accelerating opportunity

>>about the company

the company

ITT Educational Services, Inc. ("ESI") is a leading provider of technology-oriented postsecondary degree programs. At the end of 1999, ESI operated 67 ITT Technical Institutes in 28 states, which predominantly provided career-focused degree programs of study in fields of technology to more than 26,000 students. Headquartered in Indianapolis, Indiana, ESI has been actively involved in the higher education community in the United States since 1969. Shares are traded on the New York Stock Exchange under the symbol "ESI." ESI has graduated approximately 150,000 students since 1969, including 80,000 in the last 10 years.

the campuses

Each ITT Technical Institute is authorized by the state in which it is located and nationally accredited or seeking accreditation by an accrediting commission recognized by the U.S. Department of Education.

the curricula

Curriculum offerings, leading primarily to associate's and bachelor's degrees, are designed to help students begin to prepare for career opportunities in various fields involving technology, such as information technology, electronics, computer-aided drafting, industrial design, automated manufacturing, computer visualization, telecommunications and chemical technology. Programs of study offered at the ITT Technical Institutes blend traditional academic content with applied learning concepts.

Advisory committees, comprised of representatives of local businesses and employers, help each ITT Technical Institute periodically assess and update curricula, equipment and laboratory design.

the annual meeting of shareholders

will be held at 10 a.m. local time, on Wednesday, May 10, 2000 at The Jefferson Hotel, 1200 16th Street, NW, Washington, D.C. 20036

highlights

Dollars in thousands, except per share data.

	1999	1998
Revenue	$316,370	$291,375
Net Income	$24,905 (1)	$23,157 (2)
Earnings Per Share: Diluted	$0.98 (1)	$0.85 (2)
Average Outstanding Shares	25,235	27,002
Shareholders Equity at Year End	$57,771	$101,856
Shareholders' Equity Per Common Share	$2.35	$3.77
Capital Expenditures, Net	$17,005	$11,381
Number of ITT Technical Institutes at Year End (3)	67	65
Student Enrollment at Year End	26,428	25,608
Number of Employees	3,400	3,120

(1) Before one-time expenses and cumulative effect of change in accounting of $1,377 (after tax).
(2) Before one-time expenses of $9,216 (after tax).
(3) ITT Technical institutes that initiated classes prior to the end of the stated year.

the students' schedules

Students attend classes year-round with convenient breaks provided throughout the year. Year-round classes enable students to complete bachelor's degree programs and begin to pursue their careers in as few as three years. Bachelor's degree programs are offered only at selected campuses. Classes in most programs (other than in the information technology curricula) are typically offered in four-hour sessions, five days a week, and are generally available in the morning, afternoon and evening, depending on student enrollment. Most information technology programs are offered three days per week, four hours per day. This class schedule provides students with flexibility to pursue employment opportunities.

market share

According to U.S. Department of Education data, the ITT Technical Institutes granted the largest percentage (12.9 percent) of associate's and bachelor's degrees awarded in the U.S. in electronics and electronics-related programs in the 1996-1997 school year, the latest year for which statistics are available. The ITT Technical Institutes also awarded the largest share (20.5 percent) of associate's and bachelor's degrees awarded in the U.S. in drafting programs during the 1996-1997 school year.

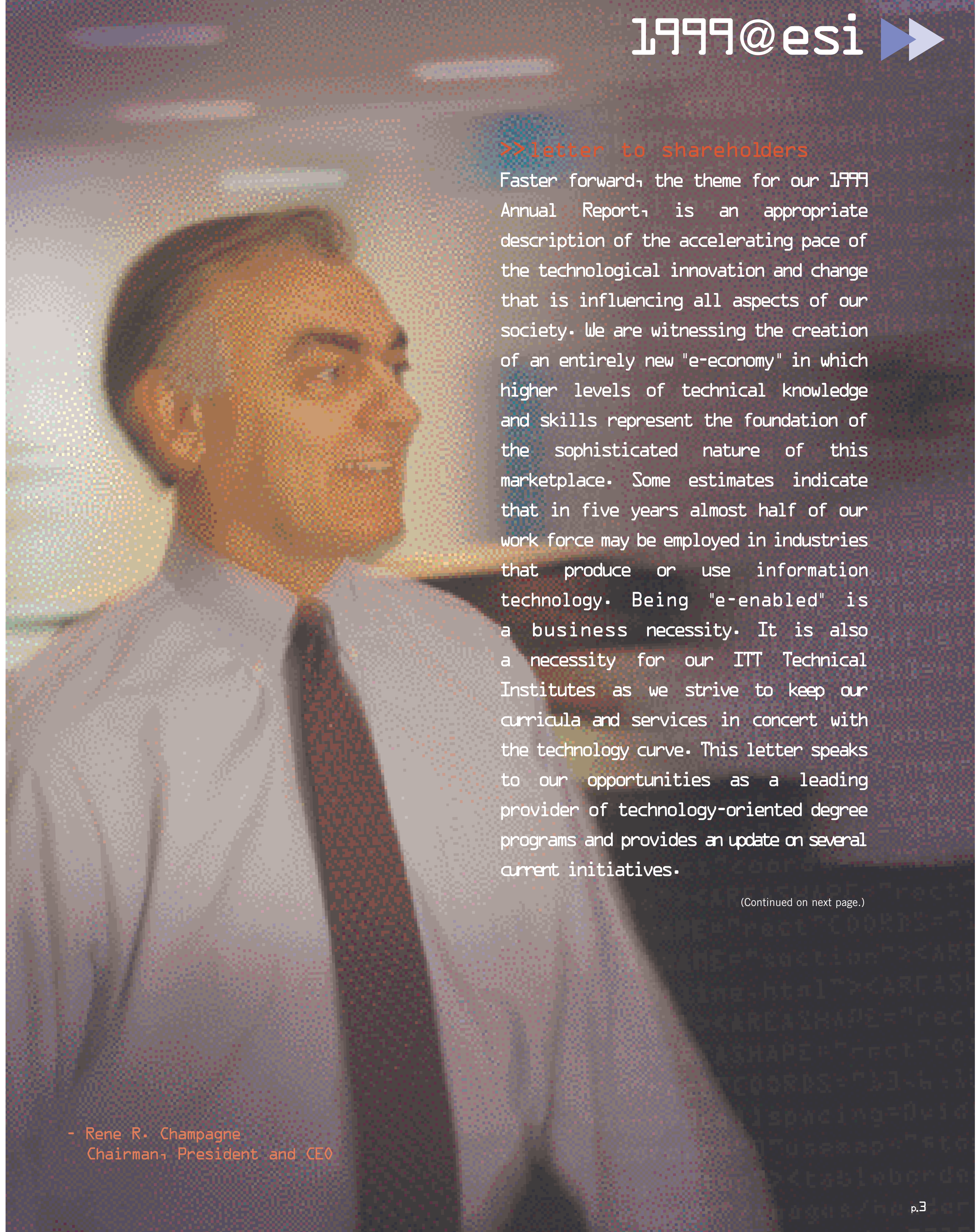
growth

The ITT Technical Institutes are positioned to benefit from projected demographic, economic and social trends. These trends include:

- changes in workplace demands;
- recognition of the value of higher education;
- an increasing number of high school graduates in the U.S.;
- growing demand for higher education by working adults; and
- an increasing demand for technically-skilled workers.

shareholders' information

Financial information about ESI and the annual report to the Securities and Exchange Commission on Form 10-K are available without charge (except for certain exhibits) upon written request to ESI's Investor Relations Department at: www.ittesi.com or ITT Educational Services, Inc., 5975 Castle Creek Parkway, North Drive, Indianapolis, Indiana 46250.



>>letter to shareholders

Faster forward, the theme for our 1999 Annual Report, is an appropriate description of the accelerating pace of the technological innovation and change that is influencing all aspects of our society. We are witnessing the creation of an entirely new "e-economy" in which higher levels of technical knowledge and skills represent the foundation of the sophisticated nature of this marketplace. Some estimates indicate that in five years almost half of our work force may be employed in industries that produce or use information technology. Being "e-enabled" is a business necessity. It is also a necessity for our ITT Technical Institutes as we strive to keep our curricula and services in concert with the technology curve. This letter speaks to our opportunities as a leading provider of technology-oriented degree programs and provides an update on several current initiatives.

(Continued on next page.)

- Rene R. Champagne
Chairman, President and CEO

As the technology revolution changes the workplace and the new "e-economy" expands, a serious deficiency of technically-skilled personnel is exacerbating an already tight labor supply in the country. The result is a growing demand for postsecondary technical education by practically every segment of the work force, from recent high school graduates to older working adults.

Faster forward. After consulting with employers and educators in 1998, we created a new degree program in computer network systems to help students develop the knowledge and skills in Information Technology ("IT") that employers are requesting. We began offering this program at one ITT Technical Institute in the third quarter of 1998. Since then, we have expanded to 34 the number of schools offering the computer network systems program. More than 3,500 new students have enrolled in the computer network systems program since its introduction.

The 33 ITT Technical Institutes that don't yet offer the IT program are each scheduled to begin offering it during 2000. We believe that the introduction of IT curricula into our 67 institutes will provide the company with attractive enrollment growth opportunities in the future.

1999 accomplishments

The IT program in computer network systems was offered at 34 ITT Technical Institutes. Overall, those 34 schools increased their new student enrollment by approximately 21 percent and, as of December 31, 1999, had increased their total student enrollment by approximately 7.8 percent.

On February 1, 1999, ITT Corporation ("ITT"), a subsidiary of Starwood Hotels & Resorts Worldwide, Inc. ("Starwood Hotels"), disposed of its remaining interest in ESI through a public offering of 7,950,000 shares of ESI common stock and ESI's repurchase of ITT's remaining 1.5 million shares of ESI common stock.

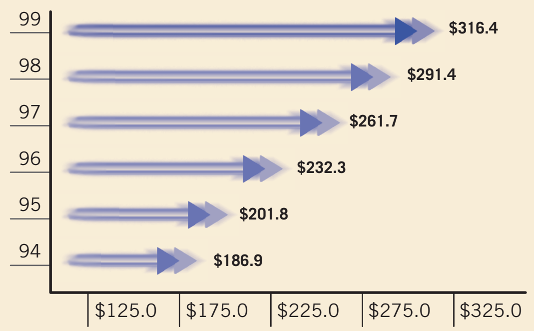
Three new ITT Technical Institutes opened, bringing the total number of institutes to 67. The three new institutes are located in Richmond, Virginia, Liverpool (Syracuse), New York, and St. Rose (New Orleans), Louisiana.

Real estate leases were negotiated for three additional institutes that are scheduled to open in 2000. These institutes will be located in Woburn (Boston), Massachusetts, Bensalem (Philadelphia), Pennsylvania and Green Bay, Wisconsin.

Sixty-four ITT Technical Institutes changed their accreditation to the Accrediting Council of Independent Colleges and Schools.

We repurchased approximately 2.4 million shares of ESI common stock for a total cost of $68.9 million, and there are approximately 1.1 million shares remaining to be repurchased under the share repurchase program authorized by the ESI Board of Directors.

Revenues increased 8.6 percent to $316.4 million compared to $291.4 million in 1998.



revenues
1994-1999 ($ In millions)

Excluding one-time expenses of approximately $1.4 million (after tax), or $0.05 per share, associated with ITT's February 1999 public offering of its ESI common stock and an accounting change regarding new school start-up expenses, net income was $24.9 million, or $0.98 per share. This compares to net income of $23.2 million, or $0.85 per share, in 1998, excluding one-time expenses of $9.2 million (after tax), or approximately $0.34 per share, associated with a change in control of ESI in February 1998, student litigation settlement costs and a secondary stock offering in June 1998.

Operating margins, excluding one-time expenses, increased to 11.9 percent compared to 11.4 percent in 1998.

New student enrollment in the fourth quarter increased 13.9 percent to 4,616 compared to 4,053 during the same period in 1998. The company's total student enrollment as of December 31, 1999 increased 3.2 percent to 26,428 compared to 25,608 on December 31, 1998.

The company remains debt free.

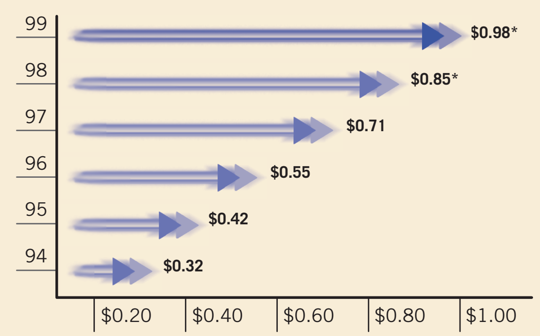
As of December 31, 1999, the company had approximately $68 million in cash, cash equivalents, restricted cash and marketable debt securities.

increasing shareholder value

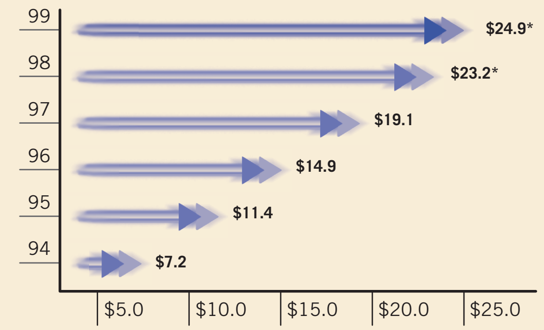
The company's stock valuation tumbled badly in 1999. The share price of ESI common stock declined from a high of $40.38 in the first quarter of 1999 to a closing share price at year-end of $15.44, a decline of approximately 62 percent. There were several reasons for the decline. The primary reason was that total student enrollment in our schools grew at a slower rate in 1999 than in 1998. Many of the stocks of the publicly traded education companies experienced increased volatility and a re-valuation causing most companies to end 1999 with their stock prices well below their 52-week highs. We know that industries, including ours, fall in and out of favor with Wall Street. We believed that, as the year began, investors expected the enrollment growth at ESI and at our peers to continue at a high rate in 1999. As 1999 progressed, the market recast its expectations, negatively impacting our stock price. Expectations are all about the future. We believe our stock is undervalued.

Our slower rate of growth in total student enrollment occurred primarily in our electronics and computer-aided drafting curricula. We believe that the robust national economy had a significant effect on our recruitment and retention of students in these programs. The typical students who enrolled in these programs in the past were 18- to 24-year olds seeking entry-level skills to commence an initial career. Historically, we have found that during periods of high employment some students choose to postpone postsecondary education in favor of immediate employment. In 1999, the nation's unemployment rate dipped to a 30-year low, causing the job market to become a substantial competitor for students in our traditional 18- to 24-year old profile and to negatively affect our recruitment and retention of these students.

Faster forward. In response to the competition that our traditional programs were receiving from the strong economy, and in response to stronger than expected initial new student enrollment in our IT program in computer network systems, we chose to accelerate the introduction of the computer network systems program at more schools in 1999 than originally planned. During 1999, the IT program in computer networking systems was offered at 34 ITT Technical Institutes. Overall, those 34 schools increased their new student enrollment by approximately 21 percent in 1999 and, as of December 31, 1999, had increased their total student enrollment by approximately 7.8 percent. In comparison, the average new student enrollment at the 33 schools that did not offer an IT program in 1999 only increased 1.5 percent, and these schools experienced a 2 percent decline in their total student enrollment as of December 31, 1999. It is this dichotomy in enrollment results for schools offering an IT program that generates our optimism that, as more schools begin offering an IT program, our total student enrollment should increase at a higher rate in 2000 than in 1999.



earnings per share (diluted)
1994-1999
* Before one-time expenses and cumulative effect of change in accounting.

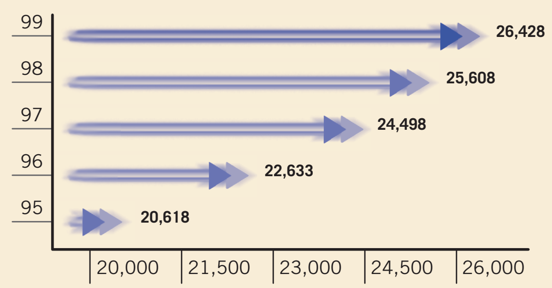


net income
1994-1999 ($ In millions)
* Before one-time expenses and cumulative effect of change in accounting.

The IT program in computer network systems has several very attractive features. This IT curriculum is structured as a three-day per week program in most locations, because many working adults have personal time restraints limiting their ability to attend our traditional five-day per week curricula. The three-day per week class schedule allows us to leverage our overhead costs and should help increase our operating margins, because a school offering the IT program on this schedule can teach twice as many students using the same number of classrooms and teaching equipment as our traditional programs that have a five-day per week class schedule. In addition, the IT program is premium priced and should generate approximately 10 percent more revenue than the blended cost of the traditional programs. Equally important is that student demand for the IT program has been significantly stronger than for our traditional programs.

Faster forward. We have created additional curricula in three other IT fields--Software Applications and Programming, Web Development and Multimedia. These programs will be introduced at several schools in the first quarter of 2000. We intend to rollout these additional IT programs to a limited number of schools over the balance of 2000. Initially, the introduction of these new IT programs will not result in any incremental capital expenditures, because the programs use the same classrooms and teaching equipment that are used in the computer network systems program. In addition, in many instances those new IT programs will use the same faculty as the computer network systems program. We expect that there will be a strong demand by employers for graduates of all four IT programs, which should help to increase the popularity of these programs in the future.

Our traditional programs in electronics and computer-aided drafting continue to attract large numbers of new students. We continue to have the largest market share in both program categories. R&D projects to enhance the content of both the electronics and computer-aided drafting curricula and to increase their attraction to working adults should be completed in 2000. Employer demand remains very strong for graduates of these traditional programs. We expect that the cash flow contribution from these programs will continue to be strong.



ITT Technical Institute student census growth

1995-1999

Faster forward. We announced that, beginning in February 2000, our schools would introduce a new private education loan program, the "College Advantage Loan Program," to help eligible students and their parents fill the funding gap when federal and state financial aid sources fail to fully cover the student's cost of education. The College Advantage Loan Program will be provided by Bank One, the nation's leading originator of student loans, and USA Group, the nation's largest student loan guarantor and administrator, to eligible students and their parents.

The increasing demand for IT personnel is perhaps best exemplified by the burgeoning growth of e-commerce on the Internet. Five to 10 years ago, the Internet was an interesting novelty. Today, being "e-enabled" is a business necessity. As our schools focus on teaching IT technologies, we have also been transforming our business environment to become "e-enabled." Not only have our schools' computer labs been networked to the Internet, we have similarly networked our administrative offices to improve productivity.

Faster forward. In 1999, we created and implemented a virtual library at our institutes. The virtual library is accessible to all of our 26,000 plus students, 7 days a week, 24 hours a day, from any location with Internet access. The virtual library has textbook websites specific to the curricula as well as links to periodical databases, electronic reference sources and information services which include millions of articles from thousands of technology-related and general interest periodicals.

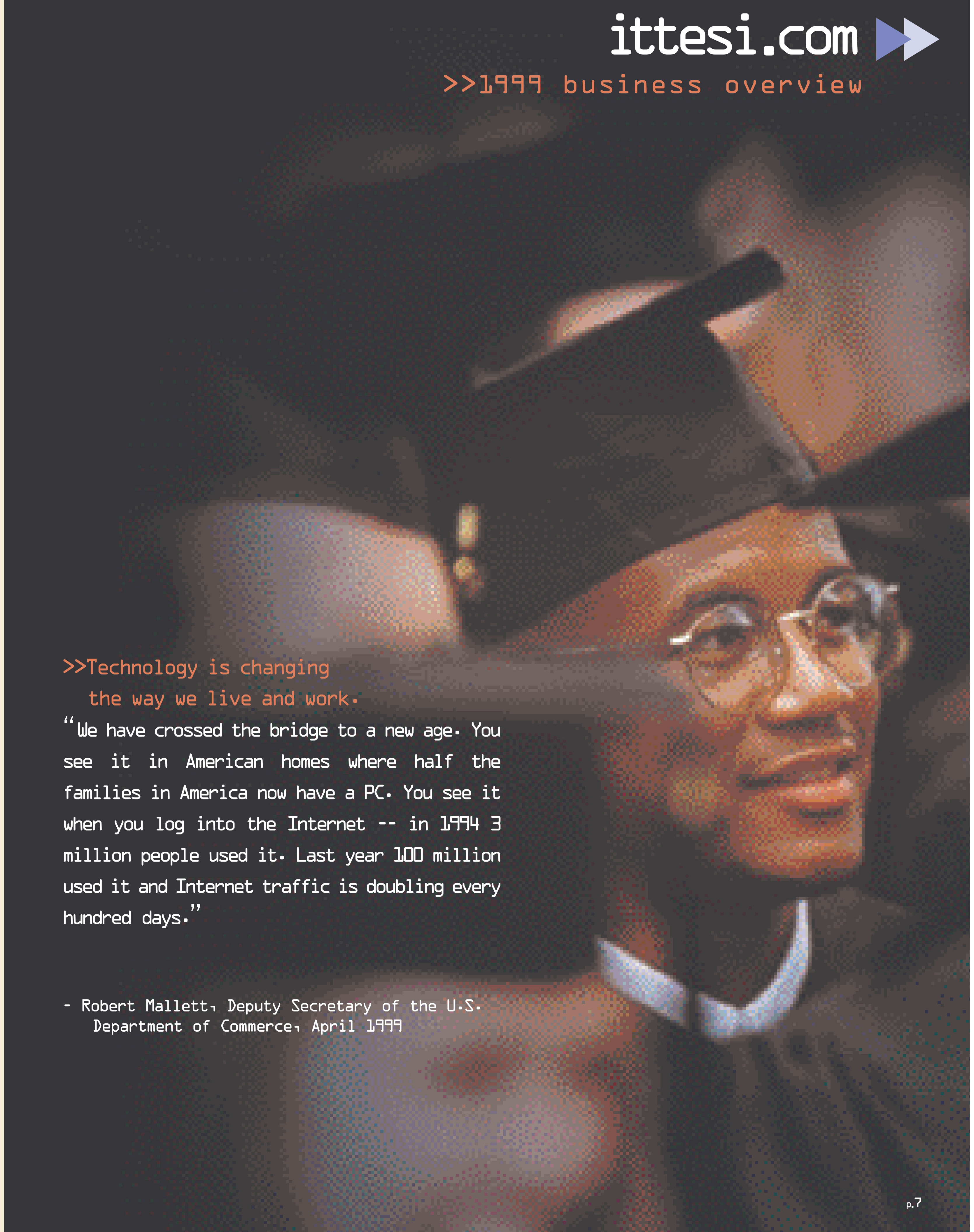
We believe that the long-term growth opportunities for the technology-oriented postsecondary degree programs offered by our schools will remain strong. The worker "skills gap," that is, the ability of employers to recruit skilled IT personnel, affects most industries, not just IT companies. The demand for personnel with the appropriate technical knowledge and skills is projected to continue growing over the next 10 years. The number of high school graduates is projected to grow substantially over the next decade, and an increasing percentage of those graduates are projected to pursue postsecondary education. Working adults, with or without prior postsecondary education, are coming back to school in increasing numbers to help them move up the career ladder or change to more lucrative careers, such as IT. We have all heard the reports of the widening wage gap between workers who have IT knowledge and skills and those who do not. As ESI adjusts to the new "e-economy" through the introduction of new IT programs and enhancements to our traditional programs, we should be well positioned to benefit from the anticipated growth in postsecondary education enrollment.

The mission of ITT Educational Services, Inc. is to provide a quality postsecondary education and the services that can help a diverse student body to prepare for career opportunities in various fields involving technology. We will strive to establish an environment for students and employees which promotes professional growth, encourages each person to achieve his or her highest potential and fosters ethical responsibility and individual creativity within a framework of equal opportunity.

My personal thanks go out to all ESI employees who fulfill our mission each day. It is the contributions of our employees and their focus on quality, compliance and customer satisfaction that will lead to increased shareholder value.

Rene R. Champagne

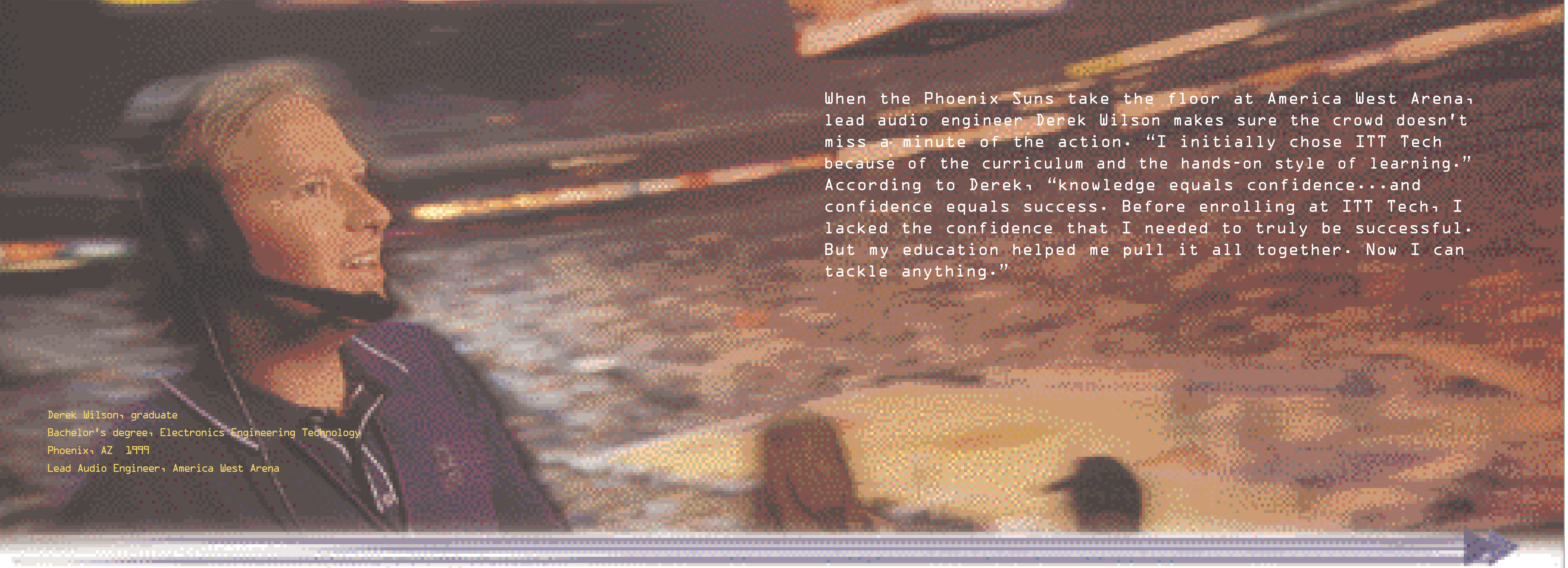
Rene R. Champagne
Chairman, President and CEO



>>Technology is changing the way we live and work.

"We have crossed the bridge to a new age. You see it in American homes where half the families in America now have a PC. You see it when you log into the Internet -- in 1994 3 million people used it. Last year 100 million used it and Internet traffic is doubling every hundred days."

- Robert Mallett, Deputy Secretary of the U.S. Department of Commerce, April 1999



When the Phoenix Suns take the floor at America West Arena, lead audio engineer Derek Wilson makes sure the crowd doesn't miss a minute of the action. "I initially chose ITT Tech because of the curriculum and the hands-on style of learning." According to Derek, "knowledge equals confidence...and confidence equals success. Before enrolling at ITT Tech, I lacked the confidence that I needed to truly be successful. But my education helped me pull it all together. Now I can tackle anything."

Derek Wilson, graduate
Bachelor's degree, Electronics Engineering Technology
Phoenix, AZ 1999
Lead Audio Engineer, America West Arena

As nothing else before it, technology and all its rapid transformations are defining how we live and work. Traditional views of learning and work are constantly being challenged. People today face the reality of changing their jobs several times over the course of their working lives. In fact, in 1998, the average 32-year-old had already worked for nine different firms.

Basic communication has been changed forever. Mailing letters and making phone calls have been replaced by sending e-mail. In fact, e-Marketers Inc. estimated that 3.4 trillion e-mail messages were sent across the Internet in 1998, up from 107 billion the year before.

U.S. President William J. Clinton said, in an online Town Hall Meeting on November 8, 1999, "You know, when I became president in January of 1993, there were only 130 sites on the Web, only 1.3 million computers connected to the Internet. Today, over 56 million computers are connected to the Internet and there are 36 million Web sites and we're adding new pages at the rate of over 100,000 an hour."

The rapidly changing nature of office equipment, communications and business applications quickly renders these tools obsolete, or at least diminishes their potential benefits. Many of today's American business leaders contend that knowledge and skills will be the currency of the 21st century.

Knowledge and skills will define the way we work, the way we thrive as individuals and the way we succeed in the marketplace. The changing nature of the world economy will cause the prospect for a high quality of life to depend -- as never before -- on having a population that is adaptable, resilient and ready to learn throughout life.

in the wired world, skills and knowledge are in a constant state of reinvention.

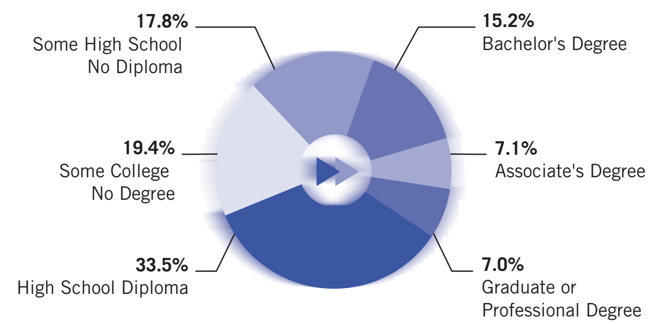
Technology can change at lightning speed and desirable job candidates need to be quick learners, good problem solvers and able to communicate. The round-the-clock and round-the-world competition the wired world creates means big changes for business and education. Technology surges through it all, generating new products and services and creating new markets and new opportunities.

As Peter Drucker said in *Knowledge Worker Productivity: The Biggest Challenge,* "The most valuable asset of a 20th century company was its production equipment. The most valuable asset of a 21st century institution (whether business or non-business) will be its knowledge workers and their productivity."

education, education, education.

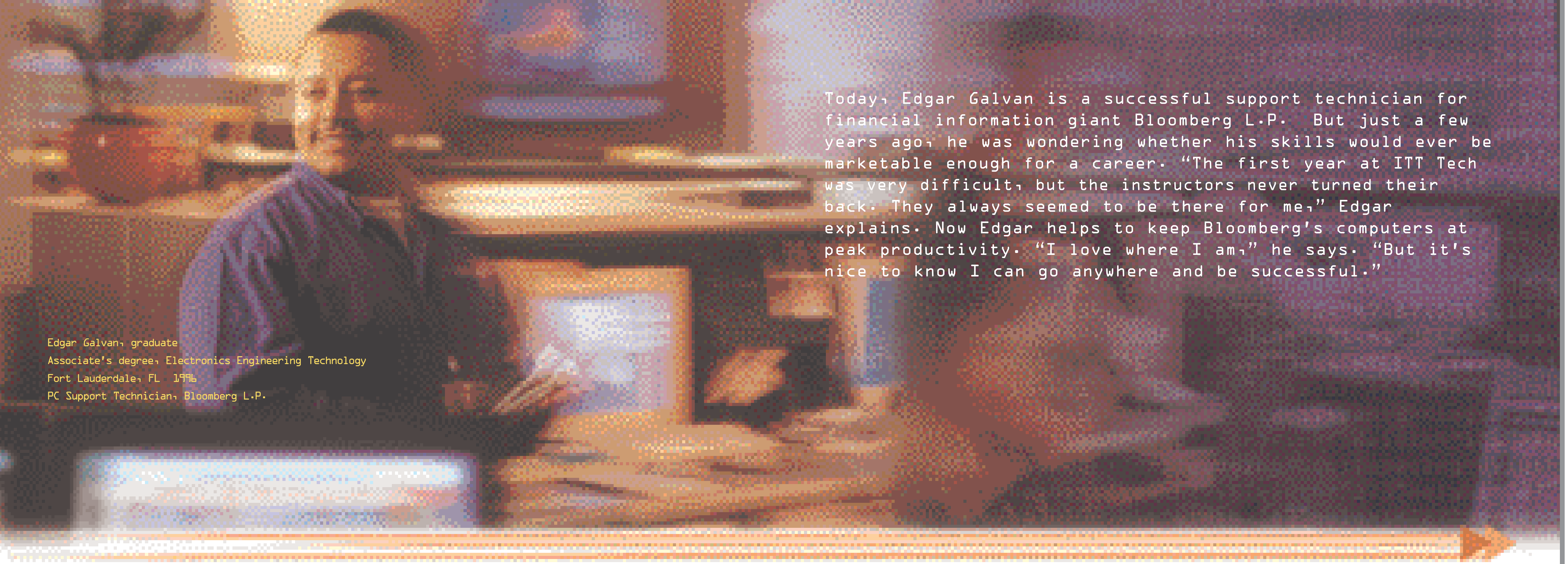
It's been said that the three most important things in real estate are "location, location, location." A similar adage for the three most important things needed to succeed in a career in this Digital Age is "education, education, education." The January 29, 2000 edition of *The Economist* advises, "for most, the lesson is stark: educate yourself, and then re-educate yourself."

Where once basic literacy served most workers adequately, lifetime learning is now a necessity. Increasingly rapid changes in technology are overtaking and displacing the skills and knowledge of particular jobs, occupations and even entire industries. Succeeding, even surviving, in such an employment environment requires workers to constantly gain new skills.



education attainment of adults in the U.S.

Source: U.S. Census Bureau



Today, Edgar Galvan is a successful support technician for financial information giant Bloomberg L.P. But just a few years ago, he was wondering whether his skills would ever be marketable enough for a career. “The first year at ITT Tech was very difficult, but the instructors never turned their back. They always seemed to be there for me,” Edgar explains. Now Edgar helps to keep Bloomberg's computers at peak productivity. “I love where I am,” he says. “But it's nice to know I can go anywhere and be successful.”

Edgar Galvan, graduate
Associate's degree, Electronics Engineering Technology
Fort Lauderdale, FL 1996
PC Support Technician, Bloomberg L.P.

Individuals seeking the higher paying jobs of the future will need to obtain an education beyond high school. Recent information from the U.S. Bureau of Labor Statistics indicates that occupations requiring at least an associate's degree, which accounted for 25 percent of all jobs in 1998, will account for 40 percent of job growth from 1998 to 2008.

These issues are key drivers for ITT Educational Services, Inc. (ESI) and its ITT Technical Institutes. Companies are realizing that the main challenge in this wired world is not the technology. Rather, it's the search for employees who can harness the power of technology to improve productivity.

John A. Challenger, chief executive officer of Challenger, Gray & Christmas, Inc., wrote in the July 1, 1999 *USA Today Magazine*, “As in most projections for the future, this one ends with a warning: Invest in education or suffer the consequences.”

skilled workers in technology fields are in great demand.

“Knowledge work,” as described by Peter Drucker, is already in demand and pays high wages. According to the American Electronics Association, the high tech industry employed more than 4.8 million workers in 1997, the most recent year for which data is available. A large number of these jobs have been created since 1993. Indeed, more than one million new high-technology jobs were added to the U.S. economy between 1993 and 1998. Additionally, high tech jobs pay 77 percent more than the average private sector wage in the United States.

Projections call for this high-skill/high-wage “knowledge work” to be abundant in the 21st century. A recent U.S. Department of Labor study on workers in the Digital Age said that the number of key technology jobs will increase by an average of 75 percent in the next six years, compared to an average increase of 14 percent in all other occupations.

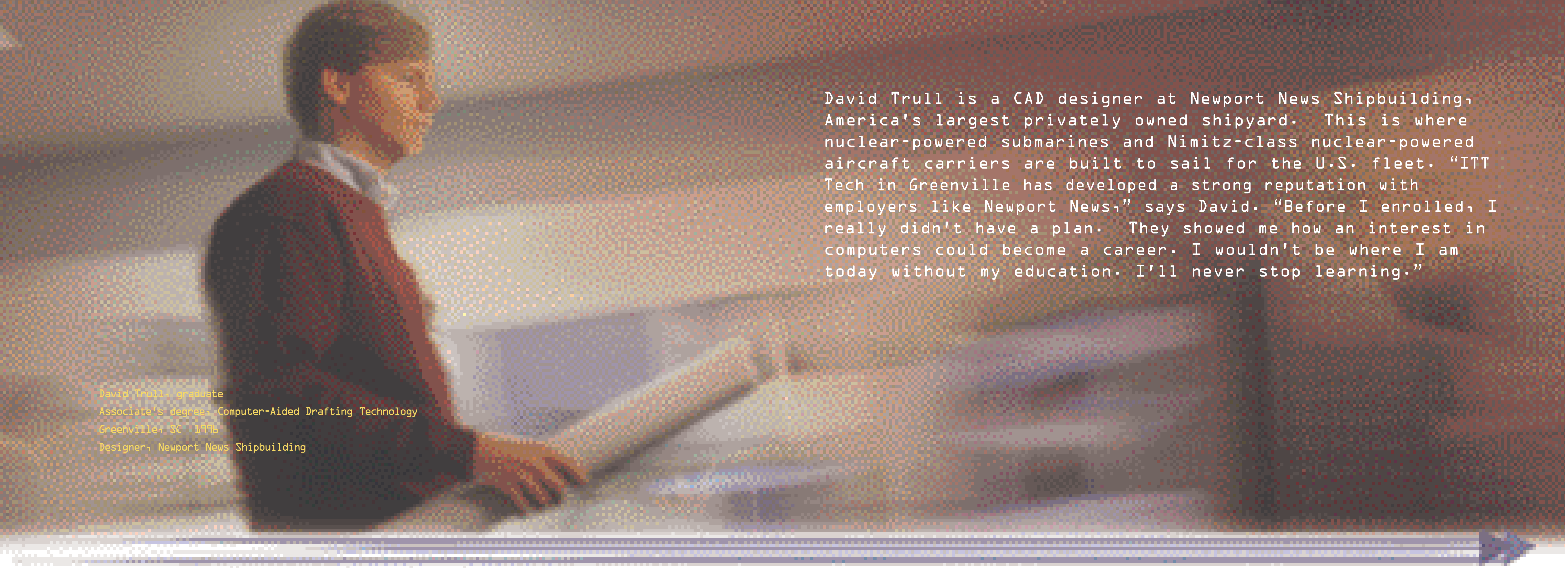
Despite the abundance of jobs, there are worker shortages. The Information Technology Association of America (ITAA) *Help Wanted* study found that qualified information technology (IT) worker shortages are large and growing. As of 1998, the “core” IT work force (including programmers, systems analysts and computer engineers) was reported to be 3,354,000. According to the study, 346,000 or approximately 10 percent of those positions were unfilled at that time.

Those positions require educated and adaptable workers who can readily learn new skills and techniques as required. Companies are recognizing that their leading asset is their human capital -- the skilled workers who can engage both their head and hands.

However, those workers are not easy to find. A 1999 survey commissioned by the Computing Technology Industry Association (CompTIA) indicates that 57 percent of respondents from America's largest companies were having difficulty finding qualified IT staff. The survey also reveals that nearly one-fourth of all companies claimed lost productivity because of a shortage of qualified IT service and support staff. Thirty-eight percent of $1 billion-plus companies and 24 percent of all companies claimed lost productivity because of a shortage of qualified IT service and support staff.

In March 1999, Amy Kaslow, senior fellow for the Council on Competitiveness, testified before the House Science Committee. She said, “Never before has the appearance of working America been so deceiving. Payrolls have hit record highs and the unemployment rate is the lowest its been in decades. But the reality behind the numbers is troubling. An acute skills shortage in every part of the country threatens the foundation of American competitiveness.”

An article in *The Boston Globe* in October 1999 suggests, “If scientists



David Trull is a CAD designer at Newport News Shipbuilding, America's largest privately owned shipyard. This is where nuclear-powered submarines and Nimitz-class nuclear-powered aircraft carriers are built to sail for the U.S. fleet. “ITT Tech in Greenville has developed a strong reputation with employers like Newport News,” says David. “Before I enrolled, I really didn't have a plan. They showed me how an interest in computers could become a career. I wouldn't be where I am today without my education. I'll never stop learning.”

David Trull, graduate
Associate's degree, Computer-Aided Drafting Technology
Greenville, SC 1996
Designer, Newport News Shipbuilding

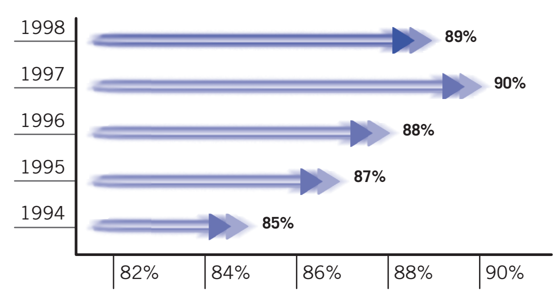
do start cloning people soon, they might want to begin with electrical engineers, computer programmers, and technicians. There just aren't enough of them.”

According to the CompTIA survey, the shortage of IT service and support staff nationwide is reducing worker productivity in the United States by an estimated $4.5 billion a year and is costing the entire economy $105.5 billion annually.

“Beyond the current tight IT labor market, our analysis indicates that the United States will need an additional 1.3 million core IT workers -- computer systems analysts, computer programmers, and computer scientists and engineers -- between 1996 and 2006,” said Kelly Carnes, the U.S. Department of Commerce's deputy assistant secretary for technology policy, in March 1999. “It is imperative that we prepare American workers for these high wage jobs which are instrumental to our country's competitiveness, productivity and innovation.”

technology is power, but only if you know how to use it.

Unless the nation's workers are properly educated, many leaders fear the United States will not be able to compete effectively in the global economy. Potential workers of tomorrow no longer can rely on brawn to help them get into a higher paying career.



Percentage of students graduating from undergraduate programs (other than those students who continued in a bachelor's degree program at an ITT Technical Institute) during the specified calendar year that obtained employment or were already employed in fields involving their programs of study by June 30 or earlier of the following calendar year. 1994-1998

U.S. Commerce Secretary William M. Daley said in June 1999, “We absolutely must have a well-trained, highly skilled work force if America is to compete in the global economy in the years to come. America's continued leadership will depend on how quickly we can assemble an army of home-grown technology workers.”

U.S. Department of Labor Secretary Alexis Herman concurred when she previewed a U.S. Labor Department study, *Futurework: Trends and Challenges for Work in the 21st Century* in September 1999. She said, “Information, technology and highly skilled workers will fuel the 21st century economy.”

it's not a lack of workers, but a lack of qualified workers.

Even in this era of record-breaking lows in unemployment, technology companies, which are contributing the lion's share of new jobs, are simultaneously declaring a shortage of qualified workers. The emphasis is on the word “qualified.”

Alexis Herman, U.S. Department of Labor Secretary, proclaimed, “I've always said we don't have a worker shortage. We have a skills shortage.”

PricewaterhouseCoopers LLP's October 1999 *Trendsetter Barometer* revealed that 66 percent of the 452 CEOs interviewed saw the growing scarcity of qualified workers as the number-one barrier to achieving their revenue goals over the next 12 months.

“Without needed additional workers, capacity is capped,” commented George R. Auxier, managing partner for PricewaterhouseCoopers LLP's middle market advisory services. “No other potential roadblock is as serious as this one.”

The number of unfilled IT jobs in the United States is expected to mushroom to 1.2 million by 2005 if current trends continue, according to a report issued in June 1999 by The META Group Inc., an IT consulting and research company based in Stanford, Conn.

Jaymie Kallsen, graduate
Associate's degree, Computer-Aided Drafting Technology
Thornton, CO 1999
CAD Operator, VideoTronix, Inc.

As a CAD Operator for VideoTronix, Inc., Jaymie Kallsen helps design security systems for commercial businesses. "The skills I acquired in the Computer-Aided Drafting Technology program at ITT Tech made me confident I could be successful," Jaymie says. "Then the school gave me the specialized attention I needed for an effective job search."

"The pipeline for IT workers is running dangerously low," said ITAA President Harris N. Miller. "Technical talent is the rocket fuel of the Information Age. As an information-intensive society, we cannot afford to stand by as the next wave in our economic future departs for foreign shores."

The ITAA suggests that the "information industry's most valuable capital and the key ingredient for its remarkable success is the knowledge and skill base of its employees."

The IT industry is concerned about the decline in the number of highly-skilled, highly-educated workers entering the work force with technology degrees. While the number of college degrees granted increased 16 percent between 1990 and 1996, the number of degrees awarded in IT areas fell 5 percent, from 219,000 to 208,000.

The deficit in skilled workers may only get worse as business dependence on high tech grows.

ITT Technical Institutes can help meet this need.

Postsecondary education institutions, like the ITT Technical Institutes, strive to help students develop the technical skills and knowledge needed to compete in the current employment market and adapt to future changes in their specific fields of technology.

Wisconsin Governor Tommy Thompson said in November 1999, "People are working, and industry is thriving. It's a wonderful time to be doing business -- unless, of course, you're an employer who can't find enough workers to get the job done...How many political science and history majors do you know or have heard about driving a cab, bartending or delivering pizzas, while across the state employers are clamoring for people with technical skills and abilities?...There may be a variety of reasons they're underemployed, but one common denominator is parents, educators and the general public often assume all high school students should attend a four-year university. While we certainly don't want to diminish a university degree, it's imperative we steer those not interested in traditional education onto a successful alternative career path....In the 21st century, more than 80 percent of the new jobs created will require a technical education. Doesn't it make sense to shift our focus to those trades and skills, and emphasize an education that will be in demand by employers? Of course, it does."

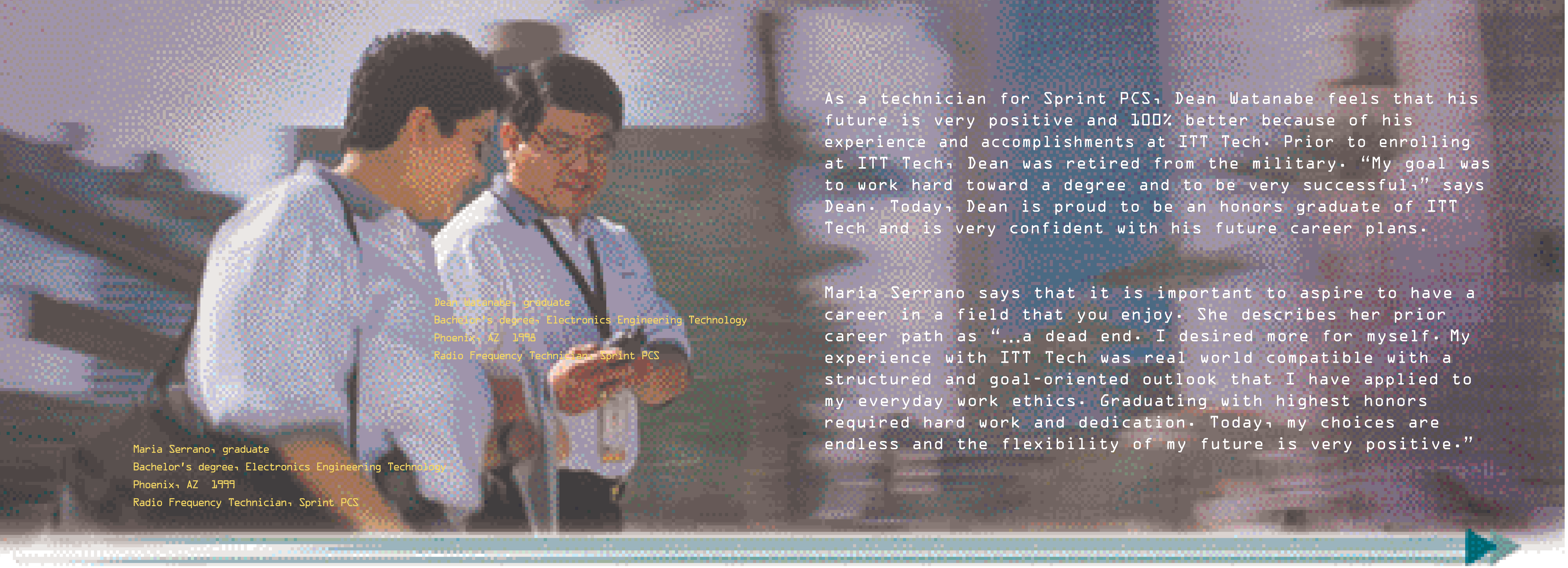
An ITT Technical Institute education combines classroom theory of technology with hands-on applications in a laboratory. Instructors provide information on how to solve problems with applications. The coursework incorporates input from local industry.

Each ITT Technical Institute has an advisory committee for each field of study which is comprised of representatives of local businesses and employers. These advisory committees assist the institutes in assessing and updating curricula, equipment and laboratory design.

The ITT Technical Institutes strive to evolve with the marketplace, delivering a skills-based education that is sensitive to market needs and convenient to students. Their goal is to help people develop into employees who are equipped to meet the challenges of a marketplace where change is the one constant.

information technology programs of study help contribute to the solution.

The demand for IT workers far outstrips the supply. This technical skills gap creates a significant business opportunity for educational institutions focused on technology, such as the ITT Technical Institutes. In an attempt to capitalize on the well-publicized skill shortage of IT workers, ESI now offers an education in four IT disciplines. The first discipline, Computer Network Systems (see "Curricula," page 22), was launched in 1998 and by year-end 1999 was offered at 34 ITT Technical Institutes. Plans call for all of the current ITT Technical Institutes to



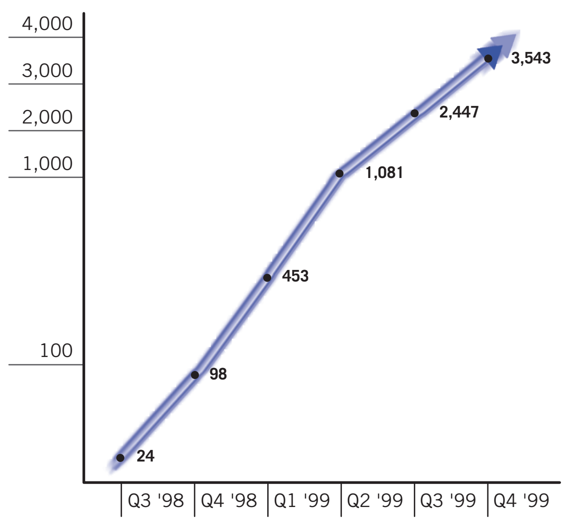
Dean Watanabe, graduate
Bachelor's degree, Electronics Engineering Technology
Phoenix, AZ 1998
Radio Frequency Technician, Sprint PCS

Maria Serrano, graduate
Bachelor's degree, Electronics Engineering Technology
Phoenix, AZ 1999
Radio Frequency Technician, Sprint PCS

As a technician for Sprint PCS, Dean Watanabe feels that his future is very positive and 100% better because of his experience and accomplishments at ITT Tech. Prior to enrolling at ITT Tech, Dean was retired from the military. "My goal was to work hard toward a degree and to be very successful," says Dean. Today, Dean is proud to be an honors graduate of ITT Tech and is very confident with his future career plans.

Maria Serrano says that it is important to aspire to have a career in a field that you enjoy. She describes her prior career path as "...a dead end. I desired more for myself. My experience with ITT Tech was real world compatible with a structured and goal-oriented outlook that I have applied to my everyday work ethics. Graduating with highest honors required hard work and dedication. Today, my choices are endless and the flexibility of my future is very positive."

begin offering an IT program in this discipline by the end of 2000. In most locations, students who successfully complete an IT program will earn an associate's degree.



cumulative new student enrollment in IT programs at ITT Technical Institutes

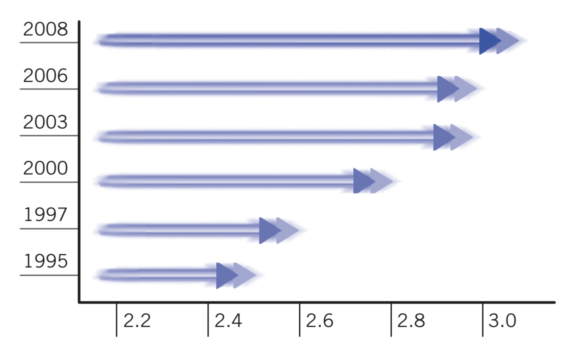
An IT program of study in the Software Applications and Programming discipline was tested at the end of 1999. IT programs in the Web Development and Multimedia disciplines will be tested in 2000.

trends move in the ITT Technical Institutes' favor.

In this new wired world, a company's major competitive advantage lies in its ability to change rapidly with the trends swirling around it. The same goes for education. ESI is uniquely positioned to capitalize on several economic, demographic and social trends that contribute to the growing demand for career-oriented education. Some of these national trends include:

Changes in Workplace Demands: Advances in technology have increased the demands on employers and employees, requiring many new workers to have some education beyond the high school level, but not necessarily the traditional four-year bachelor's degree. The U.S. Department of Labor projects the number of jobs requiring at least an associate's degree to grow by more than 20 percent between 1994 and 2005.

Increasing Numbers of High School Graduates: The teen population is on the rise. The U.S. Department of Education reports that high school enrollment will jump 13 percent between 1998 and 2007. According to the National Center for Education Statistics (NCES), the percentage of students completing high school rose from 78 percent to 87 percent between 1971 and 1997. Enrollment in postsecondary education is expected to go as high as 16.4 million students by 2006, an increase of more than 15 percent from the number enrolled in the fall of 1995.

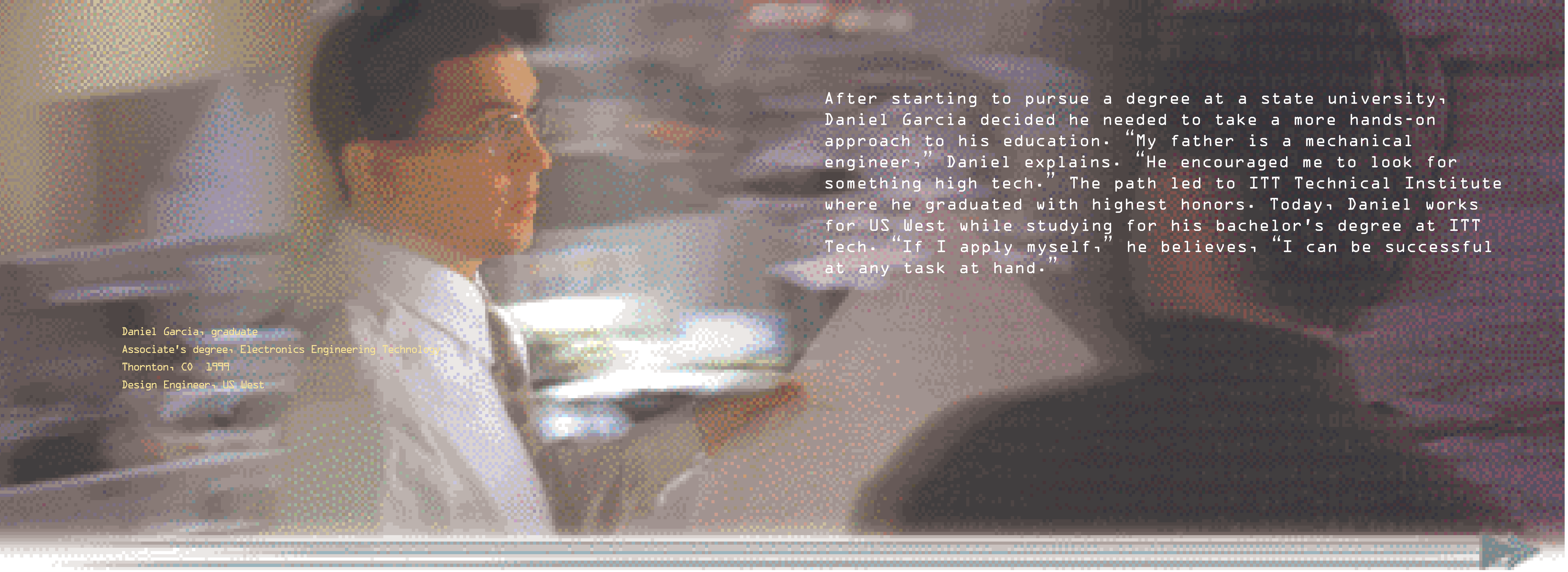


u.s. high school graduates

1995-2008 in millions / Source: NCES, Projections of Education Statistics to 2008

Adults Seeking Higher Education: Enrollment in postsecondary education is expected to increase as individuals seek to enhance their skills or go back for more schooling to learn skills for new job requirements.

Increasing Recognition of the Value of Higher Education: The public is increasingly recognizing the income premium and other improvements in career prospects associated with a postsecondary education. The U.S. Census Bureau reported that a full-time male worker with an associate's degree in 1995 earned an average of 37 percent more per year than a comparable worker with only a high school diploma. A full-time male worker with a bachelor's degree in 1995 earned an average of 72 percent more per year than a comparable worker with only a high school diploma.



After starting to pursue a degree at a state university, Daniel Garcia decided he needed to take a more hands-on approach to his education. "My father is a mechanical engineer," Daniel explains. "He encouraged me to look for something high tech." The path led to ITT Technical Institute where he graduated with highest honors. Today, Daniel works for US West while studying for his bachelor's degree at ITT Tech. "If I apply myself," he believes, "I can be successful at any task at hand."

Daniel Garcia, graduate
Associate's degree, Electronics Engineering Technology
Thornton, CO 1999
Design Engineer, US West

Growing Demand for Higher Education: High school graduates and adults are seeking higher education in increasing numbers. Between 1987 and 1997, the percentage of high school graduates going directly to postsecondary education increased from 57 percent to 67 percent, according to the NCES. Between 1971 and 1997, the percentage of high school graduates with some college rose from 44 percent to 65 percent, according to the NCES.

Decreasing Size of Military Forces: Due to defense budget cuts and the reduction in the U.S. armed forces, the U.S. military, a traditional provider of technical and career-oriented training, is able to provide fewer educational opportunities. According to the U.S. Department of Defense, the aggregate number of U.S. military personnel in 1999 declined by 32 percent from 1987. This has left a void to be filled by other sources, including career-oriented schools, like the ITT Technical Institutes.

ESI believes that its ITT Technical Institutes are in a position to take advantage of these national trends.

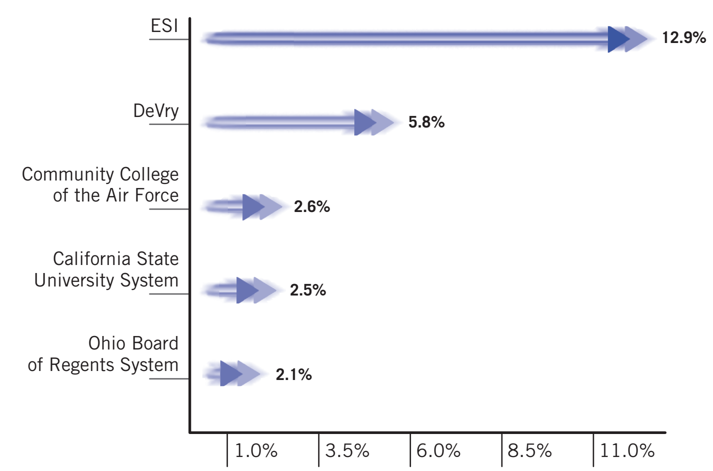
the ITT Technical Institutes are market share leaders.

The postsecondary education industry is highly fragmented, with no one college or system of colleges enjoying a significant market share.

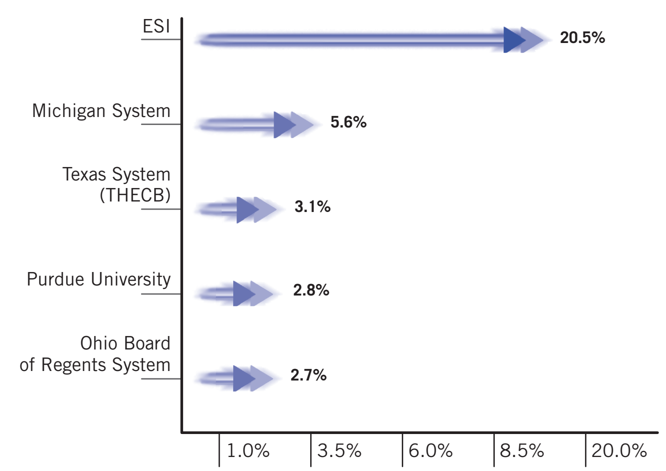
However, the ITT Technical Institutes combined are the market share leader in awarding degrees in electronics and electronics-related programs of study and in drafting programs of study. According to U.S. Department of Education data, in total the ITT Technical Institutes awarded the largest percentage (12.9 percent) of degrees granted in the United States in electronics and electronics-related programs in the 1996-1997 school year, the latest year for which statistics are available. In total, the ITT Technical Institutes also granted the largest share (20.5 percent) of all degrees awarded in the United States in drafting programs in the 1996-1997 school year.

It is ESI's goal to also become the market share leader in granting degrees in IT programs, as its curricula in this area mature.

market share data 1996/1997

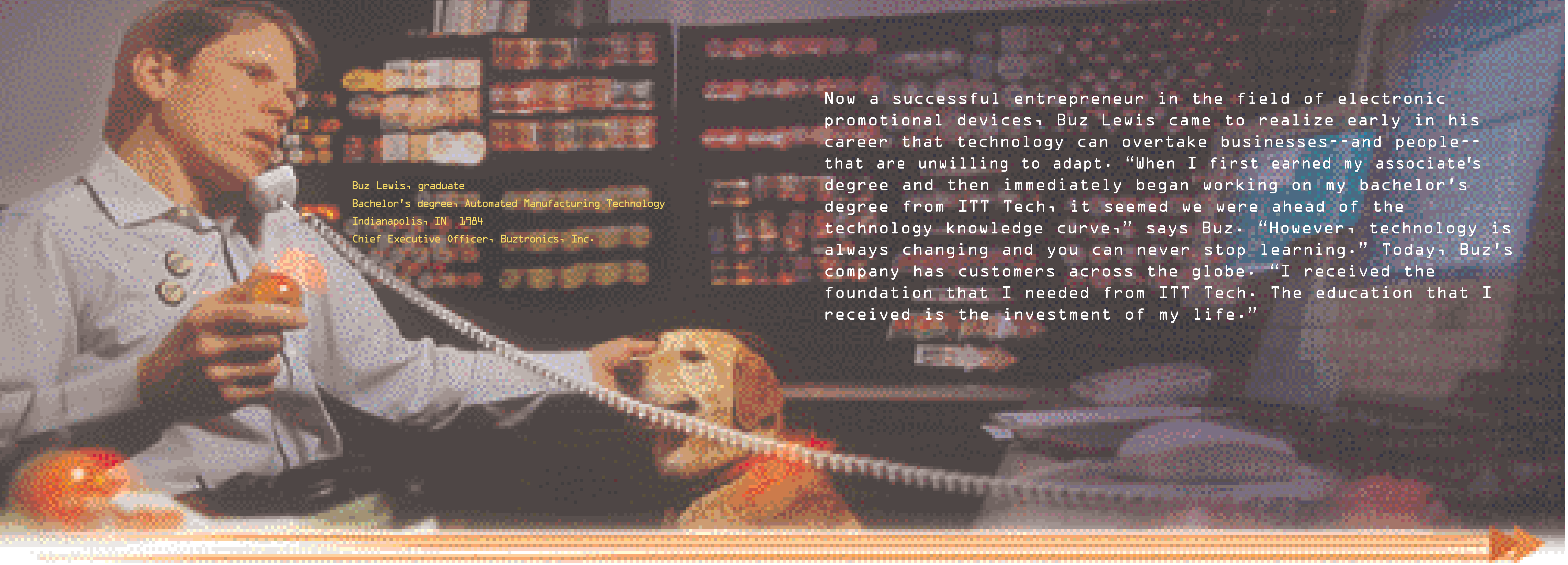


electronics-related awards (associate's through bachelor's degree level)



drafting-related awards (associate's through bachelor's degree level)

Source: U.S Integrated Postsecondary Education Data Systems (IPEDS), U.S. Department of Education.



Buz Lewis, graduate
Bachelor's degree, Automated Manufacturing Technology
Indianapolis, IN 1984
Chief Executive Officer, Buztronics, Inc.

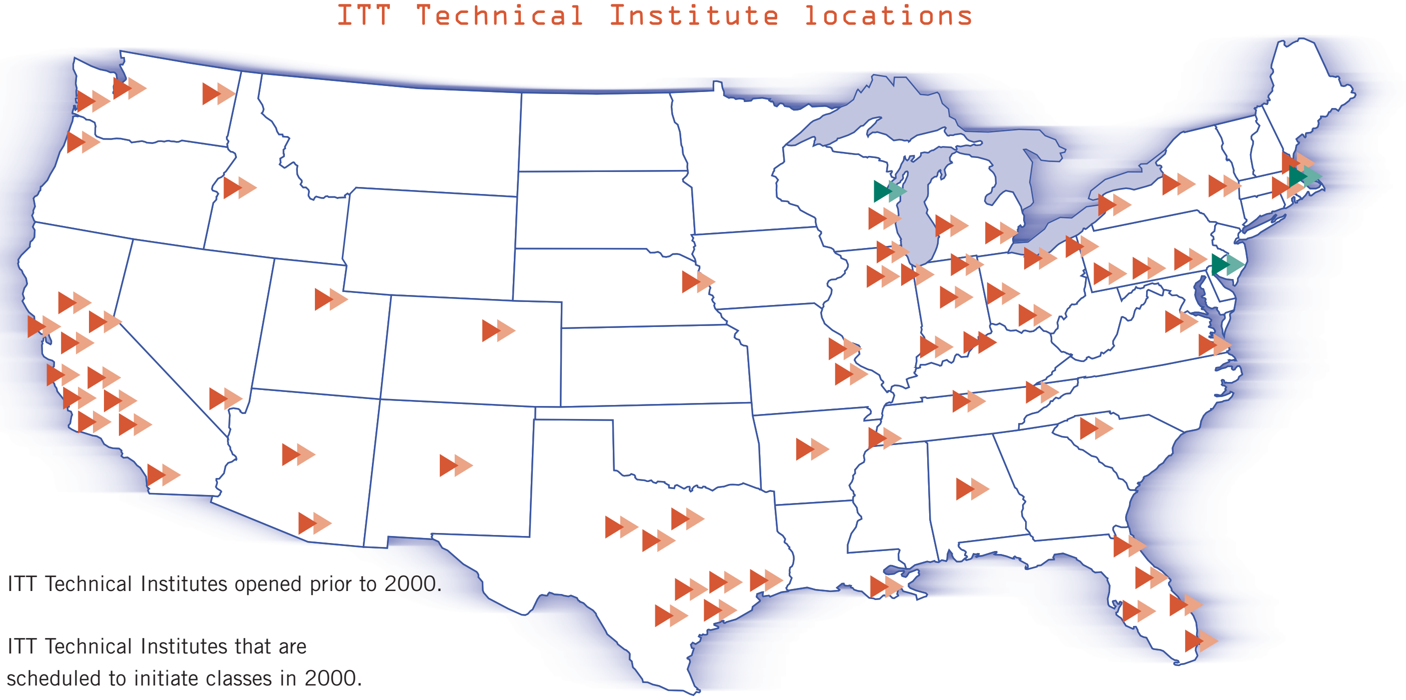
Now a successful entrepreneur in the field of electronic promotional devices, Buz Lewis came to realize early in his career that technology can overtake businesses--and people--that are unwilling to adapt. "When I first earned my associate's degree and then immediately began working on my bachelor's degree from ITT Tech, it seemed we were ahead of the technology knowledge curve," says Buz. "However, technology is always changing and you can never stop learning." Today, Buz's company has customers across the globe. "I received the foundation that I needed from ITT Tech. The education that I received is the investment of my life."

the ITT Technical Institutes are up to the challenge.

Robert T. Jones, President and CEO, National Alliance of Business, testified in July 1999 before the Senate Subcommittee on Health, Education, Labor and Pensions: "The world of work is changing rapidly. Change is driven every day by new technology, globalization of the marketplace, changing consumer demand, and shorter product cycles. This rate of change has a direct impact on the education requirements and skill sets needed by people in the workplace."

In this Digital Age, where news and information are transmitted around the world in a matter of seconds, where technology is updated and improved every day, and where manual labor is being replaced by computers, there will be an increasing need for an educated population. Technology is driving fundamental shifts in the way people and companies do business. ESI, through its ITT Technical Institutes, will strive to provide an education that is customer-driven and market responsive.

ITT Technical Institute locations



ITT Technical Institutes opened prior to 2000.

ITT Technical Institutes that are scheduled to initiate classes in 2000.

At the end of 1999, ITT Educational Services, Inc. was providing technology-oriented higher education to more than 26,000 students in 28 states through 67 ITT Technical Institutes.

curricula@esi

information technology

Associate's degree: The Information Technology program offered at various ITT Technical Institutes is comprised of four separate disciplines: Computer Network Systems, Multimedia, Software Applications and Programming and Web Development. At most locations, students who successfully complete the program of study will earn an associate's degree in Information Technology in one of these four disciplines.

The **Computer Network Systems** discipline teaches students how to perform technical tasks associated with a variety of computer network systems and functions. Through classroom and laboratory experiences, students are exposed to a variety of information on network system design, implementation and service integration of network systems and other related technical subjects.

The **Multimedia** discipline teaches students how to perform technical tasks associated with the design and creation of interactive multimedia communication. Through classroom and laboratory experiences, students are exposed to a variety of information on authoring software, motion graphics development, visual design principles and other related technical subjects.

The **Software Applications and Programming** discipline teaches students how to perform technical tasks associated with software application development and its modification. Through classroom and laboratory experiences, students are exposed to a variety of information on software scripting, programming languages, database development and other related technical subjects.

The **Web Development** discipline teaches students how to perform tasks associated with the creation, installation, security, updating and maintenance of business websites. Through classroom and laboratory experiences, students are exposed to a variety of information on software scripting, programming languages, database development, network concepts, visual design principles and other related technical subjects.

electronics engineering technology

Associate's and bachelor's degrees: In the associate's degree program, students begin to develop the knowledge and skills for entry-level positions in fields involving electronics, including aviation, communications, computers and defense. In the bachelor's degree program, students can begin to develop a more advanced foundation, with subjects such as process control, advanced communication systems and circuit design.

computer-aided drafting technology

Associate's degree: Computer-aided drafters use computers to translate ideas, sketches and specifications of an engineer, architect or designer into complete and accurate working plans. In the ITT Technical Institutes' Computer-Aided Drafting Technology programs, as well as the schools' Computer Aided-Drafting and Design Technology, Architectural Engineering Technology and Tool Engineering Technology programs, students begin to develop the knowledge and skills for various entry-level positions in fields involving computer-aided drafting.

automated manufacturing technology

Bachelor's degree: As the workplace becomes increasingly automated, there's a need for technicians who understand automated technology. In the Automated Manufacturing Technology program, the coursework includes digital electronics, hydraulics/pneumatics and robotic systems.

computer visualization technology

Bachelor's degree: Computers have become one of the world's most essential graphics tools. This program offers students a combination of theory and practical application in a variety of areas that use computer graphics technology, including prepress computing, computer modeling, 3D animation and multimedia.

telecommunications engineering technology

Bachelor's degree: This program helps graduates prepare for entry-level positions in many fields involving telecommunications technology, such as telephone voice communications, data communications, computer networks, satellite systems, mobile communications, cellular and PCS systems and fiber optics.

industrial design

Bachelor's degree: Graduates of this program often aim toward a career involving industrial design in any number of manufacturing and service industries. The program is designed to teach students to combine graphics skills with artistic talent and problem solving in order to create functional and aesthetically attractive product designs.

project management

Master's degree: This is a program designed to help students develop better critical thinking, communication and teamwork skills while reinforcing both the theoretical and applied principles of project management. The learning environment attempts to serve the needs of working adults who have multiple pressures and priorities, including full-time employment.

chemical technology

Associate's degree: In the ITT Technical Institutes' chemical technology program, students have the opportunity to use diagnostic tools similar to the ones used in the workplace. Plus, through a combination of classroom theory and practical hands-on activities, students do analysis and testing and record data in classes such as applied organic and biochemistry laboratory.

>>management's discussion and analysis of financial condition and results of operations

The following discussion should be read with the Selected Financial and Operating Data and the Consolidated Financial Statements and Notes to Consolidated Financial Statements included elsewhere in this report.

general

We operate 67 institutes in 28 states which provide technology-oriented postsecondary education to approximately 26,000 students. We derive our revenue almost entirely from tuition, textbook sales, fees and charges paid by, or on behalf of, our students. Most students at our institutes pay a substantial portion of their tuition and other education-related expenses with funds received under various government-sponsored student financial aid programs, especially the federal student financial aid programs under Title IV ("Title IV Programs") of the Higher Education Act of 1965, as amended (the "HEA"). In 1999, we indirectly derived approximately 69% of our revenues from Title IV Programs.

Our revenue varies based on the aggregate student population, which is influenced by the following factors:

- the number of students attending our institutes at the beginning of a fiscal period;
- the number of new first-time students entering and former students re-entering our institutes during a fiscal period;
- student retention rates; and
- general economic conditions.

New students generally enter our institutes at the beginning of an academic quarter that begins in March, June, September or December. We believe that, in the absence of countervailing factors, student enrollments and retention rates tend to increase as opportunities for immediate employment for high school graduates decline and decrease as such opportunities increase. Our establishment of new institutes and the introduction of additional program offerings at our existing institutes have been significant factors in increasing the aggregate student population in recent years.

A new institute must be authorized by the state in which it will operate, accredited by an accrediting commission that the U.S. Department of Education (the "DOE") recognizes, and certified by the DOE to participate in Title IV Programs. The approval processes for accreditation and DOE certification cannot commence until the first students begin classes. Accreditation and DOE certification for a new location generally take approximately nine months from the first class start date. Prior to January 1, 1999, we deferred certain direct costs incurred with respect to a new institute prior to the first class start ("institute start-up costs") and amortized them over the first year of operation after the first class start. Beginning January 1, 1999, we began expensing institute start-up costs as incurred. From January 1, 1995 through December 31, 1999, we opened 14 new institutes (six of which started classes in 1997 or 1998 and three of which started classes in 1999). New institutes historically incur a loss during the 24-month period after the first class start date. These losses during a fiscal year by institutes in their first two years of operation, together with the amortization of institute start-up costs, are referred to as "operating losses from new technical institutes." The operating losses from new technical institutes totaled $5.1 million for the year ended December 31, 1999, $5.3 million for the year ended December 31, 1998 and $3.2 million for the year ended December 31, 1997.

We earn tuition revenue on a weekly basis, pro rata over the length of each of four, 12-week academic quarters in each fiscal year. Federal and state regulations and accrediting commission criteria generally require us to refund a portion of the tuition payments received from a student who withdraws from one of our institutes during an academic quarter. Our statement of income recognizes immediately the amount of tuition, if any, that we may retain after payment of any refund.

We incur expenses throughout a fiscal period in connection with the operation of our institutes. The cost of educational services includes faculty and administrative salaries, cost of books sold, occupancy costs, depreciation and amortization of equipment costs and leasehold improvements, and certain other administrative costs incurred by our institutes.

Student services and administrative expenses include direct marketing costs (which are marketing expenses directly related to new student recruitment), indirect marketing expenses, an allowance for doubtful accounts and administrative expenses incurred at corporate headquarters. Direct marketing costs include salaries and employee benefits for recruiting representatives and direct solicitation advertising expenses. We capitalize our direct marketing costs (excluding advertising expenses) using the successful efforts method and amortize them on an accelerated basis over the average course length of 24 months commencing on the class start date. We expense as incurred our marketing costs that do not relate to the direct solicitation of potential students. In March 1998, as part of the DOE's reinstatement of our institutes' participation in Title IV Programs following our change in control resulting from Starwood Hotel's February 23, 1998 acquisition of ITT, the DOE, among other things, directed us to revise our current accounting treatment of direct marketing, revenue recognition and amortization of direct marketing costs or provide evidence that our treatment of these items conforms with Generally Accepted Accounting Principles ("GAAP"). We believe that our treatment of the items identified by the DOE is in accordance with GAAP and we have continued to communicate our position to the DOE, but we cannot assure you that the DOE will agree with our position. If the DOE required us to use certain accounting methods that differ from the methods we presently use, then we could be forced to change certain of our accounting policies. We do not believe that such a change would have a material adverse effect on our financial condition or results of operations before the cumulative effect of any change in accounting.

We have been performing our own cash management functions since February 5, 1998. Prior to February 5, 1998, ITT provided cash management services to us. We have included the invested funds in the captions "cash and cash equivalents" and "marketable debt securities" in the December 31, 1999 balance sheet. The marketable debt securities have maturity dates in excess of 90 days at the time of purchase and we record them at their market value. We include debt securities with original maturity dates of less than 90 days in cash and cash equivalents and record such securities at cost which approximates market value. We estimate that the market risk associated with our investments in marketable debt securities can best be measured by a potential decrease in the fair value of these securities resulting from a hypothetical 10% increase in interest rates. If such a hypothetical increase in rates were to occur, the reduction in the market value of our portfolio of securities would not be material.

variations in quarterly results of operations

Our quarterly results of operations have tended to fluctuate significantly within a fiscal year because of differences in the number of weeks of earned tuition revenue in each fiscal quarter and the timing of student matriculations. Prior to the first quarter of 2000, our first and third fiscal quarters had 13 weeks of earned tuition revenue, while our second and fourth quarters had only 11 weeks of earned tuition revenue because of two-week student vacation breaks in June and December. In addition, revenues in our third and fourth fiscal quarters generally benefit from increased student matriculations. The number of new students entering our institutes tends to be substantially higher in June (27% of all new students in 1999) and September (36% of all new students in 1999) because of the significant number of recent high school graduates entering our institutes for the academic quarters beginning in those two months. The academic schedule generally does not affect our incurrence of costs, however, and costs do not fluctuate significantly on a quarterly basis. Commencing with the first quarter of 2000, each of our four quarters will have 12 weeks of tuition revenue.

The following table sets forth our revenues in each quarter during the three prior fiscal years.

quarterly revenue

(Dollars in thousands)

Three-Month Period Ended	1999		1998		1997	
	Amount	Percent	Amount	Percent	Amount	Percent
March 31	$79,972	25%	$72,287	25%	$64,476	25%
June 30	70,638	22	65,077	22	58,412	22
September 30	87,465	28	81,700	28	73,060	28
December 31	78,295	25	72,311	25	65,716	25
Total for Year	$316,370	100%	$291,375	100%	$261,664	100%

Results of Operations

The following table sets forth the percentage relationship of certain statement of income data to revenues for the periods indicated.

	Year Ended December 31,		
	1999	1998	1997
Revenues	100.0%	100.0%	100.0%
Cost of educational services	60.6	60.6	62.3
Student services and administrative expenses	27.5	28.0	27.7
Legal settlements	- -	4.4	- -
Offering, changes in control and other one-time expenses	0.3	0.6	- -
Operating income	11.6	6.4	10.0
Interest income, net	0.8	1.8	2.1
Income before income taxes and cumulative effect of change in accounting principle	12.4%	8.2%	12.1%

year ended december 31, 1999 compared with year ended december 31, 1998

Revenues. Revenues increased $25.0 million, or 8.6%, to $316.4 million for the year ended December 31, 1999 from $291.4 million for the year ended December 31, 1998 primarily due to:

- a 5% increase in tuition rates in each of September 1999 and 1998;
- a 4.5% increase in the total student enrollment at January 1, 1999 compared to January 1, 1998 (25,608 at January 1, 1999 compared to 24,498 at January 1, 1998); and
- a 9.0% increase in the number of first-time and re-entering students beginning classes at our institutes (26,716 in 1999 compared to 24,521 in 1998).

The total student enrollment on December 31, 1999 was 26,428, an increase of 3.2% from the 25,608 total student enrollment on December 31, 1998.

Cost of Educational Services. Cost of educational services increased $15.3 million, or 8.7%, to $191.8 million in 1999 from $176.5 million in 1998.

The principal causes of this increase include:

- the costs required to service the increased enrollment;
- normal inflationary cost increases for wages, rent and other costs of services; and
- increased costs at new institutes (one in March 1998, one in June 1998, one in October 1998, two in January 1999 and one in April 1999).

Cost of educational services as a percentage of revenues was 60.6% in 1999, which was the same percentage as in 1998.

Student Services and Administrative Expenses. Student services and administrative expenses increased $5.5 million, or 6.7%, to $87.0 million in 1999 from $81.5 million in 1998. Student services and administrative expenses decreased to 27.5% of revenues in 1999 compared to 28.0% in 1998 primarily because the percentage increase in the costs associated with the sales representatives that we employed in 1999 was less than the percentage increase in revenues in 1999. Media advertising costs in the year ended December 31, 1999 were 9.6% more than in the year ended December 31, 1998.

One-Time Expenses. We recorded a $12.9 million ($0.28 per share) provision for the settlement of certain legal proceedings and claims in 1998. (See Note 10 of Notes to Consolidated Financial Statements). In 1999, we incurred net one-time expenses of $0.9 million ($0.02 per share) associated with the costs of ITT's February 1999 public offering of our common stock (the "February 1999 Offering") and special bonus payments to employees for extraordinary services, net of amounts reimbursed by ITT. In June 1998, we incurred total expenses of $1.1 million ($0.04 per share) for ITT's June 1998 public offering of our common stock (the "June 1998 Offering"). In addition, we incurred expenses of $0.8 million ($0.02 per share) in 1998 associated with our change in control and establishment of new employee benefit plans.

Operating Income. The following table sets forth our operating income (in thousands) for the year ended December 31, 1999 and 1998:

	Year Ended December 31,	
	1999	1998
Operating income as reported	$36,757	$18,636
Legal settlements	- -	12,858
Offering expenses, change in control and other one-time expenses	900	1,872
Operating income before one-time expenses	$37,657	$33,366

Interest Income. Interest income, net decreased $2.9 million in 1999 compared to 1998, which was primarily due to the reduction in our cash and cash equivalents, restricted cash and marketable debt securities as a result of our repurchase of 2.4 million shares of ESI common stock for $68.9 million throughout 1999.

Income Taxes. Our combined effective federal and state income tax rate in 1998 was 41.8%. Our 1999 federal and state income tax rate was 37.8%, as a result of lower state income taxes.

Net Income. The following table sets forth our net income (in thousands) for the year ended December 31, 1999 and 1998:

	Year Ended December 31,	
	1999	1998
Net income as reported	$23,528	$13,941
Legal settlements (after tax)	- -	7,715
Offering expenses, change in control and other one-time expenses (after tax)	554	1,501
Cumulative effect of change in accounting principle (after tax)	823	- -
Net income before one-time expenses and cumulative effect of change in accounting principle	$24,905	$23,157

year ended december 31, 1998 compared with year ended december 31, 1997

Revenues. Revenues increased $29.7 million, or 11.3%, to $291.4 million for the year ended December 31, 1998 from $261.7 million for the year ended December 31, 1997 primarily due to:

- a 5% increase in tuition rates in each of September 1998 and 1997;
- an 8.2% increase in the total student enrollment at January 1, 1998 compared to January 1, 1997 (24,498 at January 1, 1998 compared to 22,633 at January 1, 1997); and
- a 6.1% increase in the number of first-time and re-entering students beginning classes at our institutes (24,521 in 1998 compared to 23,111 in 1997).

The total student enrollment on December 31, 1998 was 25,608, an increase of 4.5% from the 24,498 total student enrollment on December 31, 1997.

Cost of Educational Services. Cost of educational services increased $13.4 million, or 8.2%, to $176.5 million in 1998 from $163.1 million in 1997. The principal causes of this increase include:

- the costs required to service the increased enrollment;
- normal inflationary cost increases for wages, rent and other costs of services; and
- increased costs at new institutes (one opened in June 1997, two in December 1997, one in March 1998, one in June 1998 and one in October 1998).

Cost of educational services as a percentage of revenues decreased to 60.6% in 1998 compared to 62.3% in 1997, because the greater revenues did not cause an increase in the fixed portion of our rent, administrative salaries and other costs included in cost of educational services. Cost of educational services included a $1.2 million provision in 1998 (compared to a $3.2 million provision in 1997) for legal expenses associated with the legal actions involving the hospitality program. Excluding this provision, cost of educational services in 1998 would have been 60.2% of revenues, a 0.9% improvement from 1997.

Student Services and Administrative Expenses. Student services and administrative expenses increased $9.1 million, or 12.6%, to $81.5 million in 1998 from $72.4 million in 1997. Student services and administrative expenses increased to 28.0% of revenues in 1998 compared to 27.7% in 1997 primarily because of increased media advertising (up 14.8%) and an increase in the provision for doubtful accounts. The increase in the provision for doubtful accounts resulted from a decrease in the amount of Title IV Program funds we received, which was caused by a change in the DOE regulations that became effective July 1, 1997. The DOE regulations revised the procedures governing how an institution participating in Title IV Programs requests, maintains, disburses and otherwise manages Title IV Program funds. The revised regulations require us to receive Title IV Program loan funds in three equal quarterly disbursements rather than the two disbursements previously permitted.

One-Time Expenses. We recorded a $7.7 million after tax ($0.28 per share) provision for the settlement of certain legal proceedings and claims in 1998. (See Note 10 of Notes to Consolidated Financial Statements). In June 1998, we incurred total expenses for the June 1998 Offering of $1.0 million after tax ($0.04 per share). In addition, we incurred expenses of $0.5 million after tax ($0.02 per share) in 1998 associated with our change in control and establishment of new employee benefit plans.

Operating Income. The following table sets forth our operating income (in thousands) for the year ended December 31, 1998 and 1997:

	Year Ended December 31,	
	1998	1997
Operating income as reported	$18,636	$26,223
Legal settlements	12,858	- -
June 1998 Offering expenses	1,117	- -
Change in control and other one-time expenses	755	- -
Operating income before one-time expenses	$33,366	$26,223

Interest Income. Interest income decreased $0.2 million in 1998 compared to 1997, which was primarily due to the lower interest rate earned on our cash investments and marketable debt securities (i.e., 5.5% in 1998 compared to 6.3% in 1997) partially offset by the earnings on our increased invested balances.

Income Taxes. Our combined effective federal and state income tax rate in 1997 was 39.8%. Our 1998 federal and state income tax rate was 41.8%, because $0.9 million of the June 1998 Offering expenses were not tax deductible.

Net Income. The following table sets forth our net income (in thousands) for the year ended December 31, 1998 and 1997:

	Year Ended December 31,	
	1998	1997
Net income as reported	$13,941	$19,123
Legal settlements (after tax)	7,715	- -
June 1998 Offering expenses (after tax)	1,048	- -
Change in control and other one-time expenses (after tax)	453	- -
Net income before one-time expenses	$23,157	$19,123

liquidity and capital resources

In 1999, we indirectly derived approximately 69% of our revenues from Title IV Programs. Federal regulations dictate the timing of disbursements of funds under Title IV Programs. Students must apply for a new loan for each academic year, which consists of three academic quarters. Loan funds are generally provided by lenders in three disbursements for each academic year. The first disbursement is usually received either 30 days after (in the case of students commencing a program of study) or ten days before the start of the first academic quarter of a student's academic year, and the second and third disbursements are typically received ten days before the start of each subsequent quarter of a student's academic year. While the timing of loan disbursements to us is subject to a student's directions to the lender and to existing regulatory requirements regarding such disbursements, we have typically received student loan funds upon the lender's disbursement of the student loan funds.

Simultaneous with the close of the February 1999 Offering, we repurchased 1,500,000 shares of our common stock from ITT at the per share price to the public of the shares sold in the February 1999 Offering, less underwriters' commissions and discounts, for an aggregate cost of $49,088 (the "February 1999 Stock Repurchase").

On April 21, 1999, our Board of Directors authorized ESI to repurchase up to 2,000,000 outstanding shares of our common stock in the open market or through privately negotiated transactions in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended. Subsequent to the February 1999 Stock Repurchase, we repurchased 919,000 shares of our common stock at an average cost of $21.57 per share, or $19.8 million in total. All of the repurchased shares of our common stock became treasury shares upon repurchase and most of the repurchased shares continue to be held as treasury shares. We may elect to repurchase additional shares of our common stock from time to time in the future, depending on market conditions and other considerations. The purpose of the stock repurchase program is to help us achieve our long-term goal of enhancing shareholder value.

Our principal uses of cash are to pay salaries, occupancy and equipment costs, recruiting and marketing expenses, administrative expenses and taxes, including institute start-up costs for new institutes. Our net cash items (consisting of cash and cash equivalents, restricted cash and marketable debt securities) decreased from $119.3 million at December 31, 1998 to $68.0 million at December 31, 1999. This decrease was due to our repurchase of 2,419,000 shares of our common stock for $68.9 million during 1999. Excluding our stock repurchase, cash items increased $17.6 million. Marketable debt securities and cash equivalents ranged from a low of $25.8 million in August 1999 to a high of $119.3 million on January 1, 1999.

We have generated positive cash flows from operations for the past five years. Cash flows from operations in 1999 was $34.0 million (excluding the $23.2 million decrease in marketable debt securities), an increase of $2.1 million from $31.9 million (including the $38.3 million increase in marketable debt securities) in 1998. This increase was primarily due to higher cash flows from operations caused by the increase in income and offset by the payment of the 1998 legal settlement amount in 1999.

At December 31, 1999, we had positive working capital of $20.5 million. Deferred tuition revenue, which represents the unrecognized portion of tuition revenue received from students, was $36.6 million at December 31, 1999.

An institution may lose its eligibility to participate in some or all Title IV Programs, if the rates at which the institution's students default on federal student loans exceed specific percentages. An institution whose cohort default rate on loans under the Federal Family Education Loan ("FFEL") program and the William D. Ford Federal Direct Loan ("FDL") program is 25% or greater for three consecutive federal fiscal years loses eligibility to participate in those programs for the remainder of the federal fiscal year in which the DOE determines that the institution has lost its eligibility and for the two subsequent federal fiscal years. In addition, amendments to the HEA enacted in connection with the U.S. Congress' reauthorization of the HEA in October 1998 (the "1998 HEA Amendments") provide that if an institution becomes ineligible to participate in the FFEL and FDL programs following the publication of its federal fiscal year FFEL/FDL cohort default rate, the institution will also be ineligible to participate in the Federal Pell Grant program for the same period of time.

None of our campus groups (defined as the main campus and its additional locations or branch campuses, if any) had a FFEL/FDL cohort default rate equal to or greater than 25% for the 1997 federal fiscal year, the most recent year for which the DOE has published FFEL/FDL official cohort default rates. None of our campus groups had a FFEL/FDL preliminary cohort default rate equal to or greater than 25% for the 1998 federal fiscal year, which preliminary rates were issued by the DOE in February 2000. One of our prior campus groups, consisting only of the institute in Garland, Texas, had FFEL/FDL cohort default rates exceeding 25% for three consecutive federal fiscal years beginning with the 1993 federal fiscal year. Consequently, in June 1998, the Garland institute became ineligible to participate in the FFEL and FDL programs. Shortly thereafter, we stopped enrolling new students in the Garland institute. In June 1999, we closed the Garland institute after all of the students enrolled either completed their programs of study or transferred to another school. The Garland institute accounted for approximately 0.3% of our revenues in 1999. After the Garland institute became ineligible to participate in FFEL and FDL programs, we arranged for an unaffiliated, private funding source to provide loans to the students enrolled in the Garland institute. This alternative financing source required us to guarantee repayment of the loans it issued. Based on our experience with the repayment of Title IV Program loans by students who attended the Garland institute, we believe that such guaranty should not result in a material adverse effect on our financial condition, results of operations or cash flows.

Prior to the 1998 HEA Amendments, the HEA limited how much of a student's tuition and fees an institution could retain for a student who withdrew from the institution. A student was only obligated for a pro rata portion of the education costs charged by the institution, if the student withdrew during the first 60% of the student's first period of enrollment. For our institutes, a period of enrollment is generally an academic quarter. A student who withdrew after the first period of enrollment was also subject to a refund calculation, but it was not a straight pro rata calculation. The institution had to refund any monies it collected in excess of the pro rata or other applicable portion to the appropriate lenders or Title IV Programs in a particular order.

The 1998 HEA Amendments rescinded the limitation on how much of a student's tuition and fees an institution could retain for a withdrawing student, but the standards of most of the state education authorities that regulate our institutes (the "SEAs") and the Accrediting Council for Independent Colleges and Schools ("ACICS") that accredits our institutes continue to impose such a limitation. The 1998 HEA Amendments and their implementing regulations impose a limit on the amount of Title IV Program funds a withdrawing student can use to pay his or her education costs. This limitation permits a student to use only a pro rata portion of the Title IV Program funds that the student would otherwise be eligible to use, if the student withdraws during the first 60% of any period of enrollment. The institution must refund to the appropriate lenders or Title IV Programs any Title IV Program funds that the institution receives on behalf of a withdrawing student in excess of the amount the student can use for such period of enrollment. These new requirements contained in the 1998 HEA Amendments must be implemented by all institutions no later than October 7, 2000, but an institution may elect to begin complying with these new standards at an earlier date. We do not plan to elect to comply with these new standards prior to October 7, 2000.

Under the policies of the ACICS and several of the SEAs, in a variety of instances withdrawing students will still be obligated to the institution under the new HEA requirements for education costs that the students can no longer pay with Title IV Program funds. In these instances, we expect that many withdrawing students will be unable to pay such costs and that we will be unable to collect a significant portion of such costs. Title IV Program funds are generally paid sooner and are more collectible than tuition payments from other sources. As a result, the new HEA requirements could have a material adverse effect on our financial condition, results of operations and cash flows beginning with our 2001 fiscal year.

Under a provision of the HEA commonly referred to as the "90/10" Rule, a for-profit institution, such as each of our campus groups, becomes ineligible to participate in Title IV Programs if, on a cash accounting basis, the institution derives more than 90% of its applicable revenues for a fiscal year from Title IV Programs. Prior to the 1998 HEA Amendments, the applicable percentage was 85%. For each of our 1998 and 1999 fiscal years, none of our campus groups derived more than 79% of its revenues from Title IV Programs. For our 1999 fiscal year, the range of our campus groups was from approximately 62% to approximately 78%. The 5% increase in the percentage of applicable revenues that we can derive from Title IV Programs increased the aggregate amount of Title IV Program funds that students can use to pay their education costs of attending our institutes. Title IV Program funds are generally paid sooner and are more collectible than tuition payments from other sources. As a result, this 5% increase had a positive impact on our results of operations and cash flows in our 1999 fiscal year.

The DOE, the ACICS and most of the SEAs have laws, regulations and/or criteria (collectively "Regulations") pertaining to the change in control of institutions, but these Regulations do not uniformly define what constitutes a change in control. When a change in control occurs under the DOE's Regulations, an institution's eligibility to continue to participate in Title IV Programs is subject to review and the institution could lose such eligibility, with the result that the institution would no longer be able to authorize or, with limited exceptions, disburse Title IV Program funds to its students. The DOE may provisionally certify an institution for a temporary period following a change in control. The DOE's reinstatement of an institution's certification to participate in Title IV Programs depends on its determination that the institution, under its new ownership and control, complies with specified DOE requirements for institutional eligibility. The time required for the DOE to make such a determination can vary but, if the institution submits a materially complete application for reinstatement within 10 business days after the change in control, the institution will be certified while the DOE conducts its review.

The February 1999 Offering was not a change in control under the Regulations of the DOE or the ACICS, but it was a change in control under the Regulations of some of the SEAs. The Accrediting Commission of Career Schools and Colleges of Technology ("ACCSCT"), which accredited 61 of our institutes at the time, advised us that none of our institutes' accreditation by the ACCSCT would be affected by the February 1999 Offering. We obtained all of the approvals of the February 1999 Offering from the SEAs that required approval. As a result, the February 1999 Offering did not affect our ability to participate in Title IV Programs.

A change in control could occur as a result of future transactions in which we, our institutes or a parent company as defined in DOE Regulations are involved. Some corporate reorganizations and some changes in the boards of directors of such corporations are two examples of such transactions. A material adverse effect on our financial condition, results of operations and cash flows would result if we had a change in control and a material number of our institutes failed, in a timely manner, to be reauthorized by their SEAs, reaccredited by the ACICS or recertified by the DOE to participate in Title IV Programs.

Our capital assets consist primarily of classroom and laboratory equipment (such as computers, electronic equipment and robotic systems), classroom and office furniture, software and leasehold improvements. We lease all of our building facilities. Capital expenditures totaled $17.0 million during 1999 and included expenditures of $1.3 million for new technical institutes, $6.7 million to expand curricula offerings at existing institutes, $4.2 million to replace or add furniture or equipment at existing institutes, $1.7 million on leasehold improvements and $3.1 million for software that was developed or purchased to enhance our current information systems. Leasehold improvements represent part of our continuing effort to maintain our existing facilities in good condition. Capital expenditures increased by $5.6 million to $17.0 million in 1999 from $11.4 million in 1998, principally due to the expenditure of approximately $7.0 million for the continued roll-out of our computer network systems program. To date, cash generated from operations has been sufficient to meet our capital expenditures.

We plan to continue to upgrade and expand current facilities and equipment. We expect that 2000 capital expenditures will be approximately $28.0 million, of which approximately $11.0 million would be capital expenditures for new curriculum at existing institutes and $7.0 million would be capital expenditures for planned changes in our electronics engineering technology curriculum. The capital additions for a new institute are approximately $0.4 million and the capital expenditures for each new curriculum at an existing institute are approximately $0.3 million. We anticipate that our planned capital additions can be funded from cash flows from operations. Cash flows on a long-term basis are highly dependent upon the receipt of Title IV Program funds and the amount of funds spent on new institutes, curricula additions at existing institutes and possible acquisitions.

>>results of operations (Continued)

We do not believe that any reduction in cash and cash equivalents or marketable debt securities that may result from its use to effect any future stock repurchases will have a material adverse effect on our expansion plans, planned capital expenditures, ability to meet any applicable regulatory financial responsibility standards, or ability to conduct normal operations.

new accounting pronouncements

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 “Revenue Recognition in Financial Statements” ("SAB 101"). We will begin following the guidance provided by SAB 101 effective January 1, 2000. We anticipate that SAB 101 will result in the deferral of our recognition of certain types of revenue and will require a cumulative adjustment that will reduce our net income by approximately $2.8 million in 2000.

factors that may affect future results

This report contains certain forward looking statements that involve a number of risks and uncertainties. Among the factors that could cause actual results to differ materially are the following: business conditions and growth in the postsecondary education industry and in the general economy; changes in federal and state governmental regulations with respect to education and accreditation standards, or the interpretation or enforcement thereof, including, but not limited to, the level of government funding for, and our eligibility to participate in, student financial aid programs utilized by our students; effects of any change in ownership of ESI resulting in a change in control of ESI, including, but not limited to, the consequences of such changes on the accreditation and federal and state regulation of the institutes; our ability to implement our growth strategies, including our information technology programs; receptivity of students and employers to our existing program offerings and new curricula; and loss of lender access to our students for student loans.

report of independent accountants

To The Board of Directors and Shareholders of ITT Educational Services, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained earnings and of cash flows present fairly, in all material respects, the financial position of ITT Educational Services, Inc. and its subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999 in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Company’s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

As discussed in Note 2 to the consolidated financial statements, the Company adopted AICPA Statement of Position 98-5, “Reporting on the Costs of Start-Up Activities” in 1999.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Indianapolis, Indiana
January 18, 2000

>>consolidated statements of income and retained earnings

(In thousands, except per share data)

Year Ended December 31,	1999	1998	1997
Revenues	$316,370	$291,375	$261,664
Costs and Expenses			
Cost of educational services	191,760	176,487	163,053
Student services and administrative expenses	86,953	81,522	72,388
Legal settlements	- -	12,858	- -
Offering, change in control and other one-time expenses	900	1,872	- -
Total costs and expenses	279,613	272,739	235,441
Operating income	36,757	18,636	26,223
Interest income, net	2,396	5,329	5,565
Income before income taxes and cumulative effect of change in accounting principle	39,153	23,965	31,788
Income taxes	14,802	10,024	12,665
Income before cumulative effect of change in accounting principle	24,351	13,941	19,123
Cumulative effect of change in accounting principle for institute start-up costs, net of tax	(823)	- -	- -
Net income	23,528	13,941	19,123
Retained earnings, beginning of period	68,973	55,032	35,909
Retained earnings, end of period	$ 92,501	$ 68,973	$ 55,032
Earnings (loss) per common share (basic):			
Income before cumulative effect of change in accounting principle	$0.96	$0.52	$0.71
Cumulative effect of change in accounting principle for institute start-up costs, net of tax	(0.03)	- -	- -
Net income	$ 0.93	$ 0.52	$ 0.71
Earnings (loss) per common share (diluted):			
Income before cumulative effect of change in accounting principle	$0.96	$0.51	$0.71
Cumulative effect of change in accounting principle for institute start-up costs, net of tax	(0.03)	- -	- -
Net income	$ 0.93	$ 0.51	$ 0.71

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

>>consolidated balance sheets

(In thousands, except per share data)

December 31,	1999	1998
Assets		
Current assets		
Cash and cash equivalents	$ 48,510	$ 77,335
Restricted cash	4,354	3,617
Marketable debt securities	15,097	38,316
Accounts receivable, less allowance for		
doubtful accounts of $2,972 and $2,531	11,685	10,772
Deferred income tax	5,441	5,969
Prepaids and other current assets	3,995	2,749
Total current assets	89,082	138,758
Property and equipment, net	31,686	24,985
Direct marketing costs	8,712	7,915
Other assets	1,522	3,913
Total assets	$131,002	$175,571
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable	$ 17,730	$ 15,992
Accrued compensation and benefits	8,576	6,488
Accrued legal settlements	- -	7,604
Other accrued liabilities	5,751	7,896
Deferred tuition revenue	36,565	32,261
Total current liabilities	68,622	70,241
Other liabilities	4,609	3,474
Total liabilities	73,231	73,715
Commitments and contingent liabilities (Note 10)		
Shareholders' equity		
Preferred stock, $.01 par value,		
5,000,000 shares authorized, none		
issued or outstanding	- -	- -
Common stock, $.01 par value, 150,000,000		
shares authorized, 27,034,452 and		
27,011,202 issued	270	270
Capital surplus	33,912	32,613
Retained earnings	92,501	68,973
Treasury stock, 2,419,000 shares, at cost	(68,912)	- -
Total shareholders' equity	57,771	101,856
Total liabilities and shareholders' equity	$131,002	$175,571

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

>>consolidated statements of cash flows

(In thousands)

Year Ended December 31,	1999	1998	1997
Cash flows provided by (used for) operating activities:			
Net income	$23,528	$13,941	$19,123
Adjustments to reconcile net income to net cash			
provided by operating activities:			
Depreciation and amortization	11,150	9,282	7,939
Provision for doubtful accounts	4,362	4,326	2,354
Deferred taxes	3,780	(3,219)	202
Increase/decrease in operating assets			
and liabilities:			
Marketable debt securities	23,219	(38,316)	- -
Accounts receivable	(5,275)	(5,418)	(2,656)
Direct marketing costs	(797)	(1,033)	(1,108)
Accounts payable and accrued liabilities	(7,379)	13,474	2,958
Prepaids and other assets	298	(904)	(1,769)
Deferred tuition revenue	4,304	1,411	(12,682)
Net cash provided by (used for) operating activities	57,190	(6,456)	14,361
Cash flows provided by (used for) investing activities:			
Capital expenditures, net	(17,005)	(11,381)	(11,465)
Net decrease in cash invested with ITT Corporation	- -	94,800	(4,992)
Net cash provided by (used for) investing activities	(17,005)	83,419	(16,457)
Cash flows provided by (used for) finance activities:			
Purchase of treasury stock	(68,912)	- -	- -
Exercise of stock options	639	100	- -
Net cash provided by (used for) finance activities	(68,273)	100	- -
Net increase (decrease) in cash, cash			
equivalents and restricted cash	(28,088)	77,063	(2,096)
Cash, cash equivalents and restricted cash at			
beginning of period	80,952	3,889	5,985
Cash, cash equivalents and restricted cash at			
end of period	$52,864	$80,952	$ 3,889
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Income taxes	$12,867	$12,757	$12,352
Interest	174	238	291

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

>>notes to consolidated financial statements

December 31, 1999, 1998 and 1997
(Dollar amounts in thousands, unless otherwise stated)

1. ownership and change in control

From ITT Educational Services, Inc.'s ("ESI") initial public offering in 1994 until June 9, 1998, ITT Corporation ("ITT") owned 83.3% of the outstanding shares of ESI common stock.

On February 23, 1998, Starwood Hotels & Resorts Worldwide, Inc. ("Starwood Hotels") completed the acquisition of ITT (the "Merger") and ITT became a subsidiary of Starwood Hotels. As a result of the Merger, a change in control of ESI occurred under regulations of the U.S. Department of Education ("DOE") and each ITT Technical Institute campus group became ineligible to participate in federal student financial aid programs. Effective March 20, 1998, the eligibility of each ITT Technical Institute campus group to participate in federal student financial aid programs was reinstated by the DOE with certain conditions imposed by the DOE. ESI believes that it is in compliance with or satisfies these DOE conditions (see Note 10).

On June 9, 1998, ITT sold 13,050,000 shares of ESI's common stock held by ITT to the public (48.3% of the outstanding shares) (the "June 1998 Offering"). After the June 1998 Offering, ITT owned 35% of the outstanding shares of ESI common stock. The June 1998 Offering did not constitute a change in control of ESI under the DOE's regulations.

On February 1, 1999, ITT sold 7,950,000 shares of ESI common stock held by ITT to the public (the "February 1999 Offering"). The February 1999 Offering did not constitute a change in control of ESI under the DOE's regulations. Simultaneous with the close of the February 1999 Offering, ESI repurchased 1,500,000 shares of ESI common stock from ITT at the February 1999 Offering price to the public, less underwriters' commissions and discounts, for an aggregate cost of $49,088 (the "February 1999 Stock Repurchase"). Following the February 1999 Offering and February 1999 Stock Repurchase, ITT no longer owned any shares of ESI common stock.

In conjunction with the February 1999 Offering, ITT paid ESI $2,100 related to the settlement of various intercompany matters, of which $660 is included in capital surplus.

On April 21, 1999, ESI's Board of Directors authorized ESI to repurchase up to 2,000,000 outstanding shares of ESI common stock in the open market or through privately negotiated transactions in accordance with Rule 10b-18 of the Securities Exchange Act of 1934, as amended. Subsequent to the February 1999 Stock Repurchase, ESI repurchased 919,000 shares of ESI common stock at an average cost of $21.57 per share or $19,800 in total. All of the repurchased shares of ESI common stock become treasury shares upon repurchase. ESI may elect to repurchase additional shares of ESI common stock from time to time in the future, depending on market conditions and other considerations. The purpose of the stock repurchase program is to help ESI achieve its long-term goal of enhancing shareholder value.

2. summary of accounting principles and policies

Business Activities. ESI is a leading proprietary postsecondary education system primarily offering career-focused, technical degree programs of study. At December 31, 1999, ESI operated 67 technical institutes throughout the United States. ESI maintains its corporate headquarters in Indianapolis, Indiana.

Principles of Consolidation. The consolidated financial statements include the accounts of ESI and its wholly-owned subsidiaries. All significant intercompany balances and transactions are eliminated in consolidation.

Use of Estimates. The preparation of these financial statements, in conformity with generally accepted accounting principles, includes estimates that are determined by ESI's management.

Cash Equivalents and Marketable Debt Securities. Marketable debt securities are classified as trading securities and have maturity dates in excess of 90 days at the time of purchase and are recorded at their market value. Debt securities with original maturity dates of less than 90 days are included in cash and cash equivalents and are recorded at cost, which approximates market value. The cost of securities sold is based on the first-in, first-out method.

Investment income for the year ended December 31, 1999 and 1998 consists of:

	Year Ended December 31,	
	1999	**1998**
Net realized gains (losses) on the sale of trading securities	$ (98)	$ 11
Interest and dividend income, net	2,880	4,926
Change in net unrealized holding gain (loss)	(354)	85
	$2,428	$5,022

Property and Equipment. ESI includes all property and equipment in the financial statements at cost. Provisions for depreciation of property and equipment have generally been made using the straight-line method for financial reporting purposes and accelerated methods for tax purposes. Estimated useful lives generally range from three to ten years for furniture and equipment and leasehold improvements. Maintenance, repairs and renewals not of a capital nature are expensed as incurred. Fully depreciated assets no longer in use are removed from both the asset and accumulated depreciation accounts in the year of their retirement. Any gains or losses on dispositions are credited or charged to income, as appropriate.

ESI adopted the American Institute of Certified Public Accountants (the "AICPA") Statement of Position ("SOP") 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" effective July 1, 1998, which increased net income by $508 ($0.02 per share) in the year ended December 31, 1998. Costs incurred prior to the initial application of this SOP, whether or not capitalized, were not adjusted to the amounts that would have been capitalized had this SOP been in effect when those costs were incurred. Estimated useful lives generally range from three to eight years for capitalized software.

Fair Value of Financial Instruments. The carrying amounts reported in the balance sheets for cash and cash equivalents, restricted cash, accounts receivable, accounts payable, other accrued liabilities and deferred tuition revenue approximate fair value because of the immediate or short-term maturity of these financial instruments. Marketable debt securities are recorded at their market value.

Recognition of Revenues. Tuition revenues are recorded on a straight-line basis over the length of the applicable course. If a student discontinues training, the revenue related to the remainder of that academic quarter is recorded with the amount of refund resulting from the application of federal, state or accreditation requirements recorded as an expense. On an individual student basis, tuition earned in excess of cash received is recorded as accounts receivable, and cash received in excess of tuition earned is recorded as deferred tuition revenue. Laboratory fees are recorded as revenue at the beginning of each academic quarter. Textbook sales are recognized when they occur.

In December of 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements" ("SAB 101"). ESI will begin following the guidance provided by SAB 101 effective January 1, 2000. ESI anticipates that SAB 101 will result in the deferral of its recognition of certain types of revenue and will require a cumulative adjustment that will reduce its net income by approximately $2,800 in 2000.

Advertising Costs. ESI expenses all advertising costs as incurred.

Direct Marketing Costs. Direct costs incurred relating to the enrollment of new students are capitalized using the successful efforts method. Direct marketing costs include recruiting representatives' salaries, employee benefits and other direct costs less enrollment fees. Direct marketing costs are amortized on an accelerated basis over the average course length of 24 months commencing on the start date. Direct marketing costs on the balance sheet totaled $8,712 and $7,915 at December 31, 1999 and December 31, 1998, respectively, net of accumulated amortization of $8,015 and $6,895 at those dates, respectively.

Institute Start-Up Costs. Deferred institute start-up costs consist of all direct costs (excluding advertising costs) incurred at a new institute from the date a lease for a technical institute facility is entered into until the first class start. Such capitalized costs are amortized on a straight-line basis over a one-year period. At December 31, 1998, deferred start-up costs included in other assets in the balance sheet totaled $1,354 net of accumulated amortization of $511. In conformity with AICPA SOP 98-5, "Reporting on the Costs of Start-Up Activities," ESI expensed the $1,354 of institute start-up costs, less $531 of deferred taxes, as a cumulative effect of a change in accounting principle in the first quarter of 1999. This new accounting requirement did not have a significant effect on 1999 income before the cumulative effect of the accounting change.

Offering, Change in Control and Other One-Time Expenses. In 1999, ESI incurred net one-time expenses of $900 associated with the costs of the February 1999 Offering and special bonus payments to employees for extraordinary services, net of amounts reimbursed by ITT. In 1998, ESI incurred expenses of $1,117 for the June 1998 Offering and expenses of $755 associated with its change in control and establishment of new employee benefit plans.

Income Taxes. ESI was included in the consolidated U.S. federal income tax return of ITT prior to June 9, 1998 and determined its income tax provision principally on a separate return basis in conformity with Statement of Financial Accounting Standards ("SFAS") No. 109. Under a tax sharing policy with ITT, income taxes were allocated to members of the U.S. consolidated group based principally on the amounts they would pay or receive if they filed a separate income tax return. Deferred income taxes were provided on the differences in the book and tax basis of assets and liabilities recorded on ESI's books (temporary differences) at the statutory tax rates expected to be in effect when such differences reversed. Temporary differences related to SFAS No. 106, SFAS No. 112, pension and self-insurance costs were recorded on the books of ITT where the related assets and liabilities were recorded. ITT paid current federal income taxes on behalf of ESI, as calculated under the tax sharing policy, and reflected the funding through the cash invested with ITT Corporation account.

Since June 9, 1998, ESI has filed its own federal income tax returns, paid its own federal income taxes and recorded all deferred income taxes on its books.

Earnings Per Common Share. Earnings per common share for all periods have been calculated in conformity with SFAS No. 128, "Earnings Per Share." Such data is based on historical net income and the average number of shares of ESI common stock outstanding during each period. The number of average shares outstanding utilized for basic earnings per share were 25,235,163 in 1999, 27,001,542 in 1998 and 26,999,952 in 1997. Average shares outstanding utilized for diluted earnings per share were approximately 25,380,000, 27,185,000 and 27,105,000 for 1999, 1998 and 1997, respectively. The difference in shares utilized in calculating basic and diluted earnings per share represents the average number of shares issued under ESI's stock option plans less shares assumed to be purchased with proceeds from the exercise of the stock options.

3. related party transactions

Prior to the June 1998 Offering, the relationship between ESI and ITT was governed by various agreements summarized as follows:

Intercompany Activities. ITT provided ESI with certain centralized treasury and financing functions. ESI transferred all unrestricted cash receipts to ITT and received funds from ITT for all disbursements. ESI earned interest on the average net cash balance held by ITT, at an interest rate that was set for a 12-month period and was 30 basis points over the most recently published rate for 12-month treasury bills. The net of all such cash transfers as well as charges from ITT for expenses related to ESI's participation in ITT's plans (such as pensions, medical insurance, federal income taxes, etc.) resulted in a net balance of cash invested with ITT. On February 5, 1998, ITT transferred approximately $83,000 to ESI and, since that date, ESI has been performing its own cash management function.

ITT also provided certain risk management and pension management services to ESI until June 9, 1998. The fee (contract service charge) for such services was 0.25% of ESI's annual revenue. The contract service charges were $15 and $654 for the years ended December 31, 1998 and 1997, respectively.

ESI's employees participated in certain employee benefit programs which were sponsored and administered by ITT until June 9, 1998. Administrative costs relating to these services and participation in these plans were charged to ESI using allocation methods management believes were reasonable. ESI paid a processing fee related to its participation in ITT's consolidated medical plan. The processing fee was $159 in 1997.

Tax Agreement. ITT and ESI participated in a tax agreement that provided, among other things, that ESI would pay ITT, with respect to federal income taxes for each period that ESI was included in ITT's consolidated federal return, the amount that ESI would have been required to pay had it filed a separate federal income tax return under the tax sharing policy described in Note 2.

Similarly, with respect to state, corporate, franchise or income taxes for those states where ITT filed a combined or consolidated state return that included ESI, ESI paid ITT an amount as if it filed a separate tax return. With respect to ITT's consolidated federal and state returns, ESI will be responsible for any deficiencies assessed with respect to such returns if such deficiencies relate to ESI. Similarly, ESI will be entitled to all refunds paid with respect to returns that relate to ESI. ESI will be responsible for all taxes, including assessments, if any, for prior years with respect to all other taxes payable by ESI.

Management believes the consolidated statements of income include a reasonable allocation of costs incurred by ITT which benefited ESI. The aforementioned agreements were modified in connection with the June 1998 Offering.

4. financial aid programs

ESI participates in various Title IV Programs. Approximately 69% of the ESI's 1999 revenue was derived from funds distributed under these programs.

ESI participates in the Federal Perkins Loan ("Perkins") program and administers on behalf of the federal government a pool of Perkins student loans which aggregated $7,579 and $8,565 at December 31, 1999 and 1998, respectively. ESI has recorded in its financial statements only its aggregate mandatory contributions to this program which at December 31, 1999 and 1998 aggregated $1,547 and $1,581, respectively. ESI has provided $980 and $972, respectively, for potential losses related to funds committed by ESI at December 31, 1999 and 1998.

The Title IV Programs are administered by ESI in separate accounts as required by government regulation. ESI is required to administer the funds in accordance with the requirements of the Higher Education Act of 1965, as amended, and DOE regulations and must use due diligence in approving and disbursing funds and servicing loans. In the event ESI does not comply with federal requirements, or if student loan default rates rise to a level considered excessive by the federal government, ESI could lose its eligibility to participate in the Title IV Programs or could be required to repay funds determined to have been improperly disbursed. Management believes that it is in substantial compliance with the federal requirements.

5. restricted cash

ESI participates in the Electronic Funds Transfer ("EFT") program through the DOE. All monies transferred to ESI via the EFT system are subject to certain holding period restrictions, generally from three to seven days, before they can be drawn into ESI's cash account. Such amounts are classified as restricted cash until they are applied to the students' accounts.

6. property and equipment

Fixed assets include the following:

	December 31, 1999	December 31, 1998
Furniture and equipment	$81,407	$70,581
Leasehold improvements	10,185	8,699
Capitalized software	3,982	- -
Land and land improvements	110	110
Construction in progress	342	583
	96,026	79,973
Less accumulated depreciation	(64,340)	(54,988)
	$31,686	$24,985

7. taxes

The provision for income taxes attributable to earnings before income taxes and cumulative effect of change in accounting includes the following:

	Year Ended December 31, 1999	1998	1997
Current			
Federal	$10,141	$11,052	$10,399
State	881	2,191	2,064
	11,022	13,243	12,463
Deferred			
Federal	3,081	(2,686)	168
State	699	(533)	34
	3,780	(3,219)	202
	$14,802	$10,024	$12,665

Deferred tax assets (liabilities) include the following:

	December 31, 1999	1998	1997
Direct marketing costs	$ (3,417)	$ (3,105)	$ (2,698)
Legal settlements	- -	2,983	- -
Institute start-up costs	- -	(531)	(516)
Depreciation	783	607	759
Reserves and other	1,577	3,209	2,399
Net deferred tax assets (liabilities)	$(1,057)	$ 3,163	$ (56)

Differences between effective income tax rates and the statutory U.S. federal income tax rates are as follows:

	Year Ended December 31, 1999	1998	1997
Statutory U.S. federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	2.6%	4.1%	4.1%
Non-deductible offering expenses	0.8%	1.5%	- -
Permanent differences and other	(0.6)%	1.2%	0.7%
Effective income tax rate	37.8%	41.8%	39.8%

The tax benefit associated with the exercise of non-qualified stock options reduced taxes currently payable by $135 in 1999 and was recorded as an increase to capital surplus.

8. retirement plans

Employee Pension Benefits. Prior to June 9, 1998, ESI participated in the Retirement Plan for Salaried Employees of ITT Corporation which covered substantially all employees of ESI. ITT determined the aggregate amount of pension expense on a consolidated basis based on actuarial calculations and such expense was allocated to participating units on the basis of compensation covered by the plan. Charges to ESI by ITT for pension expense for the years ended December 31, 1998 and 1997 were $1,858 and $4,458, respectively.

Effective June 9, 1998, ESI adopted its own non-contributory defined benefit pension plan. This plan, commonly referred to as a cash balance plan, provides benefits based upon annual employee earnings times established percentages of pay based on age and years of service.

During 1999, ESI adopted the ESI Excess Pension Plan, a non-qualified unfunded retirement plan, which covers a select group of management, and that provides for payment of those benefits at retirement that cannot be paid from the qualified ESI pension plan due to federal statutory legislation limits on the amount of benefits that can be paid and compensation that can be recognized under a tax-qualified retirement plan. The practical effect of the ESI Excess Pension Plan is to continue calculation of retirement benefits to all employees on a uniform basis.

The following is information on ESI's plans for 1999 and 1998:

Net periodic benefit cost:

	Year Ended December 31, 1999	Seven Months Ended December 31, 1998
Service cost	$4,336	$2,217
Interest cost	178	- -
Expected return on assets	(15)	- -
Recognized net actuarial loss/(gain)	26	- -
Net periodic pension cost	$4,525	$2,217

Change in benefit obligation:

	Year Ended December 31, 1999	Seven Months Ended December 31, 1998
Projected benefit obligation at beginning of period	$2,744	$ - -
Service cost	4,336	2,217
Actuarial loss	102	527
Interest cost	178	- -
Benefits paid	(30)	- -
Projected benefit obligation at end of period	7,330	2,744
Fair value of plan assets	2,058	- -
Funded status	(5,272)	(2,744)
Unrecognized net actuarial loss	664	527
Accrued benefit cost	$(4,608)	$(2,217)

Change in plan assets:

	Year Ended December 31, 1999
Fair value of plan assets at beginning of year	$ - -
Actual return on plan assets	(47)
Employer contributions	2,135
Benefits paid	(30)
Fair value of plan assets at end of year	$2,058

Weighted-average assumptions as of September 30, 1999 and 1998:

	1999	1998
Discount rate at beginning of year	6.5%	- -
Discount rate at end of year	7.5%	6.5%
Expected return on plan assets	9.0%	9.0%
Rate of compensation increase	4.5%	4.5%

Retirement Savings Plan. Prior to May 16, 1998, ESI participated in The ITT 401K Retirement Savings Plan, a defined contribution plan which covered substantially all employees of ESI. ESI's non-matching and matching contributions under this plan were provided for through the issuance of common shares of ITT until February 23, 1998 and paired shares of Starwood Hotels and Starwood Hotels & Resorts, a Maryland real estate investment trust, until May 16, 1998. The costs of the non-matching and matching Company contributions were charged by ITT to ESI. Effective May 16, 1998, ESI adopted its own 401(k) plan, a defined contribution plan which covers substantially all employees of ESI and operates similarly to The ITT 401K Retirement Savings Plan. ESI's non-matching and matching contributions under its 401(k) plan are made in the form of shares of ESI common stock. For the years ended December 31, 1999, 1998 and 1997, the costs of providing this benefit (including an allocation of the administrative costs of the plan) were $2,126, $2,109 and $2,104, respectively.

9. stock option and key employee incentive plans

ESI adopted and the stockholders approved the ITT Educational Services, Inc. 1994 Stock Option Plan ("1994 Plan") and the 1997 ITT Educational Services, Inc. Incentive Stock Plan ("1997 Plan"). During 1999, ESI established the 1999 Outside Directors Stock Option Plan ("1999 Stock Plan"), which provides for awards of non-qualified stock options to non-employee directors. ESI has adopted the disclosure only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Accordingly, no compensation cost has been recognized in the financial statements for the Plans. ESI has elected, as permitted by the standard, to continue following its intrinsic value based method of accounting for stock options consistent with APB Opinion No. 25, "Accounting for Stock Issued to Employees." Under the intrinsic method, compensation cost for stock options is measured as the excess, if any, of the quoted market price of ESI common stock at the measurement date over the exercise price.

Under the 1994 Plan, a maximum of 405,000 shares of ESI common stock may be issued upon exercise of options. Under the 1997 Plan, a maximum of 1.5% of the outstanding common shares may be issued each year commencing in 1997, with any unissued shares issuable in later years. Under the 1997 Plan, a maximum of 4,050,000 shares of ESI common stock may be issued upon exercise of options. Under the 1999 Stock Plan, a maximum of 250,000 shares of ESI common stock may be issued upon exercise of options. Under all Plans, the option price may not be less than 100% of the fair market value of ESI common stock on the date of grant. Under the Plans, the options will vest and become exercisable in three equal annual installments commencing with the first anniversary of the grant. Options issued during 1999 under the 1999 Stock Plan were immediately vested and exercisable. The options outstanding, granted, exercised and forfeited for the three years ended December 31, 1999 are as follows:

	1999		1998		1997	
	Number of Shares	**Average Option Price**	**Number of Shares**	**Average Option Price**	**Number of Shares**	**Average Option Price**
Outstanding at beginning of year	793,750	$17.67	405,000	$13.46	258,750	$ 7.37
Granted	507,500	32.31	405,000	21.69	146,250	24.25
Exercised	(23,250)	21.69	(11,250)	8.89	- -	- -
Forfeited	(31,500)	29.39	(5,000)	21.69	- -	- -
Outstanding at end of year	1,246,500	$23.26	793,750	$17.67	405,000	$13.46

	Exercise Price Range				
	$4.44	**$8.89–$11.94**	**$18.25–$24.25**	**$34.12–$36.25**	**Total**
Options outstanding at year end	135,000	112,500	584,000	415,000	1,246,500
Weighted average exercise price	$4.44	$10.72	$22.21	$34.26	$23.26
Remaining contractual life	5.0 years	6.0 years	8.0 years	9.1 years	7.9 years
Options exercisable at year end	135,000	112,500	289,083	- -	536,583
Weighted average exercise price	$4.44	$10.72	$ 22.36	- -	$15.41

ESI issued 23,250 and 11,250 shares of common stock for proceeds of $639 and $100 in conjunction with the exercise of stock options during 1999 and 1998, respectively.

If compensation costs for the plans had been determined based on the fair value of the stock options at grant date consistent with SFAS No. 123, ESI's net income and earnings per share for the years ended December 31, 1999, 1998 and 1997 would have been reduced to the proforma amounts indicated below:

	Year Ended December 31,		
	1999	**1998**	**1997**
Proforma			
Net income	$20,729	$12,554	$18,519
Basic earnings per share	0.82	0.46	0.69
Diluted earnings per share	0.82	0.46	0.68
As reported			
Net income	$23,528	$13,941	$19,123
Basic earnings per share	0.93	0.52	0.71
Diluted earnings per share	0.93	0.51	0.71

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions for the three years ended December 31:

	Year Ended December 31,		
	1999	**1998**	**1997**
Risk-free interest rates	4.9%	5.3%	6.6%
Expected lives (in years)	5	5	10
Volatility	39%	41%	46%
Dividend yield	None	None	None

In October 1999, the Compensation Committee of the Board of Directors awarded additional stock options for 489,500 shares of ESI common stock. The effective date of this award was January 7, 2000 and the exercise price is $13.50.

10. commitments and contingent liabilities

Lease Commitments. ESI leases substantially all of its facilities under operating lease agreements. A majority of the operating leases contain renewal options that can be exercised after the initial lease term. Renewal options are generally for periods of one to five years. All operating leases will expire over the next 14 years and management expects that leases will be renewed or replaced by other leases in the normal course of business. There are no material restrictions imposed by the lease agreements, and ESI has not entered into any significant guarantees related to the leases. ESI is required to make additional payments under the operating lease terms for taxes, insurance and other operating expenses incurred during the operating lease period.

Rent expense was composed of the following:

	Year Ended December 31,		
	1999	**1998**	**1997**
Minimum rentals	$23,396	$21,408	$18,961
Contingent rental	264	246	272
	$23,660	$21,654	$19,233

Future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 1999 are as follows:

2000	$23,670
2001	25,291
2002	23,334
2003	23,123
2004	20,832
Later Years	39,920
	$156,170

Rent expense and future minimum rental payments related to equipment leases are not significant.

Contingent Liabilities. In December 1994, ESI entered into an agreement with an unaffiliated, private funding source to provide loans to students of certain technical institutes. The agreement requires ESI to guarantee repayment of the loans. Outstanding loans at December 31, 1999 aggregated $2,736. Additionally, ESI is required to maintain on deposit with the lender 15% of the aggregate principal balance of the outstanding loans. This interest bearing deposit is included in other assets in the balance sheet.

ESI has a number of pending legal and other claims arising in the normal course of business. In September 1998, ESI agreed to settle eight legal proceedings (including *Eldredge, et al. v. ITT Educational Services, Inc., et al.*) involving 25 former students and the claims of 15 other former students that related primarily to ESI's marketing and recruitment practices and included allegations of misrepresentation, fraud and violations of certain federal and state statutes. As part of the settlement of these legal proceedings and claims, ESI received approval of a class settlement of the claims of (a) approximately 1,200 other persons who attended an associate degree program in hospitality at the ITT Technical Institute in Maitland, San Diego, Portland or Indianapolis and (b) approximately 19,000 other persons who attended any technology program at any ITT Technical Institute in California from January 1, 1990 through December 31, 1997. ESI recorded a $12,858 provision for legal settlements in the year ended December 31, 1998 as a result of the settlement of these legal proceedings and claims.

In the opinion of management, the ultimate outcome of the pending legal and other claims should not have a material adverse effect on ESI's financial condition, results of operations or cash flows.

Since March 20, 1998, all of ESI's schools have been operating under a three-year provisional certification from the DOE that allows the schools to continue to participate in various Title IV Programs. The provisional certification includes DOE imposed conditions related to certain accounting matters. No agreement between the DOE and ESI has been reached with respect to the fulfillment of certain of these conditions, because the DOE still has this matter under review. If the DOE required ESI to use certain accounting methods that differ from the methods presently used by ESI, then ESI could be forced to change certain of its accounting policies.

>>selected financial data

The following selected financial data of ESI are qualified by reference to and should be read with the Consolidated Financial Statements and Notes to Consolidated Financial Statements and other financial data included elsewhere in this report.

Year ended December 31,	1999	1998	1997	1996	1995
			(In thousands, except per share and operating data)		
Statement of Income Data:					
Revenue	$316,370	$291,375	$261,664	$232,319	$201,831
Cost of educational services	191,760	176,487	163,053	145,197	130,338
Student services and administrative expenses	86,953	81,522	72,388	66,546	57,268
Legal settlements	- -	12,858	- -	- -	- -
Offering, change in control and other one-time expenses	900	1,872	- -	- -	- -
Total costs and expenses	279,613	272,739	235,441	211,743	187,606
Operating income	36,757	18,636	26,223	20,576	14,225
Interest income, net (a)	2,396	5,329	5,565	4,119	4,802
Income before income taxes and cumulative effect of change in accounting principle	39,153	23,965	31,788	24,695	19,027
Income taxes	14,802	10,024	12,665	9,844	7,636
Income before cumulative effect of change in accounting principle	24,351	13,941	19,123	14,851	11,391
Cumulative effect of change in accounting principle for institute start-up costs, net of tax	(823)	- -	- -	- -	- -
Net income	$ 23,528	$ 13,941	$ 19,123	$ 14,851	$ 11,391
Earnings per share (b):					
Basic	$ 0.93	$ 0.52	$ 0.71	$ 0.55	$ 0.42
Diluted	$ 0.93	$ 0.51	$ 0.71	$ 0.55	$ 0.42
Other Operating Data:					
EBITDA (c)	$ 47,907	$ 27,918	$ 34,162	$ 28,069	$ 21,767
Operating losses from new technical institutes before income taxes (d)	$5,096	$ 5,257	$ 3,165	$ 5,721	$ 7,123
Capital expenditures, net	$17,005	$ 11,381	$ 11,465	$ 7,868	$ 8,206
Number of students at end of period	26,428	25,608	24,498	22,633	20,618
Number of technical institutes at end of period	67	65	62	59	56
At December 31,					
Balance Sheet Data:					
Cash, restricted cash, cash invested with ITT and marketable debt securities	$ 67,961	$119,268	$ 98,689	$ 95,793	$ 77,517
Total current assets	89,082	138,758	112,958	108,449	87,567
Property and equipment less accumulated depreciation	31,686	24,985	22,886	19,360	18,985
Total assets	131,002	175,571	145,914	135,749	114,284
Total current liabilities	68,622	70,241	55,946	65,405	58,766
Shareholders' equity	57,771	101,856	87,815	68,692	53,841

(a) See Note 3 of Notes to Consolidated Financial Statements for information concerning intercompany interest between ESI and ITT.
(b) Earnings per share data are based on historical net income and the number of shares of our common stock outstanding during each period after giving retroactive effect to the three-for-two stock splits in April and November 1996. Earnings per share for all periods have been calculated in conformity with Statement of Financial Accounting Standards No. 128, "Earnings per Share."
(c) EBITDA represents earnings before interest and financial charges, income taxes, depreciation and amortization and cumulative effect of change in accounting principle. We have included information concerning EBITDA (which is not a measure of financial performance under generally accepted accounting principles) because we understand that certain investors use it as one measure of an issuer's financial performance. EBITDA is not an alternative to operating income (as determined in accordance with generally accepted accounting principles), an indicator of our performance or cash flows from operating activities (as determined in accordance with generally accepted accounting principles) or a measure of liquidity.
(d) Operating losses from new technical institutes before income taxes represents operating losses before income taxes, including amortization of deferred start-up costs, for institutes in the first 24 months after their first class start.

>>quarterly results for 1998 and 1999

(In thousands, except per share data)

(unaudited)

	Three Months Ended				
	March 31	June 30	Sept. 30	Dec. 31	Year
1998					
Revenues	$72,287	$65,077	$81,700	$72,311	$291,375
Cost and expenses	$61,317	$66,740	$79,622	$65,060	$272,739
Operating income (1)	$10,970	$ (1,663)	$ 2,078	$ 7,251	$ 18,636
Interest income, net	$ 1,244	$ 1,191	$ 1,417	$ 1,477	$ 5,329
Net income (loss) (1)	$ 7,328	$ (660)	$ 2,097	$ 5,176	$ 13,941
Earnings per share (1)					
Basic	$ 0.27	$ (0.02)	$ 0.08	$ 0.19	$ 0.52
Diluted	$ 0.27	$ (0.02)	$ 0.08	$ 0.19	$ 0.51
1999					
Revenues	$79,972	$70,638	$87,465	$78,295	$316,370
Cost and expenses	$68,886	$69,048	$71,735	$69,945	$279,614
Operating income (2)	$11,087	$ 1,590	$15,730	$ 8,350	$ 36,757
Interest income, net	$ 855	$ 436	$ 422	$ 683	$ 2,396
Income before cumulative effect of change in accounting principle	$ 7,342	$ 1,251	$10,050	$ 5,708	$ 24,351
Cumulative effect of change in accounting principle for institute start-up costs, net of tax	$ (823)	- -	- -	- -	$ (823)
Net income (2)	$ 6,519	$ 1,251	$10,050	$ 5,708	$ 23,528
Earnings per share (2)					
Basic	$ 0.25	$ 0.05	$ 0.40	$ 0.23	$ 0.93
Diluted	$ 0.25	$ 0.05	$ 0.40	$ 0.23	$ 0.93
Other operating data:					
Operating losses from new institutes before income taxes (3)					
1998	$ 1,060	$ 1,475	$ 1,338	$ 1,384	$ 5,257
1999	$ 1,679	$ 1,634	$ 1,252	$ 531	$ 5,096

(1) Includes one-time expenses of$14,730 ($9,216 after taxes) for legal settlements, offering expenses associated with the June 1998 Offering, and change in control and other one-time expenses related to Starwood Hotels' acquisition of ITT. Excluding these one-time expenses, operating income, net income and earnings per share for the year ended December 31, 1998 would have been $33,366, $23,157 and $0.85, respectively.

(2) Includes one-time expenses of $900 ($554 after taxes) for offering expenses associated with the February 1999 Offering and other expenses. Excluding these one-time expenses and the cumulative effect of the change in accounting principle for institute start-up costs, operating income, net income and earnings per share for the year ended December 31, 1999 would have been $37,657, $24,905 and $0.98, respectively.

(3) Operating losses from new institutes before income taxes represents operating losses before income taxes, including amortization of deferred start-up costs for institutes in the first 24 months after their first class start.

leadership@esi

>>Officers

Officers' bios go from left to right.

J. Bradford Rainier (standing) joined ESI in 1974 and has served as Vice President of ESI since January 1993.

Gary L. VonIns has been with ESI since 1966 and has served as Vice President of ESI since December 1996.

Rene R. Champagne joined ESI in 1985. He has served as Chairman of ESI since October 1994, President and Chief Executive Officer of ESI since September 1985 and a Director of ESI since October 1985.

Gene A. Baugh (standing) began his service with ESI in 1977. He has served as Chief Financial Officer of ESI since December 1996 and Senior Vice President of ESI since January 1993. From 1981 through November 1996, he served as Treasurer and Controller of ESI.

Thomas W. Lauer has been with ESI since 1967 and has served as Senior Vice President of ESI since January 1993.

Edward G. Hartigan joined ESI in 1987 and has served as Senior Vice President of ESI since January 1993.

Omer E. Waddles joined ESI in 1999 and has served as Executive Vice President of ESI since April 1999.

Roger A. Booth joined ESI in 1985 and has served as Vice President of ESI since January 1993.

Clark D. Elwood has been with ESI since 1991. He has served as Senior Vice President of ESI since December 1996, Secretary of ESI since October 1992 and General Counsel of ESI since May 1991. From January 1993 through November 1996, he served as Vice President of ESI.

>>board of directors

Rand V. Araskog,

age 68, served as chairman and chief executive of ITT Corporation, a Nevada corporation ("ITT"), a hotel, gaming and entertainment company, from December 1995, and chairman of ITT Sheraton Corporation ("ITT Sheraton"), a hotel and gaming company and subsidiary of ITT, and Caesar's World, Inc., a gaming company and a subsidiary of ITT, from December 1996 until his retirement in February 1998. Mr. Araskog served as chief executive of ITT Corporation, formerly a Delaware corporation and now known as ITT Industries, Inc., an Indiana corporation and ITT's former parent corporation ("Old ITT"), an industrial, commercial machinery and equipment company, from 1979 to December 1995, chairman of Old ITT from 1980 to December 1995 and president of Old ITT from March 1991 to December 1995. He is also a director of The Hartford Financial Services Group, Inc., ITT Industries, Inc., Dow Jones & Company, Inc., Rayonier, Inc. and Shell Oil Company. Mr. Araskog has been a Director of ESI since April 1994.

Rene R. Champagne,

age 58, has been Chairman of ESI since October 1994, President and Chief Executive Officer of ESI since September 1985 and a Director of ESI since October 1985.

John E. Dean,

age 49, is a founding partner of the Washington, D.C. law firm Dean Blakey and Moskowitz, established July 1995. Prior to July 1995, Mr. Dean was a founding partner of the Clohan & Dean law firm, the predecessor to Dean Blakey & Moskowitz. Mr. Dean has been a Director of ESI since December 1994.

James D. Fowler, Jr.,

age 55, has served as president of Fowler & Associates, a consulting firm based in the Washington, D.C. area, since February 1996, president of the Executive Leadership Council and Foundation ("ELCF"), a non-profit, non-partisan charitable and educational organization, since February 2000 and executive director and administrator of the ELCF from October 1997 through January 2000. Mr. Fowler served as director of government and community relations of Old ITT from November 1993 through January 1996. Mr. Fowler has been a Director of ESI since April 1994.

Leslie Lenkowsky,

age 53, has been professor of philanthropic studies and public policy at Indiana University since September 1997. Dr. Lenkowsky served as president of Hudson Institute, a public policy research institute, from August 1990 through August 1997. He is also a director of American United Life Pooled Equity Fund B and American United Life American Series Fund. Dr. Lenkowsky has been a Director of ESI since December 1994.

Harris N. Miller,

age 48, has served as president of the Information Technology Association of America, a trade association, since April 1995, and as president of the World Information Technology and Services Alliance, an association of trade associations, since April 1995. Mr. Miller served as president of Immigration Services Associates, a Washington, D.C. government relations firm, from June 1991 through April 1995, and as government relations director of the law firm of Fragomen, Del Ray & Bernsen, P.C. from June 1991 through April 1995. Mr. Miller has been a Director of ESI since July 1999.

Daniel P. Weadock,

age 60, has served as president of The International, a golf resort and conference center in Bolton, MA, since January 1999. He served as special assistant to the chairman of Starwood Hotel & Resorts Worldwide, Inc., a hotel and resort company, from March 1998 through December 1998. Mr. Weadock served as president of ITT Sheraton from November 1993 through February 1998, chief operating officer of ITT Sheraton from November 1993 to October 1995 and chief executive officer of ITT Sheraton from October 1995 through February 1998. He served as senior vice president of ITT from December 1995 through February 1998. Mr. Weadock served as senior vice president of Old ITT from August 1995 to December 1995. Mr. Weadock has been a Director of ESI since April 1999.

Vin Weber,

age 47, has been a partner at Clark & Weinstock Inc., a Washington, D.C. management and public policy consulting firm, since 1994. He is vice chairman and co-founder of Empower America, public interest group. Mr. Weber is also a senior fellow at the University of Minnesota's Humphrey Institute of Public Affairs and co-director of the Institute's Policy Forum. He is also a director of Department 56, Inc. and OneLink Communications, Inc. Mr. Weber has been a Director of ESI since December 1994.

>>common stock market prices and dividends

	High	Low
1998		
First Quarter	$28.375	$21.375
Second Quarter	$32.750	$24.375
Third Quarter	$33.938	$26.000
Fourth Quarter	$36.125	$23.688
1999		
First Quarter	$40.357	$31.500
Second Quarter	$39.125	$19.688
Third Quarter	$28.625	$15.000
Fourth Quarter	$24.000	$14.750

The above table reflects the range of market prices of ITT Educational Services, Inc. common stock as reported in the consolidated transaction reporting system of the New York Stock Exchange, Inc.

We did not pay a cash dividend in 1998 or 1999. We do not anticipate paying any cash dividends on our common stock in the foreseeable future and we plan to retain our earnings to finance future growth. The declaration and payment of dividends on our common stock are subject to the discretion of our Board of Directors and compliance with applicable law. Our decision to pay dividends in the future will depend on general business conditions, the effect of such payment on our financial condition and other factors our Board of Directors may in the future consider to be relevant.

There were approximately 200 holders of record of our common stock on February 22, 2000.

ITT Educational Services, Inc. common stock is listed on the New York Stock Exchange, Inc., under the trading symbol "ESI."

Transfer Agent and Registrar for Common Stock

The Bank of New York
101 Barclay Street
New York, NY 10286

Address Shareholder Inquiries To:

Shareholder Relations Department–11E
P.O. Box 11258
Church Street Station
New York, NY 10286

Shareholder questions can be answered by contacting ESI's transfer agent:

THE BANK OF NEW YORK
1-800-524-4458

Send Certificates For Transfer and Address Changes To:

Receive and Deliver Department–11W
P.O. Box 11002
Church Street Station
New York, NY 10286

E-Mail Address:

Shareowner-svcs@Email.bankofny.com

Internet Address:

http://stock.bankofny.com

>>ITT Technical Institutes

ALABAMA
500 Riverhills Business Park, Birmingham 35242 (205) 991-5410

ARIZONA
4837 E. McDowell Rd., Phoenix 85008 (602) 231-0871
1455 West River Road, Tucson 85704 (520) 408-7488

ARKANSAS
4520 S. University Ave., Little Rock 72204 (501) 565-5550

CALIFORNIA
525 N. Muller Ave., Anaheim 92801 (L. A.) (714) 535-3700
3979 Trust Way, Hayward 94545 (Oakland) (510) 785-8522
16916 S. Harlan Rd., Lathrop 95330 (Stockton) (209) 858-0077
2051 Solar Dr., Oxnard 93030 (L. A.) (805) 988-0143
10863 Gold Center Dr., Rancho Cordova 95670 (916) 851-3900
630 E. Brier Dr., San Bernardino 92408 (L. A.) (909) 889-3800
9680 Granite Ridge Dr., San Diego 92123 (858) 571-8500
5104 Old Ironsides Dr., Santa Clara 95054 (San Francisco) (408) 496-0655
12669 Encinitas Ave., Sylmar 91342 (L. A.) (818) 364-5151
20050 S. Vermont Ave., Torrance 90502 (L.A.) (310) 380-1555
1530 W. Cameron Ave., West Covina 91790 (L. A.) (626) 960-8681

COLORADO
500 East 84th Avenue, Thornton 80229 (Denver) (303) 288-4488

FLORIDA
3401 S. University Dr., Fort Lauderdale 33328 (954) 476-9300
6600-10 Youngerman Circle, Jacksonville 32244 (904) 573-9100
2600 Lake Lucien Dr., Maitland 32751 (Orlando) (407) 660-2900
7955 N.W. 12th Street, Miami 33126 (305) 477-3080
4809 Memorial Highway, Tampa 33634 (813) 885-2244

IDAHO
12302 W. Explorer Dr., Boise 83713 (208) 322-8844

ILLINOIS
7040 High Grove Blvd., Burr Ridge 60521 (Chicago) (630) 455-6470
375 W. Higgins Rd., Hoffman Estates 60195 (Chicago) (847) 519-9300
600 Holiday Plaza Dr., Matteson 60443 (Chicago) (708) 747-2571

INDIANA
4919 Coldwater Rd., Fort Wayne 46825 (219) 484-4107
9511 Angola Court, Indianapolis 46268 (317) 875-8640
10999 Stahl Rd., Newburgh 47630 (Evansville) (812) 858-1600

KENTUCKY
10509 Timberwood Circle, Louisville 40223 (502) 327-7424

LOUISIANA
140 James Dr. East, St. Rose 70087 (New Orleans) (504) 463-0338

MASSACHUSETTS
333 Providence Highway, Norwood 02062 (Boston) (781)-278-0708
10 Forbes Rd., Woburn 01801* (781) 937-8324

MICHIGAN
4020 Sparks Dr. S.E., Grand Rapids 49546 (616) 956-1060
1522 E. Big Beaver Rd., Troy 48083 (Detroit) (248) 524-1800

MISSOURI
1930 Meyer Drury Dr., Arnold 63010 (St. Louis) (636) 464-6600
13505 Lakefront Dr., Earth City 63045 (St. Louis) (314) 298-7800

NEBRASKA
9814 M St., Omaha 68127 (402) 331-2900

NEVADA
168 Gibson Rd., Henderson 89014 (Las Vegas) (702) 558-5404

NEW MEXICO
5100 Masthead St., N.E., Albuquerque 87109 (505) 828-1114

NEW YORK
13 Airline Dr., Albany 12205 (518) 452-9300
2295 Millersport Highway, Getzville 14068 (Buffalo) (716) 689-2200
235 Greenfield Parkway, Liverpool 13088 (Syracuse) (315) 461-8000

OHIO
3325 Stop Eight Rd., Dayton 45414 (937) 454-2267
4750 Wesley Avenue, Norwood 45212 (Cincinnati) (513) 531-8300
14955 Sprague Rd., Strongsville 44136 (Cleveland) (440) 234-9091
1030 N. Meridian Rd., Youngstown 44509 (330) 270-1600

OREGON
6035 N.E. 78th Court, Portland 97218 (503) 255-6500

PENNSYLVANIA
3300 Tillman Drive, Bensalem 19020 (Philadelphia)*
5020 Louise Dr., Mechanicsburg 17055 (Harrisburg) (717) 691-9263
105 Mall Blvd., Monroeville 15146 (Pittsburgh) (412) 856-5920
Eight Parkway Center, Pittsburgh 15220 (412) 937-9150

SOUTH CAROLINA
One Marcus Dr., Greenville 29615 (864) 288-0777

TENNESSEE
10208 Technology Dr., Knoxville 37932 (423) 671-2800
1255 Lynnfield Rd., Memphis 38119 (901) 762-0556
441 Donelson Pike, Nashville 37214 (615) 889-8700

TEXAS
551 Ryan Plaza Dr., Arlington 76011 (Dallas) (817) 794-5100
6330 Highway 290 East, Austin 78723 (512) 467-6800
2222 Bay Area Blvd., Houston 77058 (South) (281) 486-2630
15621 Blue Ash Dr., Houston 77090 (North) (281) 873-0512
2950 S. Gessner, Houston 77063 (West) (713) 952-2294
2101 Waterview Pkwy., Richardson 75080 (Dallas) (972) 690-9100
5700 Northwest Parkway, San Antonio 78249 (210) 694-4612

UTAH
920 W. Levoy Dr., Murray 84123 (Salt Lake City) (801) 263-3313

VIRGINIA
863 Glenrock Rd., Norfolk 23502 (757) 466-1260
300 Gateway Centre Pkwy., Richmond 23235* (804) 330-4992

WASHINGTON
2525 223rd St. S.E., Bothell 98021 (Seattle) (425) 485-0303
12720 Gateway Dr., Seattle 98168 (206) 244-3300
North 1050 Argonne Rd., Spokane 99212 (509) 926-2900

WISCONSIN
6300 W. Layton Ave., Greenfield 53220 (Milwaukee) (414) 282-9494
470 Security Blvd., Green Bay 54313*

* Scheduled to open in 2000