase in admissions staff. Marketing and advertising expenses increased \$45.7 million, or 35.5%, from \$128.9 million in the first nine months of fiscal 2004 to \$174.6 million in the first nine months of fiscal 2005. The increase in marketing and advertising expenses resulted in a 13.5% increase in total student starts and a 6.1% increase in same school student starts during the first nine months of fiscal 2005.

*Impairment Charge.* As a result of the decision to close two LTU campuses, the Company reviewed the long-lived assets and goodwill of LTU for possible impairment in accordance with SFAS 142 and SFAS 144. Based on the results of the review, the Company recognized a non-cash impairment loss and related charge of \$3.2 million (pre-tax) in the quarter ended March 31, 2004. The charge included \$2.8 million of intangible asset impairment and \$389,000 of fixed asset write-offs. The fair value of the goodwill was based on the Company's estimate of discounted future cash flows.

*Income from Operations.* Income from operations decreased 3.0% from \$105.3 million in the first nine months of fiscal 2004 to \$102.1 million in the first nine months of fiscal 2005. As a percentage of net revenues, income from operations decreased from 17.9% of revenues in the first nine months of fiscal 2004 to 13.9% of revenues for the first nine months of fiscal 2005.

*Interest (Income) Expense, net.* Interest expense (net of interest income of \$2.3 million) amounted to \$0.9 million in the first nine months of fiscal 2005. In the same period of the prior year, interest expense (net of interest income of \$1.0 million) amounted to \$1.2 million.

*Provision for Income Taxes.* The effective income tax rate was 39.5% of income before taxes in the first nine months of fiscal 2005 compared to 40.0% in the first nine months of fiscal 2004.

*Net Income.* Net income decreased \$1.3 million from \$62.6 million in the first nine months of fiscal 2004 to \$61.3 million in the first nine months of fiscal 2005. As a percentage of net revenues, net income decreased from 10.7% of revenues in the first nine months of fiscal 2004 to 8.4% of revenues for the first nine months of fiscal 2005.

*Income per Share.* Diluted earnings per common share for the first nine months of fiscal 2005 decreased 1.5% to \$0.66 per diluted common share compared to \$0.67 per diluted common share for the first nine months of fiscal 2004. On February 18, 2004, we authorized a two-for-one stock split of our common stock effected in the form of a stock dividend. The additional shares were distributed on March 23, 2004 to shareholders of record on March 4, 2004. All share and per share information has been retroactively restated to reflect the stock split.

**Seasonality and Other Factors Affecting Quarterly Results**

Our net revenues normally fluctuate as a result of seasonal variations in our business. Student population varies as a result of new student enrollments and student attrition. Historically, our colleges, schools, and training

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centers have had lower revenues in the first fiscal quarter than in the remainder of the year. Our expenses, however, do not vary as significantly as student population and revenues. We expect quarterly fluctuations in operating results to continue as a result of seasonal enrollment patterns. More importantly, quarterly results may be impacted based on the timing and extent of new acquisitions, new branch openings, relocations and remodels, new program adoptions and increased high school enrollments. The operating results for any quarter are not necessarily indicative of the results for any future period.

## **Liquidity and Capital Resources**

On August 15, 2003, we amended our credit facility, and increased it to \$235 million, of which \$185 million is a domestic facility and \$50 million is a Canadian facility. The amended credit agreement expires in August 2006. The amended credit agreement has been established to provide available funds for acquisitions, to fund general corporate purposes, and to provide for letter of credit issuances of up to \$25 million for domestic letters of credit and \$10 million for Canadian letters of credit. Borrowings under the agreement bear interest at several pricing alternatives available to us, including Eurodollar and adjusted reference or base rates. The base rate is defined as the higher of the Federal Funds rate plus 1/2 of 1% or the Bank of America prime rate, plus a margin of 0% to 0.25% depending on our consolidated leverage ratio as defined in the agreement. The agreement contains customary affirmative and negative covenants including financial covenants requiring the maintenance of consolidated net worth, fixed charge coverage ratios, leverage ratios, Department of Education financial responsibility composite score ratio, and limitations on long-term student notes receivable. As of March 31, 2005, we were in compliance with all of the covenants. As of March 31, 2005, the credit facility had borrowings outstanding of \$47.0 million and approximately \$25.9 million was used to support performance bonds and standby letters of credit. The amended credit agreement is secured by the stock of our significant operating subsidiaries and it is guaranteed by our present and future significant operating subsidiaries.

Working capital amounted to \$85.4 million as of March 31, 2005 and \$62.1 million as of June 30, 2004 and the current ratios were 1.7:1 and 1.6:1, respectively. During the first quarter of fiscal 2005, we completed the acquisition of AMI. The purchase price was approximately \$11.0 million, net of cash acquired, and was funded with cash on hand. In August 2003, during the first quarter of fiscal 2004, we completed the acquisitions of 71 campuses and training centers in three separate transactions with East Coast Aero Tech, Career Choices, and CDI. The combined cash purchase price of the three acquisitions was funded with cash on hand and borrowings of approximately \$50 million from the credit facility.

Cash flows provided by operating activities amounted to \$103.2 million in the first nine months of fiscal 2005 compared to \$113.5 million provided by operating activities in the same period of fiscal 2004. The decrease in cash provided by operating activities for the first nine months of fiscal 2005 compared to the first nine months of fiscal 2004 was primarily due to a reduction in tax benefits related to stock option exercises in the first nine months of fiscal 2005 compared to 2004.

Cash flows used in investing activities amounted to \$123.7 million in the first nine months of fiscal 2005 compared to cash flows used in investing activities of \$150.4 million in the first nine months of fiscal 2004. Cash was used in the first nine months of fiscal 2005 to acquire AMI for \$9.1 million, net of cash received and to invest in short term investments for \$53.7 million. Cash used in investing activities in the first nine months of fiscal 2004 was primarily due to the acquisitions of ECAT, Career Choices, and CDI. Capital expenditures increased to approximately \$60.9 million in the first nine months of fiscal 2005 compared to \$52.9 million in the same period in fiscal 2004. Capital expenditures in fiscal 2005 were incurred, primarily, for relocations, remodels and enlargements of existing campuses, to construct new branch campuses, and to fund information systems expenditures. We expect capital expenditures to be approximately \$85 million for fiscal 2005.

Cash flows provided by financing activities for the first nine months of fiscal 2005 amounted to approximately \$3.0 million compared to cash flows provided by financing activities of \$60.0 million for the first nine months of fiscal 2004. The decrease in cash provided by financing activities in the first nine months of fiscal



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2005 compared to the same period last year, was due primarily to a reduction in our borrowings on our line of credit and fewer stock option exercises. We funded our cash needs through cash flow provided from operations.

### *Leases*

The Company currently leases almost all of its administrative and educational facilities under operating lease agreements. On February 7, 2005, the Office of the Chief Accountant of the Securities and Exchange Commission ( OCASEC ) issued a letter to the American Institute of Certified Public Accountants expressing its views regarding certain operating lease accounting issues and their application under generally accepted accounting principles in the United States of America. In light of this letter, the Company initiated a review of its lease-related accounting and determined that its previous method of accounting for leasehold improvements funded by landlord incentives or allowances under operating leases ( tenant improvement allowances ) was not in accordance with the guidance provided by OCASEC.

The Company has historically accounted for tenant improvement allowances as reductions to the related leasehold improvement asset on the condensed consolidated balance Sheets and capital expenditures in investing activities on the condensed consolidated statements of cash flows. Management determined that the appropriate interpretation of Financial Accounting Standards Board ( FASB ) Technical Bulletin No. 88-1, Issues Relating to Accounting for Leases, requires these allowances to be recorded as a deferred rent liability on the condensed consolidated balance Sheets and as a component of operating activities on the condensed consolidated statements of cash Flows. As a result of these reclassifications, the purchases of leasehold improvements and related amortization expense will increase and will be offset by a corresponding increase in the deferred rent liability and a reduction in rent expense for all periods presented. There is no impact on the condensed consolidated statements of operations as a result of this reclassification. In the third quarter of 2005, the Company reclassified \$15.1 million and \$22.0 million of unamortized tenant improvement allowances from leasehold improvements to a long-term deferred rent liability in its condensed consolidated balance sheets as of June 30, 2004 and March 31, 2005, respectively. In addition, for the nine-months ended March 31, 2004 and 2005, the Company reclassified \$6.4 million and \$9.1 million, respectively in the condensed consolidated statements of cash flows from purchases of property and equipment included in investing activities to depreciation and amortization expense and other liabilities included in operating activities. These reclassifications did not have a material effect on the prior periods.

A tabular presentation of our contractual obligations at June 30, 2004, is provided in the Liquidity and Capital Resources portion of Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K as filed with the Securities and Exchange Commission. There were no material changes in our contractual obligations during the first nine months of fiscal 2005.

### **Update Regarding Regulatory and Accreditation Matters**

*DOE Program Updates:* As previously disclosed, the U.S. DOE conducted a program review at our Bryman College in San Jose, California in December 2003. Shortly thereafter, that school was placed on reimbursement status by the DOE. On September 22, 2004, the Company announced that the DOE had returned the campus to the advance system of funding. As required by the DOE, we delivered a written response to the program review on December 14, 2004. We believe the costs associated with the review will not have a material adverse impact on our results of operations or financial condition. We expect to receive a final determination letter from the DOE regarding the program review, the timing of which is undetermined. Although we have had a cooperative working relationship with the DOE during the program review, we will have the right to an administrative appeal of the DOE's determination, if we determine that is appropriate.

*Accreditation Actions.* As previously reported, three of our schools had previously received show cause orders from their respective institutional accrediting agencies. A show cause order is issued based upon an accrediting agency's concerns that an accredited institution may be out of

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compliance with one or more accrediting standards. It affords the institution the opportunity to respond before any adverse action is taken. The institution may demonstrate that the concern is unfounded or that it has taken corrective action to resolve the concern. The accrediting agency may then vacate the show cause order, continue the show cause order or seek additional information through reports required of the institution. If the agency's concerns are not resolved, it may act to withdraw accreditation from the institution.



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The Accrediting Commission of Career Schools and Colleges of Technology ( ACCSCT ) recently vacated the previously reported show cause order for Bryman College, West Los Angeles, California. We expect to respond to ACCSCT with respect to the previously reported show cause order for Georgia Medical Institute in a timely manner and will continue to work with ACCSCT to address and resolve any concerns regarding that school .

Following our response, the Accrediting Council of Independent Colleges and Schools ( ACICS ) vacated the previously reported show cause order for Mountain West College in Salt Lake City, Utah.

ACCSCT also recently issued a show cause order to Bryman Institute in Chelsea, Massachusetts. That show cause order has also since been vacated.

We believe we will be able to satisfactorily respond to the remaining show cause order regarding Georgia Medical Institute and work with the accrediting agency to resolve its concerns. Accordingly, we believe the remaining show cause order will not have a material adverse impact on our results of operations or financial condition.

### **Item 3. Quantitative and Qualitative Disclosure about Market Risk**

We are exposed to the impact of interest rate changes and foreign currency fluctuations. We do not utilize interest rate swaps, forward or option contracts on foreign currencies or commodities, or other types of derivative financial instruments to manage these risks.

*Interest Rate Exposure.* As of March 31, 2005, our only assets or liabilities subject to risks from interest rate changes are (i) mortgage debt and debt under the credit facility in the aggregate amount of \$48.4 million and capital lease obligations of \$12.5 million, and (ii) student notes receivable, net, in the aggregate amount of \$6.0 million. Our mortgage debt, capital lease obligations and student notes receivable are all at fixed interest rates. We do not believe we are subject to material risks from reasonably possible near-term changes in market interest rates.

*Foreign Currency Exposure.* A portion of our operations consists of an investment in a foreign subsidiary whose functional currency is the Canadian dollars. Our investment in our foreign operations as of March 31, 2005 was CAD \$51.9 million and we had borrowings outstanding under the credit facility of CAD \$56.8 million. As a result, the consolidated financial results have been and could continue to be affected by changes in foreign currency exchange rates.

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

The Company maintains certain disclosure controls and procedures designed to ensure that the information required to be disclosed by the Company in its periodic reports filed with the SEC is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and that the information is communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, on a timely basis to permit decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, the Company's management recognizes that any controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving the desired control objectives, and management's duties require it to make its best judgment regarding the design of such controls and procedures.

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The Company and its management, including the Chief Executive Officer and Chief Financial Officer, evaluate the effectiveness of the design and implementation of the Company's disclosure controls and procedures on an ongoing basis. Based on these evaluations, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of March 31, 2005.

There has been no change in the Company's internal control over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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Section 404 of the Sarbanes-Oxley Act of 2002 requires the Company to include an internal control report from management in its Annual Report on Form 10-K for the year ended June 30, 2005. In order to achieve compliance with Section 404 within the required timeframe, the Company has been conducting a process to document and evaluate its internal controls over financial reporting since late 2003. The Company has dedicated significant internal resources, hired additional staff and engaged outside consultants to assist in the project. During fiscal 2005, the Company has accelerated and intensified these efforts; however, the documentation and testing is continuing. There is a risk that during the course of these efforts, the Company may identify deficiencies that it may not be able to remediate in time to meet the June 30, 2005 deadline for compliance with Section 404. Management's current view is that the work required to be performed by the Company can be completed on a timely basis, such that the Company's external auditors would have sufficient time to complete their work on evaluating the results of management's assessment and the effectiveness of internal control prior to the Form 10-K filing deadline. In a letter dated April 22, 2005, the Company's external auditors notified management and the audit committee of the Company's board of directors that a significant amount of work remains and the schedule is extremely tight. If management is not able to adhere to its timetable, the external auditors could provide no assurances regarding their ability to complete their assessment and report on internal control over financial reporting by the filing deadline, which would be necessary for the Company to be in compliance with the SEC's rules.

The Company is endeavoring to complete the documentation and testing process in a timely manner and believes it is devoting sufficient resources to achieve this goal. However, the Company can provide no assurances that it will meet this objective. Even if the Company is able to complete the documentation and testing process in a timely manner, it can provide no assurance as to its, or its independent public accounting firm's, conclusions as of June 30, 2005 with respect to the effectiveness of its internal controls over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

See Note 12 to the attached condensed consolidated financial statements regarding Commitments and Contingencies.

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

None

### **Item 3. Defaults Upon Senior Securities**

None

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

None

**Item 5. Other Information**

None

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**Item 6. Exhibits**

(a) Exhibits:

|              |  |
|--------------|--|
| Exhibit 10.1 | Description of Verbal Arrangements with Members of the Company's Board of Directors                                    |
| Exhibit 31.1 | Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                        |
| Exhibit 31.2 | Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                        |
| Exhibit 32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.2 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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**CORINTHIAN COLLEGES, INC. AND SUBSIDIARIES**

**SIGNATURES**

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

CORINTHIAN COLLEGES, INC.

May 11, 2005

/s/ JACK D. MASSIMINO

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**Jack D. Massimino**

**President and Chief Executive Officer**

**(Principal Executive Officer)**

May 11, 2005

/s/ KENNETH S. ORD

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**Kenneth S. Ord**

**Executive Vice President and Chief Financial Officer**

**(Principal Financial Officer)**

May 11, 2005

/s/ ROBERT C. OWEN

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**Robert C. Owen**

**Senior Vice President and Chief Accounting Officer**

**(Principal Accounting Officer)**