LINCOLN EDUCATIONAL SERVICES CORP
Form 10-Q
November 14, 2006

U. S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

or

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

Commission File Number 000-51371

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

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

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

(973) 736-9340
(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 ý No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer ý

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

As of November 13, 2006, there were 25,440,695 shares of the registrant's common stock outstanding.

LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES

INDEX TO FORM 10-Q

FOR THE QUARTER ENDING SEPTEMBER 30, 2006

Index

PART I - FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS

LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

	September 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 12,440	$ 50,257
Restricted cash	2,424	-
Accounts receivable, less allowance of $11,714 and $7,647 at September 30, 2006 and December 31, 2005, respectively	22,200	13,950
Inventories	2,571	1,764
Deferred income taxes	4,819	3,545
Due from federal funds	374	-
Prepaid expenses and other current assets	3,499	3,190
Prepaid income taxes	1,105	-
Other receivable	-	452
Total current assets	49,432	73,158
PROPERTY, EQUIPMENT AND FACILITIES - At cost, net of accumulated depreciation and amortization of $69,482 and $59,570 at September 30, 2006 and December 31, 2005, respectively	93,268	68,932
OTHER ASSETS:		
Deferred finance charges	1,067	1,211
Interest rate swap agreement	184	-
Prepaid pension cost	5,046	5,071
Deferred income taxes	145	2,790
Goodwill	84,578	59,467
Other assets	4,211	4,163
Total other assets	95,231	72,702
TOTAL	$ 237,931	$ 214,792
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt and lease obligations	$ 335	$ 283
Unearned tuition	32,680	34,930
Accounts payable	16,123	12,675
Accrued expenses	12,562	11,060
Advance payments of federal funds	-	840
Income taxes payable	-	4,085
Total current liabilities	61,700	63,873

NONCURRENT LIABILITIES:				
Long-term debt and lease obligations, net of current portion		26,682		10,485
Other long-term liabilities		5,314		4,444
Total liabilities		93,696		78,802
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS' EQUITY:				
Preferred stock, no par value - 10,000 shares authorized, no shares issued andoutstanding at September 30, 2006 and December 31, 2005		-		-
Common stock, no par value - authorized 100,000 shares at September 30, 2006 and December 31, 2005, issued and outstanding 25,431 shares at September 30, 2006 and 25,168 shares at December 31, 2005		120,122		119,453
Additional paid-in capital		7,448		5,665
Deferred compensation		(527)		(360)
Retained earnings		17,192		11,232
Total stockholders' equity		144,235		135,990
TOTAL	$	237,931	$	214,792

See notes to unaudited condensed consolidated financial statements.

1

Index

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
REVENUES	$ 84,505	$ 78,352	$ 235,381	$ 217,457
COSTS AND EXPENSES:				
Educational services and facilities	36,818	32,514	101,565	91,158
Selling, general and administrative	43,064	37,943	122,687	115,091
Loss (gain) on sale of assets	(7)	(3)	(7)	(3)
Total costs & expenses	79,875	70,454	224,245	206,246
OPERATING INCOME	4,630	7,898	11,136	11,211
OTHER:				
Interest income	82	278	860	308
Interest expense	(696)	(472)	(1,740)	(2,429)
Other income (loss)	(200)	243	(130)	243
INCOME BEFORE INCOME TAXES	3,816	7,947	10,126	9,333
PROVISION FOR INCOME TAXES	1,584	2,462	4,166	3,034
NET INCOME	$ 2,232	$ 5,485	$ 5,960	$ 6,299
Earnings per share - basic:				
Net income available to common shareholders	$ 0.09	$ 0.22	$ 0.24	$ 0.27
Earnings per share - diluted:				
Net income available to common shareholders	$ 0.09	$ 0.21	$ 0.23	$ 0.26
Weighted average number of common shares outstanding:				
Basic	25,410	25,037	25,300	22,908
Diluted	26,120	25,992	26,081	24,011

See notes to unaudited condensed consolidated financial statements.

Index

LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(In thousands)
(Unaudited)

	Common Stock		Additional Paid-in	Deferred	Retained	
	Shares	Amount	Capital	Compensation	Earnings	Total
BALANCE - December 31, 2005	25,168	$ 119,453	$ 5,665	$ (360)	$ 11,232	$ 135,990
Net income	-	-	-	-	5,960	5,960
Reduction of issuance expenses associated with the initial public offering	-	150	-	-	-	150
Issuance of restricted stock and amortization of deferred compensation	19	-	300	(167)	-	133
Stock-based compensation expense	-	-	1,000	-	-	1,000
Tax benefit of options exercised	-	-	483	-	-	483
Exercise of stock options	244	519	-	-	-	519
BALANCE - September 30, 2006	25,431	$ 120,122	$ 7,448	$ (527)	$ 17,192	$ 144,235

See notes to unaudited condensed consolidated financial statements.

Index

LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 5,960	$ 6,299
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,076	9,602
Amortization of deferred finance charges	144	148
Write-off of deferred finance costs	-	365
Deferred income taxes	(2,983)	(342)
Fixed asset donations	(16)	-
Loss (gain) on disposal of assets	(7)	(3)
Provision for doubtful accounts	12,268	8,055
Stock-based compensation expense	1,133	1,160
Tax benefit associated with exercise of stock options	483	620
Deferred rent	850	1,247
(Increase) decrease in assets, net of acquisitions:		
Accounts receivable	(19,797)	(9,704)
Inventories	(720)	(323)
Prepaid expenses and current assets	(498)	738
Other assets	492	510
Increase (decrease) in liabilities, net of acquisitions:		
Accounts payable	2,562	1,157
Other liabilities	(1,084)	(1,214)
Prepaid income taxes	(5,190)	(916)
Accrued expenses	1,453	(576)
Unearned tuition	(4,460)	(3,594)
Total adjustments	(4,280)	6,930
Net cash provided by operating activities	1,666	13,229
CASH FLOWS FROM INVESTING ACTIVITIES:		
Restricted cash	(2,424)	-
Capital expenditures	(13,806)	(11,527)
Acquisitions, net of cash acquired	(32,807)	(18,755)
Net cash used in investing activities	(49,037)	(30,282)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from borrowings	12,000	31,000
Payments on borrowings	(2,079)	(66,750)
Payments of deferred finance fees	-	(833)
Proceeds from exercise of stock options	519	596
Principal payments under capital lease obligations	(886)	(234)
Repayment from shareholder loans	-	181
Proceeds from issuance of common stock, net of issuance costs of $6,956 and $6,895 as of September 30, 2006 and 2005, respectively.	-	56,343

Net cash provided by financing activities		9,554		20,303
NET DECREASE IN CASH AND CASH EQUIVALENTS		(37,817)		3,250
CASH AND CASH EQUIVALENTS—Beginning of period		50,257		41,445
CASH AND CASH EQUIVALENTS—End of period	$	12,440	$	44,695
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid during the year for:				
Interest	$	1,704	$	2,002
Income taxes	$	11,859	$	4,456
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:				
Cash paid during the period for:				
Fair value of assets acquired	$	40,021	$	22,303
Net cash paid for the acquisitions		(32,807)		(18,755)
Liabilities assumed	$	7,214	$	3,548

See notes to unaudited condensed consolidated financial statements.

Index

LINCOLN EDUCATIONAL SERVICES CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005
(In thousands, except share and per share amounts and unless otherwise stated)
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Activities - Lincoln Educational Services Corporation and its wholly owned subsidiaries ("LESC" or the "Company") operate career-oriented post-secondary schools in various locations, which offer technical programs of study in several different specialties.

Basis of Presentation - The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission and in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Certain information and footnote disclosures normally included in annual financial statements have been omitted or condensed pursuant to such regulations. These statements, when read in conjunction with the December 31, 2005 consolidated financial statements of the Company reflect all adjustments, consisting solely of normal recurring adjustments, necessary to present fairly the consolidated financial position, results of operations, and cash flows for such periods. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2006.

The unaudited condensed consolidated financial statements as of September 30, 2006 and the condensed consolidated financial statements as of December 31, 2005 and for the three and nine months ended September 30, 2006 and 2005 include the accounts of the Company. All significant intercompany accounts and transactions have been eliminated.

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

Restricted Cash - Restricted cash represents amounts received from the federal and state governments under various student aid grant and loan programs. These funds are either received prior to the completion of the authorization and disbursement process for the benefit of the student or just prior to that authorization. Restricted funds are held in separate bank accounts. Once the authorization and disbursement process has been completed and authorization obtained, the funds are transferred to unrestricted accounts, and these funds then become available for use in the Company's current operations.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 158, *"Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)."* Among other items, SFAS 158 requires recognition of the overfunded or underfunded status of an entity's defined benefit postretirement plan as an asset or liability in the financial statements, requires the measurement of defined benefit postretirement plan assets and obligations as of the end of the employer's fiscal year, and requires recognition of the funded status of defined benefit postretirement plans in other comprehensive income. SFAS 158 is effective for fiscal years ending after December 15, 2006. The adoption of the provision of SFAS No. 158 is not expected to have a material effect on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements."* SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. The provisions of SFAS No. 157 are effective as of January 1, 2008. The adoption of the provision of SFAS No. 157 is not expected to have a material effect on the Company's consolidated financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin ("SAB") No. 108 which provides interpretive guidance on how the effects of the carryover or reversal of prior year unrecorded misstatements should be considered in quantifying a current year misstatement. SAB No. 108 is effective for us as of January 1, 2007. The adoption of the provision of SAB No. 108 is not expected to have a material effect on the Company's consolidated financial statements.

Index

In June 2006, FASB issued FASB Interpretation ("FIN") No. 48, "*Accounting for Uncertainty in Income Taxes*." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB SFAS No. 109, "Accounting for Income Taxes". This Interpretation defines the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the effect that the adoption of FIN 48 will have on its consolidated financial statements.

In March 2006, FASB issued SFAS No. 156, "*Accounting for Servicing of Financial Assets.*" SFAS No. 156 provides guidance addressing the recognition and measurement of separately recognized servicing assets and liabilities, common with mortgage securitization activities, and provides an approach to simplify efforts to obtain hedge accounting treatment. SFAS No. 156 is effective for all separately recognized servicing assets and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006, with early adoption being permitted. The adoption of the provision of SFAS No. 156 is not expected to have a material effect on the Company's consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, "*Accounting for Certain Hybrid Financial Instruments*." SFAS No. 155 is effective beginning January 1, 2007. The adoption of the provision of SFAS No. 155 is not expected to have a material effect on the Company's consolidated financial statements.

In June 2005, the FASB issued SFAS No. 154,*"Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3*." SFAS No. 154 applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. Accounting Principles Boards ("APB") Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS No. 154 requires that a change in method of depreciation, amortization, or depletion for long-lived, nonfinancial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. APB Opinion No. 20 previously required that such a change be reported as a change in accounting principle. The Company adopted SFAS No. 154 on January 1, 2006. The adoption of the provisions of SFAS No. 154 had no effect on the Company's consolidated financial statements.

In March 2005, the FASB issued FIN 47, "*Accounting for Conditional Asset Retirement Obligations"*. FIN 47 clarifies that a conditional asset retirement obligation, as used in SFAS 143, "*Accounting for Asset Retirement Obligations*," refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of the settlement are conditional on a future event that may or may not be within the control of the entity. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value can be reasonably estimated. The Company adopted FIN 47 on January 1, 2006. The adoption of the provisions of FIN 47 had no effect on the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153,*"Exchanges of Nonmonetary Assets, an Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions*." SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets and requires that such exchanges be measured at fair value, with limited exceptions. SFAS No. 153 amends APB Opinion No. 29*"Accounting for Nonmonetary Transactions,"* by eliminating the exception that required nonmonetary exchanges of similar productive assets be recorded on a carryover basis. The Company adopted SFAS No. 153 on January 1, 2006. The adoption of the provisions of SFAS No. 153 had no effect on the Company's consolidated financial statements.

3. STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "*Share-Based Payment*," ("FAS 123R"). This Statement requires companies to expense the estimated fair value of stock options and similar equity instruments issued to employees over the estimated service period. On December 1, 2005, the Company adopted FAS 123R in advance of the mandatory adoption date of the first quarter of 2006 to better reflect the full cost of employee compensation. The Company adopted FAS 123R using the modified prospective method, which requires it to record compensation expense for all awards granted after the date of adoption, and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. Prior to the adoption of FAS 123R, the Company recognized stock-based compensation under FAS 123 *"Stock Based Compensation"* and as a result, the implementation of FAS 123R did not have a material impact on the Company's financial presentation. Reflected in the accompanying statements of income is compensation expense of approximately $0.3 million and $0.4 million for the three months ended September 30, 2006 and 2005 and $1.0 million and $1.1 million for the nine months ended September 30, 2006 and 2005, respectively.

The fair value concepts were not changed significantly under FAS 123R from those utilized under FAS No. 123; however, in adopting this Standard, companies must choose among alternative valuation models and amortization assumptions. After assessing these alternatives, the Company decided to continue using the Black-Scholes valuation model. However, the Company decided to utilize straight-line amortization of compensation expense over the requisite service period of the grant, rather than over the individual grant requisite period as chosen under FAS 123. Under FAS 123, the Company had recognized stock option forfeitures as they incurred. Commencing with the adoption of FAS 123R, the Company makes an estimate of expected forfeitures upon grant issuance.

Index

4. WEIGHTED AVERAGE COMMON SHARES

The weighted average numbers of common shares used to compute basic and diluted income per share for the three and nine months ended September 30, 2006 and 2005, respectively, were as follows:

	Three Months Ended September 30, (in thousands)		Nine Months Ended September 30, (in thousands)	
	2006	2005	2006	2005
Basic shares outstanding	25,410	25,037	25,300	22,908
Dilutive effect of stock options	710	955	781	1,103
Diluted shares outstanding	26,120	25,992	26,081	24,011

For the three and nine months ended September 30, 2006 and 2005, options to acquire 240,500 and 206,923 shares, respectively, were excluded from the above table as the result on reported earnings per share would have been antidilutive.

5. BUSINESS ACQUISITIONS

On May 22, 2006, a wholly-owned subsidiary of the Company, acquired New England Institute of Technology at Palm Beach, Inc. (“FLA”) for approximately $40.0 million, net of cash acquired. The FLA purchase price has been preliminarily allocated to identifiable net assets with the excess of the purchase price over the estimated fair value of the net assets acquired recorded as goodwill.

On December 1, 2005, a wholly-owned subsidiary of the Company acquired Euphoria Institute LLC (“EUP”) for approximately $9.2 million, net of cash acquired.

On January 11, 2005, a wholly-owned subsidiary of the Company acquired New England Technical Institute (“NETI”) for approximately $18.8 million, net of cash acquired.

The consolidated financial statements include the results of operations of FLA, EUP and NETI from their respective acquisition dates. The purchase prices have been allocated to identifiable net assets with the excess of the purchase price over the estimated fair value of the net assets acquired recorded as goodwill. None of the acquisitions were deemed material to the Company’s financial statements.

The following unaudited pro forma results of operations for the nine months ended September 30, 2006 and three and nine months ended September 30, 2005 assumes that the acquisitions occurred at the beginning of the year of acquisition. For the three months ended September 30, 2006, all acquisitions were owned for the entire period. The unaudited pro forma results of operations are based on historical results of operations, include adjustments for depreciation, amortization, interest, and taxes, but do not necessarily reflect the actual results that would have occurred.

	Nine months ended September 30, 2006		
	Historical 2006	Pro forma impact FLA 2006	Pro forma 2006
Revenue	$		