

SKILLSOFT PUBLIC LIMITED CO

Form 10-Q

December 10, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

(MARK ONE)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED OCTOBER 31, 2007  
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
COMMISSION FILE NUMBER 000-25674  
SKILLSOFT PUBLIC LIMITED COMPANY  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)**

REPUBLIC OF IRELAND  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

N/A  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

107 NORTHEASTERN BOULEVARD  
NASHUA, NEW HAMPSHIRE  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

03062  
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (603) 324-3000

Not Applicable

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

On November 30, 2007, the registrant had outstanding 111,592,623 Ordinary Shares (issued or issuable in exchange for the registrant's outstanding American Depositary Shares).

SKILLSOFT PLC  
FORM 10-Q  
FOR THE QUARTER ENDED OCTOBER 31, 2007  
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## PART I

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
SKILLSOFT PLC AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

|   | <b>OCTOBER<br/>31,<br/>2007<br/>(Unaudited)</b> | <b>JANUARY<br/>31,<br/>2007</b> |
|---|---|---------------------------------|
| <b>ASSETS</b>   |   |                                 |
| Current assets:   |   |                                 |
| Cash and cash equivalents   | \$ 30,363                                       | \$ 48,612                       |
| Short-term investments  | 20,202  | 55,505                          |
| Restricted cash   | 3,919   | 20,095                          |
| Accounts receivable, net  | 94,249  | 94,343                          |
| Prepaid expenses and other current assets   | 24,134  | 22,215                          |
| <br>  |   |                                 |
| Total current assets  | 172,867   | 240,770                         |
| Property and equipment, net   | 8,033   | 9,672                           |
| Intangible assets, net  | 34,909  | 2,638                           |
| Goodwill  | 316,301   | 83,171                          |
| Long-term investments   |   | 3,598                           |
| Deferred tax assets, net  | 45,376  | 159                             |
| Other assets  | 9,205   | 2,962                           |
| <br>  |   |                                 |
| Total assets  | \$ 586,691                                      | \$ 342,970                      |
| <br>  |   |                                 |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |   |                                 |
| Current liabilities:  |   |                                 |
| Current maturities of long-term debt  | \$ 2,000  | \$                              |
| Accounts payable  | 3,186   | 3,327                           |
| Accrued compensation  | 16,441  | 17,870                          |
| Accrued expenses  | 46,349  | 35,427                          |
| Deferred revenue  | 140,598   | 146,012                         |
| <br>  |   |                                 |
| Total current liabilities   | 208,574   | 202,636                         |
| Long term debt  | 197,500   |                                 |
| Other long term liabilities   | 4,176   | 2,405                           |
| <br>  |   |                                 |
| Total long term liabilities   | 201,676   | 2,405                           |
| Commitments and contingencies (Note 12)   |   |                                 |
| Shareholders equity:  |   |                                 |
| Ordinary shares, Euro 0.11 par value: 250,000,000 shares authorized;<br>111,515,993 and 109,255,366 shares issued at October 31, 2007 and<br>January 31, 2007, respectively | 12,374  | 12,039                          |
| Additional paid-in capital  | 588,124   | 573,394                         |
| Treasury stock, at cost, 6,533,884 ordinary shares  | (24,524)  | (24,524)                        |
| Accumulated deficit   | (395,961)                                       | (421,661)                       |

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|  |            |            |
|--|------------|------------|
| Accumulated other comprehensive loss       | (3,572)    | (1,319)    |
| Total shareholders' equity                 | 176,441    | 137,929    |
| Total liabilities and shareholders' equity | \$ 586,691 | \$ 342,970 |

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

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**SKILLSOFT PLC AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED INCOME STATEMENTS**  
(UNAUDITED, IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

|  | <b>THREE MONTHS ENDED</b> |             | <b>NINE MONTHS ENDED</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>October 31,</b>        |             | <b>October 31,</b>       |             |
|  | <b>2007</b>               | <b>2006</b> | <b>2007</b>              | <b>2006</b> |
| Revenue  | \$ 75,124                 | \$ 57,135   | \$ 203,733               | \$ 167,521  |
| Cost of revenue amortization of intangible assets  | 1,740                     | 740         | 3,683                    | 4,203       |
| Cost of revenue (1)  | 8,282                     | 6,846       | 23,827                   | 19,962      |
| Gross profit   | 65,102                    | 49,549      | 176,223                  | 143,356     |
| Operating expenses:  |                           |             |                          |             |
| Research and development (1)   | 13,710                    | 10,047      | 35,315                   | 29,913      |
| Selling and marketing (1)  | 25,227                    | 21,983      | 71,489                   | 68,375      |
| General and administrative (1)   | 9,449                     | 6,844       | 25,572                   | 20,948      |
| Amortization of intangible assets  | 3,634                     | 412         | 7,955                    | 1,240       |
| Merger and integration related expenses  | 2,616                     |             | 11,110                   |             |
| Restructuring  |                           | 25          | 34                       | 47          |
| Restatement SEC investigations   | 105                       | 114         | 1,328                    | 434         |
| Total operating expenses   | 54,741                    | 39,425      | 152,803                  | 120,957     |
| Operating income   | 10,361                    | 10,124      | 23,420                   | 22,399      |
| Other expense, net   | (642)                     | (35)        | (1,026)                  | (67)        |
| Interest income  | 654                       | 1,137       | 2,990                    | 3,011       |
| Interest expense   | (3,927)                   | (69)        | (7,741)                  | (205)       |
| Income before provision / (benefit) for income taxes from continuing operations  | 6,446                     | 11,157      | 17,643                   | 25,138      |
| Provision / (benefit) for income taxes   | 270                       | 4,073       | (7,886)                  | 9,176       |
| Income from continuing operations  | 6,176                     | 7,084       | 25,529                   | 15,962      |
| (Loss) / income from operations of businesses to be disposed, net of income tax benefit / (expense) of \$311 and (\$76) for the three and nine months ended October 31, 2007, respectively | (351)                     |             | 173                      |             |
| Net income   | \$ 5,825                  | \$ 7,084    | \$ 25,702                | \$ 15,962   |
| Net income / (loss) per share (see Note 10):   |                           |             |                          |             |
| Basic continuing operations  | \$ 0.06                   | \$ 0.07     | \$ 0.25                  | \$ 0.16     |
| Basic discontinued operations  | \$ (0.00)                 | \$          | \$ 0.00                  | \$          |
|  | \$ 0.06                   | \$ 0.07     | \$ 0.25                  | \$ 0.16     |

|   |             |             |             |             |
|---|-------------|-------------|-------------|-------------|
| Basic weighted average shares outstanding   | 104,789,720 | 101,763,654 | 104,165,555 | 101,446,427 |
| Diluted continuing operations               | \$ 0.06     | \$ 0.07     | \$ 0.24     | \$ 0.15     |
| Diluted discontinued operations             | \$ (0.00)   | \$          | \$ 0.00     | \$          |
|   | \$ 0.05     | \$ 0.07     | \$ 0.24     | \$ 0.15     |
| Diluted weighted average shares outstanding | 108,552,456 | 104,724,685 | 108,018,673 | 103,887,852 |

(1) Share-based compensation included in cost of revenue and operating expenses:

|                            | <b>THREE MONTHS ENDED</b> |             | <b>NINE MONTHS ENDED</b> |             |
|----------------------------|---------------------------|-------------|--------------------------|-------------|
|                            | <b>October 31,</b>        |             | <b>October 31,</b>       |             |
|                            | <b>2007</b>               | <b>2006</b> | <b>2007</b>              | <b>2006</b> |
| Cost of revenue            | \$ 54                     | \$ 14       | \$ 119                   | \$ 31       |
| Research and development   | 226                       | 151         | 659                      | 818         |
| Selling and marketing      | 442                       | 269         | 1,309                    | 1,646       |
| General and administrative | 657                       | 404         | 1,921                    | 1,657       |

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

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SKILLSOFT PLC AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED, IN THOUSANDS)

|  | <b>NINE MONTHS ENDED</b> |             |
|--|--------------------------|-------------|
|  | <b>OCTOBER 31,</b>       |             |
|  | <b>2007</b>              | <b>2006</b> |
| Cash flows from operating activities from continuing operations:   |                          |             |
| Net income, continuing operations  | \$ 25,529                | \$ 15,962   |
| Adjustments to reconcile net income from continuing operations to net cash provided by operating activities: |                          |             |
| Share-based compensation   | 4,008                    | 4,152       |
| Depreciation and amortization  | 5,481                    | 4,502       |
| Amortization of intangible assets  | 11,638                   | 5,443       |
| Provision for / (recovery of) bad debts  | 470                      | (477)       |
| Non-cash interest expense  | 481                      |             |
| (Benefit) / provision for income tax non-cash  | (8,986)                  | 8,245       |
| Realized loss on sale of assets, net   | (58)                     |             |
| Changes in current assets and liabilities, net of acquisitions:  |                          |             |
| Accounts receivable  | 36,344                   | 39,354      |
| Prepaid expenses and other current assets  | 14,145                   | 8,498       |
| Accounts payable   | (1,313)                  | (403)       |
| Accrued expenses, including long-term liabilities  | (45,563)                 | (13,190)    |
| Deferred revenue   | (33,707)                 | (40,043)    |
| Net cash provided by operating activities from continuing operations   | 8,469                    | 32,043      |
| Cash flows from investing activities from continuing operations:   |                          |             |
| Purchases of property and equipment  | (2,321)                  | (3,989)     |
| Cash used in purchase of businesses, net of cash acquired  | (278,923)                |             |
| Purchases of investments   | (9,575)                  | (74,843)    |
| Maturity of investments  | 48,378                   | 39,810      |
| Release of restricted cash   | 16,183                   | 335         |
| Net cash used in investing activities from continuing operations   | (226,258)                | (38,687)    |
| Cash flows from financing activities from continuing operations:   |                          |             |
| Borrowings under long-term debt, net of debt financing costs   | 194,133                  |             |
| Principal payment on long-term debt  | (500)                    |             |
| Exercise of share options  | 8,280                    | 1,977       |
| Proceeds from employee share purchase plan   | 2,776                    | 2,561       |
| Net cash provided by financing activities from continuing operations   | 204,689                  | 4,538       |
| Change in cash from discontinued operations  | (7,013)                  |             |
| Effect of exchange rate changes on cash and cash equivalents   | 1,864                    | 562         |
| Net decrease in cash and cash equivalents  | (18,249)                 | (1,544)     |
| Cash and cash equivalents, beginning of period   | 48,612                   | 51,937      |
| Cash and cash equivalents, end of period   | \$ 30,363                | \$ 50,393   |



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

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**SKILLSOFT PLC AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1. THE COMPANY**

SkillSoft PLC, (the Company or SkillSoft), was incorporated in Ireland on August 8, 1989. The Company is a leading software as a service (SaaS) provider of on-demand e-learning and performance support solutions for global enterprises, government, education and small to medium-sized businesses. SkillSoft helps companies to maximize business performance through a combination of content, online information resources, flexible technologies and support services. SkillSoft is the surviving corporation as a result of a merger between SmartForce PLC and SkillSoft Corporation on September 6, 2002 (the Merger). On May 14, 2007, the Company completed its acquisition of Thomson NETg (NETg) from The Thomson Corporation for approximately \$270 million in cash (see Note 6).

**2. BASIS OF PRESENTATION**

The accompanying, unaudited condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of management, the condensed consolidated financial statements reflect all material adjustments (consisting only of those of a normal and recurring nature) which are necessary to present fairly the consolidated financial position of the Company as of October 31, 2007 and the results of its operations for the three and nine months ended October 31, 2007 and 2006 and cash flows for the nine months ended October 31, 2007 and 2006. These condensed consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2007. The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full year.

Certain reclassifications have been made to the consolidated financial statements for the three and nine month periods ended October 31, 2006 to conform to current year presentation. Specifically, amortization of intangible assets expense related to acquired technology and capitalized software development costs of approximately \$0.7 million and \$4.2 million for the three and nine months ended October 31, 2006, respectively, are now included in cost of revenues. These costs were previously recorded within operating expense under the caption amortization of intangible assets.

**3. CASH, CASH EQUIVALENTS, RESTRICTED CASH AND INVESTMENTS**

The Company considers all highly liquid investments with original maturities of 90 days or less at the time of purchase to be cash equivalents. At October 31, 2007 and January 31, 2007, cash equivalents consisted mainly of commercial paper.

At October 31, 2007, the Company had approximately \$3.9 million of restricted cash: approximately \$2.8 million is held voluntarily to defend named former executives and board members of SmartForce PLC for actions arising out of the SEC investigation and litigation related to the 2002 securities class action and approximately \$1.1 million is held in certificates of deposits with a commercial bank pursuant to terms of certain facilities lease agreements. In the quarter ended April 30, 2007, the Company made the final payment with respect to the 2002 securities class action settlement of approximately \$15.5 million plus payments made for named defendants, which amount had previously been recorded as restricted cash.

The Company accounts for certain investments in commercial paper, corporate debt securities and federal agency notes in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115). Under SFAS No. 115, securities that the Company does not intend to hold to maturity or for trading purposes are reported at market value, and are classified as available for sale. At October 31, 2007, the Company's investments were classified as available for sale and had an

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average maturity of approximately 63 days. These investments are classified as current assets or long-term investments in the accompanying condensed consolidated balance sheets based upon maturity date.

**4. REVENUE RECOGNITION**

The Company generates revenue from the license of products and services and from providing hosting/application service provider services (ASP).

The Company follows the provisions of the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended by SOP 98-4 and SOP 98-9 to account for revenue derived pursuant to license agreements under which customers license the Company's products and services.

The pricing for the Company's courses varies based upon the number of course titles or the courseware bundle licensed by a customer, the number of users within the customer's organization and the length of the license agreement (generally one, two or three years). License agreements permit customers to exchange course titles, generally on the contract anniversary date. Additional product features, such as hosting and online mentoring services, are separately licensed for an additional fee.

The pricing for content licenses varies based on the content offering selected by the customer, the number of users within the customer's organization and the length of the license agreement. A license can provide customers access to a range of learning products including courseware, Referenceware®, simulations, mentoring and prescriptive assessment.

The Company offers discounts from its ordinary pricing, and purchasers of licenses for a larger number of courses, larger user bases or longer periods of time generally receive discounts. Generally, customers may amend their license agreements, for an additional fee, to gain access to additional courses or product lines and/or to increase the size of the user base. The Company also derives revenue from hosting fees for clients that use its solutions on an ASP basis and from the provision of online mentoring services and professional services. In selected circumstances, the Company derives revenue on a pay-for-use basis under which some customers are charged based on the number of courses accessed by users. Revenue derived from pay-for-use contracts has been minimal to date.

The Company recognizes revenue ratably over the license period if the number of courses that a customer has access to is not clearly defined, available, or selected at the inception of the contract, or if the contract has additional undelivered elements for which the Company does not have vendor specific objective evidence (VSOE) of the fair value of the various elements. This may occur if the customer does not specify all licensed courses at the outset, the customer chooses to wait for future licensed courses on a when and if available basis, the customer is given exchange privileges that are exercisable other than on the contract anniversaries, or the customer licenses all courses currently available and to be developed during the term of the arrangement. Revenue from nearly all of the Company's contractual arrangements is recognized on a subscription or straight-line basis over the contractual period of service. The Company also derives revenue from extranet hosting/ASP services and online mentoring services. The Company recognizes revenue related to extranet hosting/ASP services and online mentoring services on a straight-line basis over the period the services are provided. Upfront fees are recorded over the contract period.

The Company generally bills the annual license fee for the first year of a multi-year license agreement in advance and license fees for subsequent years of multi-year license arrangements are billed on the anniversary date of the agreement. Occasionally, the Company bills customers on a quarterly basis. In some circumstances, the Company offers payment terms of up to six months from the initial shipment date or anniversary date for multi-year license agreements to its customers. To the extent that a customer is given extended payment terms (defined by the Company as greater than six months), revenue is recognized as payments become due, assuming all of the other elements of revenue recognition have been satisfied.

The Company typically recognizes revenue from resellers when both the sale to the end user has occurred and the collectibility of cash from the reseller is probable. With respect to reseller agreements with minimum commitments, the Company recognizes revenue related to the portion of the minimum commitment that exceeds the end user sales at the expiration of the commitment period provided the Company has received payment. If a definitive service

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period can be determined, revenue is recognized ratably over the term of the minimum commitment period, provided that cash has been received or collectibility is probable.

The Company provides professional services, including instructor led training, customized content development, website development / hosting and implementation services. If the Company determines that the professional services are not separable from an existing customer arrangement, revenue from these services is recognized over the existing contractual terms with the customer; otherwise the Company typically recognizes professional service revenue as the services are performed.

The Company records reimbursable out-of-pocket expenses in both revenue and as a direct cost of revenue, as applicable, in accordance with Emerging Issues Task Force (EITF) Issue No. 01-14, *Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred* ( EITF 01-14 ).

The Company records as deferred revenue amounts that have been billed in advance for products or services to be provided. Deferred revenue includes the unamortized portion of revenue associated with license fees for which the Company has received payment or for which amounts have been billed and are due for payment in 90 days or less for resellers and 180 days or less for direct customers. In addition, deferred revenue includes amounts which have been billed and not collected for which revenue is being recognized ratably over the license period.

SkillSoft contracts often include an uptime guarantee for solutions hosted on the Company's servers whereby customers may be entitled to credits in the event of non-performance. The Company also retains the right to remedy any nonperformance event prior to issuance of any credit. Historically, the Company has not incurred substantial costs relating to this guarantee and the Company currently accrues for such costs as they are incurred. The Company reviews these costs on a regular basis as actual experience and other information becomes available; and should they become more substantial, the Company would accrue an estimated exposure and consider the potential related effects of the timing of recording revenue on its license arrangements. The Company has not accrued any costs related to these warranties in the accompanying consolidated financial statements.

**5. ACCOUNTING FOR SHARE-BASED COMPENSATION**

The Company has several share-based compensation plans under which employees, officers, directors and consultants may be granted options to purchase the Company's ordinary shares, generally at the market price on the date of grant. The options become exercisable over various periods, typically four years, and have a maximum term of up to ten years. As of October 31, 2007, 2,588,263 ordinary shares remain available for future grant under the Company's share option plans. Please see Note 9 of the Notes to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K as filed with the SEC on April 13, 2007 for a detailed description of the Company's share option plans. A summary of share option activity under the Company's plans during the nine months ended October 31, 2007 is as follows:

| <b>Share Options</b>          | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term<br/>(Years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in<br/>thousands)</b> |
|-------------------------------|---------------|--|--|---|
| Outstanding, January 31, 2007 | 20,188,177    | \$ 7.48  | 5.47   |   |
| Granted                       | 90,000        | 9.31   |  |   |
| Exercised                     | (1,780,554)   | 4.65   |  |   |
| Cancelled                     | (1,835,446)   | 14.81  |  |   |
| Outstanding, October 31, 2007 | 16,662,177    | \$ 7.06  | 4.96   | \$ 49,380   |
| Exercisable, October 31, 2007 | 11,114,666    | \$ 7.38  | 4.40   | \$ 35,250   |
|                               | 15,903,230    | \$ 7.09  | 4.91   | \$ 47,452   |

Vested and Expected to Vest, October 31,  
2007 (1)

(1) This represents the number of vested options as of October 31, 2007 plus the number of unvested options as of October 31, 2007 that are expected to vest based on an estimated forfeiture rate of 11.6%. The Company recognizes expense incurred under SFAS 123(R) on a straight line basis. Due to the Company's vesting schedule, expense is incurred on options that have not yet vested but which are expected to vest in a future

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period. The options for which expense has been incurred but have not yet vested are included above as options expected to vest.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the closing price of the shares on October 31, 2007 of \$8.95 and the exercise price of each in-the-money option) that would have been received by the option holders had all option holders exercised their options on October 31, 2007. The total intrinsic value of options exercised during the three months ended October 31, 2007 and 2006 was approximately \$593,635 and \$451,362, respectively. The total intrinsic value of options exercised during the nine months ended October 31, 2007 and 2006 was approximately \$6.3 million and \$1.3 million, respectively.

**6. ACQUISITIONS****(a) NETg**

On May 14, 2007, the Company completed its acquisition of NETg from The Thomson Corporation for approximately \$270 million in cash, subject to customary post-closing adjustments. The combined entity offers a more robust multi-modal solution that includes online courses, simulations, digitized books and an on-line video library as well as complementary learning technologies. The acquisition supports SkillSoft's mission to deliver comprehensive and high quality learning solutions and positions the Company to serve the demands of this growing marketplace.

The acquisition of NETg was accounted for as a business combination under SFAS No. 141, *Business Combinations* using the purchase method. Accordingly, the results of NETg have been included in the Company's consolidated financial statements since the date of acquisition. The components of the consideration paid are as follows:

|                            |            |
|----------------------------|------------|
| Cash paid                  | \$ 269,738 |
| Transaction costs incurred | 7,249      |
| Total purchase price       | \$ 276,987 |

The Stock and Asset Purchase Agreement entered into in connection with the acquisition also provides for an adjustment to the purchase price related to NETg's closing balance sheet. The Company and The Thomson Corporation are currently engaged in discussions concerning a potential purchase price adjustment. The Company has considered the provisions of EITF Issue No. 95-8, *Accounting for Contingent Consideration Paid to the Shareholders of and Acquired Enterprise in a Purchase Business Combination*, and concluded that this contingent consideration represents either additional purchase price or a reduction thereof. As a result, goodwill will be adjusted by the amount of the change in consideration, if any.

The purchase price was allocated based upon the fair value of the assets acquired and liabilities assumed at the date of acquisition. The following table summarizes the preliminary allocation of the initial purchase price (in thousands):

| <b>Description</b>            | <b>Amount</b> |
|-------------------------------|---------------|
| Current assets                | \$ 44,137     |
| Deferred tax asset            | 10,194        |
| Property and equipment        | 1,470         |
| Goodwill                      | 255,692       |
| Amortizable intangible assets | 43,050        |
| Current liabilities*          | (52,071)      |

|                  |            |
|------------------|------------|
| Deferred revenue | (25,485)   |
| Total            | \$ 276,987 |

\* Includes exit costs of \$15.8 million.

Intangible assets and their estimated useful lives consist of the following (in thousands):

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| <b>Description</b>                     | <b>Amount</b> | <b>Life</b> |
|--|---------------|-------------|
| Non-compete agreement                  | \$ 6,900      | 2.5 years   |
| Trademark/tradename                    | 2,700         | 2 years     |
| Developed software/courseware          | 9,950         | 1.5 years   |
| Customer contractual relationships     | 1,000         | 1 year      |
| Customer non-contractual relationships | 22,500        | 4 years     |
|  | \$ 43,050     |             |

The non-compete agreement, trademark/tradename and customer relationships were valued using the income approach and the developed software/courseware was valued using the cost approach. Values and useful lives assigned to intangible assets were determined using management's estimates.

Goodwill represents the excess of the purchase price over the net identifiable tangible and intangible assets acquired. The Company determined that the acquisition of NETg resulted in the recognition of goodwill primarily because the acquisition is expected to help SkillSoft reach critical mass and shorten its timeframe to approach its long term operating profitability objectives through incremental scalability and significant cost synergies. The goodwill recorded as a result of this acquisition is expected to be deductible for tax purposes.

Goodwill is subject to review for impairment annually and when there are any interim indicators of impairment. The Company performs its goodwill impairment tests as of November 1 each year.

Acquired intangible assets are reviewed for impairment upon the occurrence of any events or changes in circumstances that indicate the carrying amount of an asset may not be recoverable. The useful life of each intangible asset is evaluated for each reporting period to determine whether events and circumstances warrant a revision to the remaining useful life.

The Company assumed certain liabilities in the acquisition including deferred revenue that was ascribed a fair value of \$25.5 million using a cost-plus profit approach in accordance with EITF 01-03, *Accounting in a Business Combination for Deferred Revenue of an Acquiree*. The Company is amortizing deferred revenue over the average remaining term of the contracts, which reflects the estimated period to satisfy these customer obligations. In allocating the preliminary purchase price, the Company recorded an adjustment to reduce the carrying value of NETg's deferred revenue by \$22.2 million. Approximately \$5.7 million of unamortized acquired NETg deferred revenue remained at October 31, 2007.

In connection with the acquisition, the Company's management approved and initiated plans to integrate NETg into its operations and to eliminate redundant facilities and headcount, reduce cost structure and better align operating expenses with existing economic conditions and the Company's operating model. In accordance with EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* (EITF 95-3) the Company has accrued for certain liabilities incurred directly related to the NETg acquisition and accounted for those in the allocation of the purchase price. The items accounted for in accordance with EITF Issue No. 95-3 primarily relate to severance related costs incurred in association with workforce reductions and totaled approximately \$10.1 million for employee separation costs for approximately 360 employees. The Company also estimated a liability of \$1.8 million representing the estimated fair value of abandoned lease obligations. The Company made severance payments of \$1.0 million during the quarter ended October 31, 2007 and expects to pay out the balance by the end of the second quarter of fiscal 2009. As of October 31, 2007, \$3.0 million of the liability for accrued severance was unpaid and included in accrued expenses in the accompanying balance sheet. The Company's outstanding liability for abandoned leases at October 31, 2007 was \$1.4 million, which is included in the accrued expense balance on the accompanying balance sheet as of October 31, 2007 (see Note 7). The Company also estimated a liability of \$4.0 million and \$0.7 million for NETg content re-branding and legal and outplacement services, respectively. The Company made legal and outplacement services payments of \$0.3 million during the quarter ended October 31, 2007 and expects to pay out the balances by the end of the second quarter of fiscal 2009.





**Table of Contents****SUPPLEMENTAL PRO-FORMA INFORMATION (UNAUDITED)**

The Company has concluded that the NETg acquisition represents a material business combination. The following unaudited pro forma information presents the consolidated results of operations of the Company and NETg as if the acquisition had occurred at the beginning of each of fiscal 2008 and 2007, with pro forma adjustments to give effect to amortization of intangible assets, an increase in interest expense on acquisition financing and certain other adjustments:

|                                       | <b>THREE MONTHS<br/>ENDED<br/>OCTOBER 31,</b> |             | <b>NINE MONTHS<br/>ENDED<br/>OCTOBER 31,</b> |             |
|---------------------------------------|---|-------------|--|-------------|
|                                       | <b>2007</b>                                   | <b>2006</b> | <b>2007</b>                                  | <b>2006</b> |
|                                       | <b>(in thousands except per share data)</b>   |             |  |             |
| Revenue                               | \$ 75,124                                     | \$ 72,011   | \$ 266,233                                   | \$ 256,780  |
| Net income / (loss)                   | 5,978   | 6,152       | (18,647)                                     | (25,114)    |
| Net income / (loss) per share basic   | \$ 0.06                                       | \$ 0.06     | \$ (0.18)                                    | \$ (0.25)   |
| Net income / (loss) per share diluted | \$ 0.05                                       | \$ 0.06     | \$ (0.17)                                    | \$ (0.24)   |

The unaudited pro forma results are not necessarily indicative of the results that the Company would have attained had the acquisition of NETg occurred at the beginning of the periods presented.

**(b) Targeted Learning Corporation**

On February 9, 2007, the Company acquired the assets of Targeted Learning Corporation (TLC), an on-line video library business, for approximately \$4.1 million in cash plus liabilities assumed of \$0.8 million. Additional consideration of up to \$0.5 million is payable to the shareholders of TLC at various times prior to February 2008 contingent upon achievement of certain integration milestones. As of October 31, 2007, approximately \$0.3 million of this contingent consideration had been paid. The acquisition resulted in an allocation of the purchase price to goodwill and identified intangible assets of \$3.2 million and \$0.9 million, respectively. Intangible assets consist of internally developed software, comprised of learning content valued at \$510,000, which will be amortized over a period of 4 years, customer contracts and relationships valued at \$330,000, which will be amortized over 3 years and the TLC tradename valued at \$20,000 which will be amortized over 2 years. Values and useful lives assigned to intangible assets were determined using management's estimates which in part were based on valuation reports prepared by a third party specialist. The Company has concluded that the acquisition of TLC does not represent a material business combination and therefore no pro forma financial information has been provided herein.

**7. SPECIAL CHARGES****MERGER AND EXIT COSTS**

In connection with the closing of the NETg acquisition on May 14, 2007 (the Acquisition), the Company's management effected an acquisition integration effort to eliminate redundant facilities and employees and reduce the overall cost structure of the acquired business to better align the Company's operating expenses with existing economic conditions, business requirements and the Company's operating model. Pursuant to this restructuring, the Company recorded \$15.8 million of costs related to severance and related benefits, costs to vacate leased facilities and other pre-Acquisition liabilities. These costs were accounted for under EITF 95-3, *Recognition of Liabilities in Connection with Purchase Business Combinations*. These costs, which were recognized as a liability assumed in the purchase business combination, were included in the allocation of the purchase price.

The reductions in employee headcount will total approximately 360 employees from the administrative, sales, marketing and development functions, and amounted to a liability of approximately \$10.1 million. Approximately \$7.1 million was paid against the exit plan accrual through October 31, 2007, and the remaining amount of \$3.0 million, net of adjustments for foreign currency translation, is expected to be paid by the end of the second quarter of fiscal 2009.

In connection with the exit plan, the Company intends to abandon certain leased facilities resulting in a facilities consolidation liability of \$1.4 million as of October 31, 2007, consisting of lease termination costs, broker commissions and other facility costs. As part of the plan, two sites will be vacated. The fair value of the lease termination costs was calculated with certain assumptions related to the Company's estimated cost recovery efforts from subleasing vacated space, including (i) the time period over which the property will remain vacant, (ii) the sublease terms and (iii) the sublease rates.

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The Company's merger and exit liabilities which include previous merger and acquisition transactions are recorded in accrued expenses (see Note 14) and long-term liabilities. Activity in the nine month period ended October 31, 2007 is as follows (in thousands):

|  | <b>EMPLOYEE<br/>SEVERANCE<br/>AND<br/>RELATED<br/>COSTS</b> | <b>CLOSEDOWN<br/>OF<br/>FACILITIES</b> | <b>OTHER</b> | <b>TOTAL</b> |
|--|---|--|--------------|--------------|
| Merger and exit accrual January 31, 2007   | \$ 878  | \$ 2,278                               | \$ 121       | \$ 3,277     |
| Provision for merger and exit costs as of the date of acquisition of NETg (May 14, 2007) accounted for in the allocation of purchase price | 10,176  | 2,038                                  | 4,654        | 16,868       |
| Payments made during the nine months ended October 31, 2007  | (7,082)   | (727)                                  | (13)         | (7,822)      |
| Merger and exit accrual October 31, 2007   | \$ 3,972  | \$ 3,589                               | \$ 4,762     | \$ 12,323    |

The Company anticipates that the remainder of the merger and exit accrual will be paid by October 2011 as follows (in thousands):

|   |           |
|---|-----------|
| Year ended January 31,<br>2008 (remaining 3 months) | \$ 10,382 |
| 2009  | 779       |
| 2010  | 384       |
| 2011  | 778       |
| Total   | \$ 12,323 |

Certain of the former NETg employees continued employment during a transition period and certain of the former NETg facilities being vacated are being used as the Company transitions operations to other locations. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, such costs are being expensed as incurred and are included in merger and integration related expenses in the accompanying statements of income. The Company recorded \$2.6 million and \$11.1 million of merger and integration related expenses in the three and nine months ended October 31, 2007, respectively.

**DISCONTINUED OPERATIONS**

In connection with the NETg acquisition, the Company decided to discontinue four product lines acquired from NETg because the Company believes these product offerings do not represent areas that can grow in a manner consistent with the Company's operating model or be consistent with the Company's profit model. The product lines that have been identified as discontinued operations are Financial Campus, NETg Press, Interact Now and Wave.

As a result, the assets and liabilities of NETg Press, Interact Now and Financial Campus were classified as held for sale in the second quarter of fiscal 2008 and qualify for held for disposal treatment under Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. On August 21, 2007 the Company entered into an Asset Purchase Agreement pursuant to which it agreed to sell to SmartPros, LTD, the Financial Campus assets. The Company classified the Financial Campus business as discontinued operations in the second quarter of fiscal 2008. The closing of the sale of the Financial Campus assets occurred on August 21, 2007, resulting in nominal cash proceeds and potential earnout payments for three years from the date of the sale based on the SmartPros' gross revenue from the Financial Campus business line. Due to the

purchase price being contingent and not fixed or currently determinable, the carrying value is considered the fair value. At the time of the transaction the nominal purchase price exceeded the fair market value of the Financial Campus assets due to more liabilities being released than assets sold, which resulted in a pre-tax gain of approximately \$0.1 million during the quarter ended October 31, 2007.

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Financial results of Financial Campus are reported separately as discontinued operations for all periods presented. Summarized results of operations for Financial Campus for the three and nine months ended October 31, 2007 were as follows (in thousands):

|   | <b>THREE<br/>MONTHS<br/>ENDED<br/>OCTOBER<br/>31, 2007</b> | <b>NINE MONTHS<br/>ENDED<br/>OCTOBER<br/>31, 2007</b> |
|---|--|---|
| Revenue from discontinued operations                  | \$ 0   | \$ 9  |
| Loss from discontinued operations before income taxes | (187)  | (531)   |
| Income tax (benefit)                                  | (106)  | (236)   |
| Loss from discontinued operations                     | \$ (81)  | \$ (295)  |

On October 31, 2007, the Company entered into an Asset Purchase Agreement pursuant to which it agreed to sell to AXZO Press LLC the NETg Press assets. The Company classified the NETg Press business as discontinued operations in the second quarter of fiscal 2008. The closing of the sale of the NETg Press assets occurred on October 31, 2007, resulting in a total purchase price of \$8.0 million subject to customary post-closing adjustments. Per the agreement the purchase price will be paid over a three year period starting in September 2008.

Since the NETg Press operations were acquired through the acquisition of NETg, its carrying value has been adjusted to its fair value. The fair value of the NETg Press assets and liabilities acquired in the NETg acquisition were determined to be \$8.0 million, which was based on the price for which the NETg Press operations have been sold. As a result, the refinement to the fair value estimate was recorded as a purchase accounting adjustment to goodwill and therefore no gain or loss was recorded in the operations for the period ended October 31, 2007.

Financial results of NETg Press are reported separately as discontinued operations for all periods presented. Summarized results of operations for NETg Press for the three and nine months ended October 31, 2007 were as follows (in thousands):

|   | <b>THREE<br/>MONTHS<br/>ENDED<br/>OCTOBER<br/>31, 2007</b> | <b>NINE MONTHS<br/>ENDED<br/>OCTOBER<br/>31, 2007</b> |
|---|--|---|
| Revenue from discontinued operations                    | \$ 2,158   | \$ 3,874  |
| Income from discontinued operations before income taxes | 257  | 408   |
| Income tax provision                                    | 111  | 163   |
| Income from discontinued operations                     | \$ 146   | \$ 245  |

The Company also determined it would not be feasible to sell the Interact Now business line; therefore, the Company has removed the assets and liabilities from classification as held for sale. The Company expects to exit the Interact Now business by the middle of fiscal 2009.

Financial results of Interact Now are reported separately as discontinued operations for all periods presented. Summarized results of operations for Interact Now for the three and nine months ended October 31, 2007 were as

follows (in thousands):

|  | <b>THREE<br/>MONTHS<br/>ENDED<br/>OCTOBER<br/>31, 2007</b> | <b>NINE MONTHS<br/>ENDED<br/>OCTOBER<br/>31, 2007</b> |
|--|--|---|
| Revenue from discontinued operations                             | \$ 452   | \$ 656  |
| Income / (loss) from discontinued operations before income taxes | 52   | (0)   |
| Income tax provision / (benefit)                                 | 22   | (1)   |
| Income / (loss) from discontinued operations                     | \$ 30  | \$ (1)  |

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The Company exited the Wave business in October 2007. Financial results of Wave are reported separately as discontinued operations for all periods presented. Summarized results of operations for Wave for the three and nine months ended October 31, 2007 were as follows (in thousands):

|  | <b>THREE<br/>MONTHS<br/>ENDED<br/>OCTOBER<br/>31, 2007</b> | <b>NINE MONTHS<br/>ENDED<br/>OCTOBER<br/>31, 2007</b> |
|--|--|---|
| Revenue from discontinued operations                             | \$ 524   | \$ 2,221  |
| Income / (loss) from discontinued operations before income taxes | (784)  | 373   |
| Income tax (benefit) / provision                                 | (338)  | 150   |
| (Loss) / income from discontinued operations                     | \$ (446)   | \$ 224  |

**RESTRUCTURING**

During the three months ended October 31, 2007 the Company revised certain of its estimates made in connection to the previous restructurings related to contractual obligations.

Activity in the Company's restructuring accrual was as follows (in thousands):

|  | <b>FACILITY<br/>LEASE<br/>OBLIGATIONS</b> |
|--|---|
| Total restructuring accrual as of January 31, 2007                           | \$ 1,421                                  |
| Payments made during the nine months ended October 31, 2007                  | (461)                                     |
| Restructuring charges incurred during the nine months ended October 31, 2007 | 527                                       |
| Total restructuring accrual as of October 31, 2007                           | \$ 1,487                                  |

**8. GOODWILL AND INTANGIBLE ASSETS**

Goodwill and intangible assets are as follows (in thousands):

|   | <b>OCTOBER 31, 2007</b>              |                                     |                                    | <b>JANUARY 31, 2007</b>              |                                     |                                    |
|---|--------------------------------------|-------------------------------------|------------------------------------|--------------------------------------|-------------------------------------|------------------------------------|
|   | <b>GROSS<br/>CARRYING<br/>AMOUNT</b> | <b>ACCUMULATED<br/>AMORTIZATION</b> | <b>NET<br/>CARRYING<br/>AMOUNT</b> | <b>GROSS<br/>CARRYING<br/>AMOUNT</b> | <b>ACCUMULATED<br/>AMORTIZATION</b> | <b>NET<br/>CARRYING<br/>AMOUNT</b> |
| Internally developed software/ courseware | \$ 38,716                            | \$ 31,518                           | \$ 7,198                           | \$ 28,257                            | \$ 27,836                           | \$ 421                             |
| Customer contracts                        | 36,848                               | 17,594                              | 19,254                             | 13,018                               | 11,701                              | 1,317                              |
| Non-compete                               | 6,900                                | 1,380                               | 5,520                              |                                      |                                     |                                    |
| Trademarks and trade names                | 3,625                                | 688                                 | 2,937                              | 905                                  | 5                                   | 900                                |
|   | 86,089                               | 51,181                              | 34,909                             | 42,180                               | 39,542                              | 2,638                              |
| Goodwill                                  | 316,301                              |                                     | 316,301                            | 83,171                               |                                     | 83,171                             |
|   | \$ 402,390                           | \$ 51,181                           | \$ 351,209                         | \$ 125,351                           | \$ 39,542                           | \$ 85,809                          |



The change in goodwill at October 31, 2007 from the amount recorded at January 31, 2007 is as follows:

|   | <b>Total</b> |
|---|--------------|
| Gross carrying amount of goodwill, January 31, 2007 | \$ 83,171    |
| Utilization of tax benefit                          | (25,784)     |
| Acquisition of TLC                                  | 3,382        |
| Acquisition of NETg                                 | 255,692      |
| Other   | (160)        |
| Gross carrying amount of goodwill, October 31, 2007 | \$ 316,301   |

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The Company will be conducting its annual impairment test of goodwill for fiscal 2008 in the fourth quarter. Amortization expense related to the intangible assets for the remainder of fiscal 2008 and the following fiscal years is expected to be as follows (in thousands):

| <b>Fiscal Period</b>                       | <b>Amortization<br/>Expense</b> |
|--|---------------------------------|
| Three month period ending January 31, 2008 | \$ 5,022                        |
| Year ending January 31, 2009               | 16,415                          |
| Year ending January 31,2010                | 8,245                           |
| Year ending January 31,2011                | 3,712                           |
| Year ending January 31,2012                | 615                             |
| <b>Total</b>                               | <b>\$ 34,090</b>                |

**9. COMPREHENSIVE INCOME (LOSS)**

SFAS No. 130, *Reporting Comprehensive Income*, requires disclosure of all components of comprehensive income/(loss) on an annual and interim basis. Comprehensive income/(loss) is defined as the change in equity of a business enterprise during a period resulting from transactions, other events and circumstances related to non-owner sources. Comprehensive income for the three and nine months ended October 31, 2007 and 2006 was as follows (in thousands):

|  | <b>THREE MONTHS<br/>ENDED<br/>OCTOBER 31,</b> |                 | <b>NINE MONTHS<br/>ENDED<br/>OCTOBER 31,</b> |                  |
|--|---|-----------------|--|------------------|
|  | <b>2007</b>                                   | <b>2006</b>     | <b>2007</b>                                  | <b>2006</b>      |
| Comprehensive income:  |   |                 |  |                  |
| Net income   | \$ 5,825                                      | \$ 7,084        | \$ 25,702                                    | \$ 15,962        |
| Other comprehensive income/(loss) Foreign<br>currency adjustment | (701)   | (147)           | (1,116)                                      | (613)            |
| Change in fair value of interest rate hedge                      | (842)   |                 | (1,074)                                      |                  |
| Unrealized holding gains/(losses)                                | 22  | 74              | (65)   | 100              |
| <b>Comprehensive income</b>                                      | <b>\$ 4,304</b>                               | <b>\$ 7,011</b> | <b>\$ 23,447</b>                             | <b>\$ 15,449</b> |

Accumulated other comprehensive income as of October 31, 2007 and January 31, 2007 was as follows (in thousands):

|  | <b>OCTOBER<br/>31,<br/>2007</b> | <b>JANUARY<br/>31,<br/>2007</b> |
|--|---------------------------------|---------------------------------|
| Unrealized holding (losses)/gains on available for sale securities | \$ 2                            | \$ 67                           |
| Change in fair value of interest rate hedge                        | (1,074)                         |                                 |
| Foreign currency adjustment  | (2,500)                         | (1,386)                         |
| <b>Total accumulated other comprehensive loss</b>                  | <b>\$ (3,572)</b>               | <b>\$ (1,319)</b>               |

**10. NET INCOME PER SHARE**

Basic net income per share was computed using the weighted average number of shares outstanding during the period. Diluted net income per share was computed by giving effect to all dilutive potential shares outstanding. The weighted

average number of shares outstanding used to compute basic net income per share and diluted net income per share was as follows:

|  | <b>THREE MONTHS ENDED</b> |             | <b>NINE MONTHS ENDED</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>OCTOBER 31,</b>        |             | <b>OCTOBER 31,</b>       |             |
|  | <b>2007</b>               | <b>2006</b> | <b>2007</b>              | <b>2006</b> |
| Basic weighted average shares outstanding        | 104,789,720               | 101,763,654 | 104,165,555              | 101,446,427 |
| Effect of dilutive shares outstanding            | 3,762,736                 | 2,961,031   | 3,853,118                | 2,441,425   |
| Weighted average shares outstanding, as adjusted | 108,552,456               | 104,724,685 | 108,018,673              | 103,887,852 |

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The following share equivalents have been excluded from the computation of diluted weighted average shares outstanding for the three and nine months ended October 31, 2007 and 2006, respectively, as they would be anti-dilutive:

|                            | THREE MONTHS ENDED<br>OCTOBER 31, |            | NINE MONTHS ENDED<br>OCTOBER 31, |            |
|----------------------------|-----------------------------------|------------|----------------------------------|------------|
|                            | 2007                              | 2006       | 2007                             | 2006       |
| Options to purchase shares | 12,899,442                        | 13,174,010 | 12,809,058                       | 13,693,616 |

**11. INCOME TAXES**

The Company operates as a holding company with operating subsidiaries in several countries, and each subsidiary is taxed based on the laws of the jurisdiction in which it operates.

The Company has significant net operating loss ( NOL ) carryforwards, some of which are subject to potential limitations based upon the change in control provisions of Section 382 of the United States Internal Revenue Code. For the nine months ended October 31, 2007 and 2006, the Company's effective tax rates were (44.3%) and 36.5%, respectively. Providing for the differences in book and tax accounting required in purchase accounting for the NETg acquisition had the effect of significantly increasing the Company's projected provision for income taxes for the current year. However, this increase was offset by the net release of valuation allowance discussed below, resulting in the tax rate benefit for the nine month period ended October 31, 2007. The tax rate benefit of 44.3% is comprised of the non-cash valuation allowance release benefit of approximately \$25.0 million partially offset by the provision for income taxes for the nine months ended October 31, 2007 of \$17.1 million.

*Deferred Taxes*

Under SFAS No. 109, *Accounting for Income Taxes*, the Company can only recognize a deferred tax asset for future benefit of our tax loss, temporary differences and tax credit carryforwards to the extent that it is more likely than not that these assets will be realized. In determining the realizability of these assets, the Company considered numerous factors, including historical profitability, estimated future taxable income and the industry in which the Company operates. Based on current and preceding years' results of operations and anticipated profit levels, the Company believes that certain of its deferred tax assets are more likely than not realizable. Accordingly, in the nine months ended October 31, 2007, the Company released approximately \$49.1 million of U.S. valuation allowance on NOL carryforwards, which will more likely than not, be realized in future periods. Approximately \$25.0 million of this asset was recorded through reductions to tax expense and \$24.1 million was recorded through reductions to goodwill. The benefit recorded through reductions to tax expense is a component of the net release of valuation allowance discussed above.

As a result of purchase accounting for the NETg acquisition, the Company recorded a \$10.2 million deferred tax asset on certain deferred revenue that has previously been recognized for tax purposes and is included in the allocation of purchase price. At October 31, 2007, the value of this deferred tax asset was \$2.3 million. The Company expects to realize this asset by taking tax deductions through the period ending July 31, 2008. Additionally, certain costs incurred to service contracts acquired in the NETg acquisition are deductible over 15 years for tax purposes. The Company has recorded a valuation allowance against the portion of these costs for which realizability is uncertain. This increase in valuation allowance is a component of the net release of the valuation allowance discussed above.

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ), on February 1, 2007. On the date of adoption of FIN 48, the Company had total unrecognized tax benefits of approximately \$3.6 million (including interest and penalties of \$1.1 million) that, if recognized, would impact the Company's effective tax rate. The Company continues to assess recognition and measurement for new and existing uncertain positions and monitor tax developments in relevant jurisdictions for potential changes in the sustainability or measurement of positions. At October 31, 2007, the Company had \$4.1 million of unrecognized tax benefits. The Company recognizes interest and penalties accrued related to unrecognized tax benefits as income tax

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expense. As of October 31, 2007, the Company had approximately \$0.5 million of accrued interest related to uncertain tax positions.

The Company conducts its business globally and, as a result, the Company and its subsidiaries file income tax returns in the U.S. and in certain foreign jurisdictions. In the normal course of business the Company is subject to examination by taxing authorities throughout the world, including but not limited to such major jurisdictions as Canada, the United Kingdom and the United States. With few exceptions, the Company is no longer subject to U.S. and international income tax examinations for years before 2002.

**12. COMMITMENTS AND CONTINGENCIES**

The Company had been the subject of a formal investigation by the United States Securities and Exchange Commission ( SEC ) into the events and circumstances giving rise to the 2003 restatement of SmartForce PLC s accounts (the Restatement Investigation ). On July 19, 2007, the SEC announced that three former officers and one former employee of SmartForce had settled SEC claims in connection with the Restatement Investigation. The Company understands that the restatement investigation has now been concluded without any claim being brought against it.

In January 2007, the Boston District Office of the SEC informed the Company that it is the subject of an informal investigation concerning option granting practices at SmartForce for the period beginning April 12, 1996 through July 12, 2002 (the Option Granting Investigation ). These grants were made prior to the September 6, 2002 merger with SmartForce PLC. The Company has produced documents in response to requests from the SEC. The SEC staff has informed the Company that despite closure of the Restatement Investigation, the staff has not determined whether to close the Options Granting Investigation.

The Company believes that it accounted for SmartForce stock option grants properly in the merger, and believes that as a result of the merger accounting the Company s financial statements are not going to change even if the SEC concludes that SmartForce did not properly account for its pre-merger option grants. When SkillSoft Corporation and SmartForce merged on September 6, 2002, SkillSoft Corporation was for accounting purposes deemed to have acquired SmartForce. Accordingly, the pre-merger financial statements of SmartForce are not included in the historical financial statements of the Company, and the Company s financial statements include results from what had been the business of SmartForce only from the date of the merger. Under applicable accounting rules, the Company valued all of the outstanding SmartForce stock options assumed in the merger at fair value upon consummation of the merger.

Accordingly, SkillSoft believes that its accounting for SmartForce stock options will not be affected by any error that SmartForce may have made in its own accounting for stock option grants and that that the Options Granting Investigation should not require any change in SkillSoft s financial statements.

The Company continues to cooperate with the SEC in the Option Granting Investigation. At the present time, the Company is unable to predict the outcome of the Option Granting Investigation or its potential impact on its operating results or financial position.

From time to time, the Company is a party to or may be threatened with other litigation in the ordinary course of its business. The Company regularly analyzes current information, including, as applicable, the Company s defenses and insurance coverage and, as necessary, provides accruals for probable and estimable liabilities for the eventual disposition of these matters.

**13. GEOGRAPHICAL DISTRIBUTION OF REVENUES**

The Company attributes revenues to different geographical areas on the basis of the location of the customer. Revenues by geographical area for the three and nine month periods ended October 31, 2007 and 2006 were as follows (in thousands):

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|                       | <b>THREE MONTHS<br/>ENDED<br/>OCTOBER 31,</b> |             | <b>NINE MONTHS<br/>ENDED<br/>OCTOBER 31,</b> |             |
|-----------------------|---|-------------|--|-------------|
|                       | <b>2007</b>                                   | <b>2006</b> | <b>2007</b>                                  | <b>2006</b> |
| Revenue:              |   |             |  |             |
| United States         | \$ 59,076                                     | \$ 44,689   | \$ 160,161                                   | \$ 131,155  |
| United Kingdom (UK)   | 8,234   | 6,651       | 22,493                                       | 18,972      |
| Canada                | 2,726   | 2,347       | 7,855  | 7,062       |
| Europe, excluding UK  | 1,036   | 491         | 2,055  | 1,532       |
| Australia/New Zealand | 3,290   | 2,177       | 9,128  | 6,473       |
| Other                 | 762   | 780         | 2,041  | 2,327       |
| Total revenue         | \$ 75,124                                     | \$ 57,135   | \$ 203,733                                   | \$ 167,521  |

Long-lived tangible assets at international facilities are not significant.

**14. ACCRUED EXPENSES**

Accrued expenses in the accompanying condensed combined balance sheets consisted of the following (in thousands):

|                                | <b>OCTOBER 31,<br/>2007</b> | <b>JANUARY 31,<br/>2007</b> |
|--------------------------------|-----------------------------|-----------------------------|
| Course development fees        | \$ 1,848                    | \$ 1,860                    |
| Professional fees              | 6,676                       | 2,639                       |
| Accrued payables               | 483                         | 415                         |
| Accrued miscellaneous taxes    | 662                         | 385                         |
| Accrued merger related costs*  | 10,805                      | 1,892                       |
| Sales tax payable/VAT payable  | 4,952                       | 4,405                       |
| Accrued royalties              | 7,766                       | 3,693                       |
| Accrued interest               | 1,510                       |                             |
| Accrued litigation settlements |                             | 15,250                      |
| Accrued restructuring          | 522                         | 659                         |
| Other accrued liabilities      | 11,125                      | 4,229                       |
| Total accrued expenses         | \$ 46,349                   | \$ 35,427                   |

\* Includes \$1,460 and \$1,188 of accrued payroll taxes in October 31, 2007 and January 31, 2007, respectively.

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In connection with the closing of the NETg acquisition on May 14, 2007, the Company entered into a Credit Agreement (the "Credit Agreement") with certain lenders (the "Lenders") providing for a \$225 million senior secured credit facility comprised of a \$200 million term loan facility and a \$25 million revolving credit facility. The term loan was used to finance the Acquisition and the revolving credit facility may be used for general corporate purposes. The term loan bears interest at a rate per annum equal to, at the Company's election, (i) an alternative base rate plus a margin of 1.75% or (ii) adjusted LIBOR plus a margin of 2.75%, and revolving loans bear interest at a rate per annum equal to, at the Company's election, (i) an alternative base rate plus a margin of 1.50% to 1.75% or (ii) adjusted LIBOR plus a margin of 2.50% to 2.75%. The alternative base rate is the greater of certain of the Lenders' prime rate and the federal funds effective rate plus 0.50%. Overdue amounts under the Credit Agreement bear interest at a rate per annum equal to 2.00% plus the rate otherwise applicable to such loan.

The Company is required to pay the Lenders a commitment fee at a rate per annum of 0.50% on the average daily unused amount of the revolving credit facility commitments of such Lenders during the period for which payment is made, payable quarterly in arrears. The term loan is payable in 24 consecutive quarterly installments of (i) \$500,000 in the case of each of the first 23 installments, on the last day of each of September, December, March, and June commencing September 30, 2007 and ending on March 31, 2013, and (ii) the balance due on May 14, 2013. The revolving credit facility terminates on May 14, 2012, at which time all outstanding borrowings under the revolving credit facility are due. The Company may optionally prepay loans under the Credit Agreement at any time, without penalty. The loans are subject to mandatory prepayment in certain circumstances.

The Credit Agreement contains customary representations and warranties as well as affirmative and negative covenants. Affirmative covenants include, among others, with respect to the Company and its subsidiaries, maintenance of existence, financial and other reporting, payment of obligations, maintenance of properties and insurance, maintenance of a credit rating, and interest rate protection. Negative covenants include, among others, with respect to the Company and its subsidiaries, limitations on incurrence or guarantees of indebtedness, limitations on liens, limitations on sale and lease-back transactions, limitations on investments, limitations on mergers, consolidations, asset sales and acquisitions, limitations on dividends, share redemptions and other restricted payments, limitations on affiliate transactions, limitations on hedging transactions, and limitations on capital expenditures. The Credit Agreement also includes a leverage ratio covenant and an interest coverage ratio covenant (the ratio of the Company's consolidated EBITDA to its consolidated interest expense as calculated pursuant to the Credit Agreement). Within the definitions of the Credit Agreement, a material adverse effect shall mean a material adverse condition or material adverse change in or materially and adversely affecting (a) the business, assets, liabilities, operations or financial condition of Holdings, the Borrower and the Subsidiaries, taken as a whole, or (b) the validity or enforceability of any of the Loan Documents or the rights and remedies of Administrative Agent, the Collateral Agent or the Secured Parties there under. No event, change or condition has occurred since January 31, 2007 that has caused, or could reasonably be expected to cause, a material adverse effect, and as of October 31, 2007 the Company was in compliance with all other covenants under the Credit Agreement.

The Company's obligations under the Credit Agreement are guaranteed by the Company, its domestic subsidiaries, and certain other material subsidiaries of the Company pursuant to a Guarantee and Collateral Agreement, dated May 14, 2007 (the "Guarantee and Collateral Agreement"), among the Company, the subsidiary guarantors thereto from time to time (the "Guarantors"), and the Agent on behalf of the Lenders, and in addition by certain foreign law guarantees issued by certain of the Guarantors. The loans and the other obligations of the Company under the Credit Agreement and related loan documents and the guarantee obligations of the Company and Guarantors are secured by substantially all of the tangible and intangible assets of the Company, and each Guarantor (including, without limitation, the intellectual property and the capital stock of certain subsidiaries) pursuant to the Guarantee and Collateral Agreement, and pursuant to certain foreign debentures and charges against their assets.

In connection with the Credit Agreement, the Company incurred debt financing costs of \$5.9 million, which were capitalized and are being amortized as additional interest expense over the term of the loans. During the three and nine months ended October 31, 2007, the Company paid approximately \$4.0 million and \$7.5 million, respectively, in interest. The Company recorded \$254,382 and \$480,645 of amortized interest expense related to the capitalized





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debt financing costs for the three and nine months ended October 31, 2007, respectively. During the three and nine months ended October 31, 2007, the Company paid \$0.5 million against the term amount.

The Lenders required the Company to enter into an interest rate swap agreement for at least 50% of the term loan, or \$100 million, as a means of reducing the Company's interest rate exposure. Accordingly, the Company entered into an interest rate swap agreement with an initial notional amount of \$159.6 million which amortizes over a period consistent with the Company's anticipated payment schedule. This strategy uses an interest rate swap to effectively convert \$159.6 million in variable rate borrowings into fixed rate liabilities at 5.1015% effective interest rate. The interest rate swap is considered to be a hedge against changes in the amount of future cash flows associated with interest payments on a variable rate loan (see Note 16).

**16. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), as amended and interpreted, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. As required by SFAS 133, the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation. Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges.

For derivatives designated as fair value hedges, changes in the fair value of the derivative and the hedged item related to the hedged risk are recognized in earnings. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Company assesses the effectiveness of each hedging relationship by comparing the changes in fair value or cash flows of the derivative hedging instrument with the changes in fair value or cash flows of the designated hedged item or transaction. For derivatives not designated as hedges, changes in fair value are recognized in earnings.

The Company's objective in using derivatives is to add stability to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, the Company primarily uses interest rate swaps as part of its cash flow hedging strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. During the three months ended October 31, 2007, an interest rate swap was used to hedge the variable cash flows associated with \$159.6 million of existing variable-rate debt.

At October 31, 2007, no derivatives were designated as fair value hedges, hedges of net investments in foreign operations or were not designated in hedging relationships under SFAS 133. Additionally, the Company does not use derivatives for trading or speculative purposes.

At October 31, 2007, the interest rate swap was designated as a cash flow hedge with a fair value of (\$1.1 million) which was included in other liabilities. For the three months ended October 31, 2007, the change in net unrealized losses of \$842,000 for the interest rate swap is separately disclosed as a component of comprehensive income. No hedge ineffectiveness on the cash flow hedge was recognized in earnings during the three months ended October 31, 2007. As a result the Company did not have to record any gain or loss due to the change in the value of the hedge in its statement of operations.

Amounts reported in accumulated other comprehensive income related to the interest rate swap will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. For the three months ended October 31, 2007, the change in net unrealized losses on the cash flow hedge reflects a reclassification of \$81,000 of net unrealized gains from accumulated other comprehensive income to interest expense. For the previous three month ended July 31, 2007, the change in net unrealized losses on the cash flow hedge reflects a reclassification of \$83,000 of net unrealized gains from accumulated other comprehensive income to interest expense. For the year ending January 31, 2008, the Company estimates that an additional \$23,000 of net unrealized losses will be reclassified from

accumulated other comprehensive income to interest expense.

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**17. RELATED PARTY TRANSACTION**

In connection with the NETg acquisition, the Company paid a special bonus of \$500,000 to one of the members of our Board of Directors for his assistance in negotiating and completing the transaction. This bonus payment is included in general and administrative expense in the accompanying statements of income for the nine months ended October 31, 2007.

**18. SHARE REPURCHASE PROGRAM**

On March 23, 2006, the Company's shareholders approved a program for the repurchase by the Company of up to an aggregate of 3,500,000 American Depositary Shares (ADS). None of these shares were repurchased under the shareholder approved repurchase program, which expired on September 22, 2007. On May 14, 2007, in connection with the closing of the NETg acquisition, the Company entered into a Credit Agreement that contains customary negative covenants that place limitations on the repurchase of the Company's shares.

**19. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. The Company is currently analyzing the effect, if any, SFAS No. 157 will have on its consolidated financial position and results of operations.

In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value and is effective for fiscal years beginning after November 15, 2007, or February 1, 2008 for SkillSoft. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. The Company is in the process of evaluating the impact this pronouncement may have on its results of operations and financial condition and whether to adopt the provisions of SFAS No. 159 for the fiscal year beginning February 1, 2007.

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

Any statement in this Quarterly Report on Form 10-Q about our future expectations, plans and prospects, including statements containing the words believes, anticipates, plans, expects, will and similar expressions, constitute forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those indicated by such forward-looking statements as a result of various important factors, including those set forth under Part II, Item 1A, Risk Factors.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and notes appearing elsewhere in this Quarterly Report on Form 10-Q.

**OVERVIEW**

We are a leading software as a service (SaaS) provider of on-demand e-learning and performance support solutions for global enterprises, government, education and small to medium-sized businesses. SkillSoft helps companies to maximize employee performance through a combination of comprehensive e-learning content, online information resources, flexible learning technologies and support services. Our multi-modal learning solutions support and enhance the speed and effectiveness of both formal and informal learning processes and integrate SkillSoft's in-depth content resources, learning management system, virtual classroom technology and support services.

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We derive revenue primarily from agreements under which customers license our products and purchase our services. The pricing for our courses varies based upon the number of course titles or the courseware bundle licensed by a customer, the number of users within the customer's organization and the length of the license agreement (generally one, two or three years). Our agreements permit customers to exchange course titles, generally on the contract anniversary date. Additional services, such as hosting and online mentoring, are subject to additional fees. Cost of revenue includes the cost of materials (such as storage media), packaging, shipping and handling, CD duplication, the cost of online mentoring and hosting services, royalties, certain infrastructure and occupancy expenses and share-based compensation. We generally recognize these costs as incurred. Also included in cost of revenue is amortization expense related to capitalized software development costs and intangible assets related to developed software and courseware acquired in business combinations.

We account for software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*, which requires the capitalization of certain computer software development costs incurred after technological feasibility is established. No software development costs incurred during the first nine months of fiscal 2008 met the requirements for capitalization in accordance with SFAS No. 86.

Research and development expenses consist primarily of salaries and benefits, share-based compensation, certain infrastructure and occupancy expenses, fees to consultants and course content development fees. Selling and marketing expenses consist primarily of salaries and benefits, share-based compensation, commissions, advertising and promotion expenses, travel expenses and certain infrastructure and occupancy expenses. General and administrative expenses consist primarily of salaries and benefits, share-based compensation, consulting and service expenses, legal expenses, audit and tax preparation costs, regulatory compliance costs and certain infrastructure and occupancy expenses.

Amortization of intangible assets represents the amortization of customer value, non-compete agreements, trademarks and tradenames from our acquisitions of NETg, TLC, Books 24x7 and GoTrain Corp. and our merger with SkillSoft Corporation (the SmartForce Merger).

Merger and integration related expenses primarily consist of salaries paid to NETg employees for transitional work assignments, facilities, systems and process integration activities.

Restructuring primarily consists of charges associated with international restructuring activities.

Restatement SEC investigation primarily consists of legal and consulting fees incurred related to the ongoing SEC investigation relating to the restatement of SmartForce's financial statements for 1999, 2000, 2001 and the first two quarters of 2002, and more recently, the SEC's review of SmartForce's option granting practices prior to the SmartForce Merger.

**BUSINESS OUTLOOK**

In the three and nine months ended October 31, 2007, we generated revenue of \$75.1 million and \$203.7 million respectively, as compared to \$57.1 million and \$167.5 million in the three and nine months ended October 31, 2006, respectively. We reported net income in the three and nine months ended October 31, 2007 of \$5.8 million and \$25.7 million, respectively, as compared to \$7.1 million and \$16.0 million in the three and nine months ended October 31, 2006, respectively.

We continue to find ourselves in a challenging business environment due to (i) the overall market adoption rate for e-learning solutions remaining relatively slow, (ii) budgetary constraints on information technology (IT) spending by our current and potential customers and (iii) price competition and value based competitive offerings from a broad array of competitors in the learning market generally. Despite these challenges, we have seen some stability in the marketplace and our core business has performed in accordance with our expectations. Our recent revenue growth and our growth prospects are strongest in our product lines focused on or bundled with informal learning, such as those available from our Books 24x7 subsidiary. As a result, we have increased our sales and marketing investment related to those product lines to help capitalize on the recent growth and potential continued growth for

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informal learning related products. We have also invested aggressively in research and development in those areas to accelerate the time by which our planned new products will be available to our customers. In order to pursue the small business market we continue to invest in our telesales unit, but we need to see renewal rates consistent with those of our direct sales business to determine its potential. We also will consider continuing to invest in our new business direct field sales team and lead generators.

On May 14, 2007, we completed our acquisition of NETg for approximately \$270 million, subject to customary post-closing adjustments. NETg is a global enterprise-learning delivering integrated learning solutions for businesses, professional associations and government agencies that include instructional content, multiple delivery options, enabling technologies, and a range of expert consulting services. NETg offers many of the same financial and operating characteristics as SkillSoft's business model, including an annual recurring subscription-based licensing model for access to its learning resources library, a direct sales force distribution system complemented by resellers and telesales support, and a Global 2000 client base offering visibility through multi-year contracts and renewal rates. The acquisition added to our existing offerings through the addition of complementary NETg offerings such as live virtual instructor-led training, blended learning, learning content and custom development services among others. The acquisition supports our overall strategy to continually increase the quality, breadth and flexibility of the learning solutions we can make available to our corporate, government, education and small-to-medium size business customers. Also, the addition of NETg's capabilities strengthens our ability to compete for a greater share of the \$13.2 billion corporate training market that includes many larger players with more comprehensive product offerings. In addition to our recent acquisition of NETg, we acquired Targeted Learning Corporation (TLC) on February 9, 2007. Under the terms of the acquisition, we paid approximately \$4.1 million in cash to acquire TLC. Additional consideration of up to \$0.5 million is payable to the shareholders of TLC upon achievement of certain integration milestones prior to February 2008. As of October 31, 2007, \$0.3 million of this additional consideration has been paid. The acquisition provides us with a new offering that includes an on-line library of over 300 video-based programs featuring organizational and leadership experts, CEOs and best-selling authors. Programs range in length from two minutes to two hours, and much of this content is presented as 3 to 5 minute segments, or Quick Talks, for easy access. Selected programs as indicated on the course profile page are available for offline use with portable devices that support video, including the Apple iPod®. Users can search the content by Leadership Model category or by title, speaker/author or topic. This product offers many of the same financial and operating characteristics as our business model, including an annual recurring subscription-based licensing model for access to its video-based resource library to be sold through our direct sales force, complemented by resellers and telesales.

During the remainder of fiscal 2008, we will continue to focus on the integration of NETg into our operations. We also will continue to focus on revenue and earnings growth, excluding normal and anticipated acquisition and integration related expenses, primarily by cross selling and up selling, looking at new markets, acquiring new customers, continuing to execute on our new product and telesales distribution initiatives, and continuing to evaluate merger and acquisition opportunities that could contribute to our long-term objectives.

**CRITICAL ACCOUNTING POLICIES**

We believe that our critical accounting policies are those related to revenue recognition, amortization of intangible assets and impairment of goodwill, share-based compensation, deferral of commissions, restructuring charges, legal contingencies, income taxes and valuation of business combinations. We believe these accounting policies are particularly important to the portrayal and understanding of our financial position and results of operations and require application of significant judgment by our management. In applying these policies, management uses its judgment in making certain assumptions and estimates. Our critical accounting policies are more fully described under the heading

Critical Accounting Policies in Note 2 of the Notes to the Consolidated Financial Statements and under Management's Discussion and Analysis of Financial Conditions and Results of Operations - Critical Accounting Policies in our Annual Report on Form 10-K as filed with the SEC on April 13, 2007. The policies set forth in our Form 10-K have not changed, except that the critical accounting policy for business combinations described in our Form 10-Q for the quarter ended July 31, 2007 filed with the SEC is a new critical accounting policy in light of the NETg acquisition and income taxes which, has been modified as a result of the adoption of FASB Interpretation (FIN) 48 on February 1, 2007 as described in our Form 10-Q for the quarter ended April 30, 2007 filed with the SEC.



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## RESULTS OF OPERATIONS

THREE MONTHS ENDED OCTOBER 31, 2007 VERSUS THREE MONTHS ENDED OCTOBER 31, 2006

|   | Three Months Ended October 31,                        |                                  |               |      |
|---|---|----------------------------------|---------------|------|
|   | Dollar  | Percent Change                   | Percentage of |      |
|   | Increase/(Decrease)<br>2006/2007<br>(In<br>thousands) | Increase/(Decrease)<br>2006/2007 | 2007          | 2006 |
| Revenue   | \$ 17,989   | 31%                              | 100%          | 100% |
| Cost of revenue amortization of intangible assets                               | 1,000   | 135%                             | 2%            | 1%   |
| Cost of revenue   | 1,436   | 21%                              | 11%           | 12%  |
| Gross profit  | 15,553  | 31%                              | 87%           | 87%  |
| Research and development  | 3,663   | 36%                              | 18%           | 18%  |
| Selling and marketing   | 3,244   | 15%                              | 34%           | 38%  |
| General and administrative  | 2,605   | 38%                              | 13%           | 12%  |
| Amortization of intangible assets   | 3,222   | 782%                             | 5%            | 1%   |
| Merger related integration expenses   | 2,616   | *                                | 3%            |      |
| Restructuring   | (25)  | (100)%                           |               |      |
| Restatement SEC investigation   | (9)   | (8)%                             |               |      |
| Total operating expenses  | 15,316  | 39%                              | 73%           | 69%  |
| Operating income  | 237   | 2%                               | 14%           | 18%  |
| Other income/(expense) , net  | (607)   | 1,734%                           | (1)%          |      |
| Interest income   | (483)   | (42)%                            | 1%            | 2%   |
| Interest expense  | (3,858)   | 5,591%                           | (5)%          |      |
| Income before (benefit) / provision for income taxes from continuing operations | (4,711)   | (42)%                            | 9%            | 20%  |
| Provision for income taxes  | (3,803)   | (93)%                            |               | 7%   |
| Income from continuing operations   | (908)   | (13)%                            | 8%            | 12%  |
| (Loss)/income from operations of businesses to be disposed, net of income tax   | (351)   | *                                |               |      |
| Net income  | \$ (1,259)  | (18)%                            | 8%            | 12%  |

\* Not meaningful

Does not add  
due to rounding.

REVENUE

|                      | <b>THREE MONTHS ENDED OCTOBER 31,</b> |                           |               |
|----------------------|---------------------------------------|---------------------------|---------------|
|                      | <b>2007</b>                           | <b>2006</b>               | <b>CHANGE</b> |
|                      |                                       | <b>(In<br/>thousands)</b> |               |
| Revenue:             |                                       |                           |               |
| Multi-Modal Learning | \$ 75,124                             | \$ 55,888                 | \$ 19,236     |
| Retail Certification |                                       | 1,247                     | (1,247)       |
| Total                | \$ 75,124                             | \$ 57,135                 | \$ 17,989     |

The primary reasons for the increase in revenue are the additional revenues realized from the acquisitions of NETg in May 2007 and TLC in February 2007, a growth in sales of our informal learning product lines and additional revenue earned under agreements with third party resellers of our products. Approximately \$9.0 million of revenues earned in the three months ended October 31, 2007 related to the amortization of acquired deferred revenue we retained following the NETg acquisition.

The sale of certain assets related to SmartCertify, our Retail Certification business, resulted in a reduction in revenue of \$1.3 million in our Retail Certification business for the three months ended October 31, 2007 as compared to the



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three months ended October 31, 2006. Revenues from our Retail Certification business will be \$0.2 million in fiscal 2008 as compared to \$5.0 million in fiscal 2007. Our Retail Certification business will not contribute additional revenue in fiscal 2008.

|               | <b>THREE MONTHS ENDED OCTOBER 31,</b> |             |               |
|---------------|---------------------------------------|-------------|---------------|
|               | <b>2007</b>                           | <b>2006</b> | <b>CHANGE</b> |
|               | <b>(In thousands)</b>                 |             |               |
| Revenue:      |                                       |             |               |
| United States | \$ 59,076                             | \$ 44,689   | \$ 14,387     |
| International | 16,048                                | 12,446      | 3,602         |
| Total         | \$ 75,124                             | \$ 57,135   | \$ 17,989     |

Revenue increased by 32% and 29% in the United States and internationally, respectively, in the three months ended October 31, 2007 as compared to the three months ended October 31, 2006 as a result of increased Multi-Modal Learning (MML) revenue generated from the NETg and TLC acquisitions increased orders from existing customers and new business.

We exited the fiscal year ended January 31, 2007 with non-cancelable backlog of approximately \$181 million compared to \$171 million at January 31, 2006. This amount is calculated by combining the amount of deferred revenue at each fiscal year end with the amounts to be added to deferred revenue throughout the next twelve months from billings under committed customer contracts and determining how much of these amounts are scheduled to amortize into revenue during fiscal 2008. The amount scheduled to amortize into revenue during fiscal 2008 is disclosed as backlog as of January 31, 2007. Amounts to be added to deferred revenue during fiscal 2008 include subsequent installment billings for ongoing contract periods as well as billings for new or continuing contracts. As a result of the previously described sale of certain assets related to SmartCertify, the balance of non-cancelable backlog at January 31, 2007 reflects a reduction of approximately \$5.0 million in SmartCertify backlog when compared to January 31, 2006, and SmartCertify will not contribute new contracts during fiscal 2008. We have included this non-GAAP disclosure due to the fact that it is directly related to our subscription based revenue recognition policy. This is a key business metric, which factors into our forecasting and planning activities and provides visibility into fiscal 2008 revenue. The backlog figures provided do not give effect to the NETg acquisition.

**COSTS AND EXPENSES**

The increase in cost of revenue in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to increased revenue, including costs associated with legacy NETg revenue transactions.

The increase in cost of revenue amortization of intangible assets in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to the addition of the amortization of the intangible assets acquired from the acquisition of NETg. This increase was partially offset by certain intangible assets related to capitalized software development costs and technology acquired in previous business combinations becoming fully amortized during the previous fiscal year.

The increase in research and development expenses in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to expenses of \$2.2 million associated with maintaining multiple platforms as a result of the NETg acquisition, fulfilling obligations of acquired customer contracts and product commitments assumed in the acquisition of NETg. In addition we incurred an increase in compensation and benefits of \$1.3 million as a result of our increased headcount. We anticipate that there will be additional research and development expenses in subsequent periods for content outsourcing, software outsourcing and additional personnel. Consequently we expect to incur research and development expenses of approximately \$15.0 to \$16.0 million in the fourth quarter of fiscal 2008.

The increase in selling and marketing expenses in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to an increase in compensation and benefits of \$2.2 million as a result of our increased headcount, which includes additional direct sales, telesales and field support personnel required to service our the increased customer base as a result of the NETg acquisition. In addition we incurred an additional \$0.4 million in commission expense resulting from increased sales as well as incremental marketing costs of \$0.6

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million to support our increased customer base. We anticipate making additional investments related to our sales distribution efforts, sales support and marketing to support our increased customer base and our growth initiatives. As a result we expect to incur sales and marketing expenses of approximately \$28.0 million to \$29.0 million in the fourth quarter of fiscal 2008.

The increase in general and administrative expenses in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to an increase of \$1.7 million in costs related to additional headcount, contractors and professional services required to support the increase in customer contracts and the transitional activities undertaken as a result of the NETg acquisition. In addition, we incurred an incremental \$0.6 million of depreciation and facility-related costs due to acquired assets and leased office space from the NETg acquisition. We anticipate making additional investments related to headcount and services as required to support our increased customer base and our growth initiatives. Consequently, we expect to incur general and administrative expenses of approximately \$8.5 million to \$9.5 million for the fourth quarter of fiscal 2008.

The increase in amortization of intangible assets in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to the amortization of intangible assets acquired as a result of the NETg acquisition.

In the three months ended October 31, 2007, we incurred approximately \$2.6 million of merger and integration related expenses as a result of efforts undertaken to integrate NETg's operations into ours. Included in these costs are approximately \$1.6 million of salary and benefits for NETg employees conducting transition activities as well as approximately \$1.0 million of charges related to facilities, systems and process integration activities.

**OTHER INCOME/(EXPENSE), NET**

The change in other income/(expense), net in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to foreign currency fluctuations. Due to our multi-national operations, our business is subject to fluctuations based upon changes in the exchange rates between the currencies used in our business.

**INTEREST INCOME**

The decrease in interest income in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to less funds being available for investment as a result of cash used for the acquisition of NETg in May 2007.

**INTEREST EXPENSE**

The increase in interest expense in the three months ended October 31, 2007 versus the three months ended October 31, 2006 was primarily due to the interest expense recognized as a result of the debt incurred for the acquisition of NETg as well as the amortization of prepaid debt financing costs as interest expense.

**DISCONTINUED OPERATIONS**

In connection with the NETg acquisition, we decided to discontinue four product lines that were acquired from NETg because we believe these product offerings do not represent areas that can grow or be consistent with our profit model. The product lines that have been identified as discontinued operations are Wave, NETg Press, Interact Now and Financial Campus. We recorded a loss from discontinued operations, net of tax, of \$351,000 in the three months ended October 31, 2007. NETg Press and Financial Campus were both sold in the three months ended October 31, 2007. In addition, we exited the Wave business in the three months ended October 31, 2007. We expect to exit the Interact Now business by the middle of fiscal 2009 and we do not anticipate it to materially affect our liquidity, financial condition or results of operations.



|                      | <b>NINE MONTHS ENDED OCTOBER 31,</b> |             |               |
|----------------------|--------------------------------------|-------------|---------------|
|                      | <b>2007</b>                          | <b>2006</b> | <b>CHANGE</b> |
|                      | <b>(In<br/>thousands)</b>            |             |               |
| Revenue:             |                                      |             |               |
| Multi-Modal Learning | \$ 203,520                           | \$ 163,018  | \$ 40,502     |
| Retail Certification | 213                                  | 4,503       | (4,290)       |
| Total                | \$ 203,733                           | \$ 167,521  | \$ 36,212     |

The primary reasons for the increase in revenue are the additional revenues realized from the NETg acquisition, a growth in sales of our informal learning product lines and additional revenue earned under agreements with third party resellers of our products. Approximately \$19.8 million of revenue earned in the nine months ended October 31, 2007 relates to the amortization of acquired deferred revenue we retained following the NETg acquisition.

The sale of certain assets related to SmartCertify, our Retail Certification business, resulted in a reduction in revenue of \$4.3 million in our Retail Certification business for the nine months ended October 31, 2007 as compared to the nine months ended October 31, 2006. Revenue from our Retail Certification business will be \$0.2 million in fiscal 2008 as compared to \$5.0 million in fiscal 2007 as our Retail Certification business will not contribute additional revenue in fiscal 2008.

| <b>(IN THOUSANDS)</b> | <b>NINE MONTHS ENDED OCTOBER 31,</b> |             |               |
|-----------------------|--------------------------------------|-------------|---------------|
|                       | <b>2007</b>                          | <b>2006</b> | <b>CHANGE</b> |
|                       | <b>(In<br/>thousands)</b>            |             |               |
| Revenue:              |                                      |             |               |
| United States         | \$ 160,161                           | \$ 131,155  | \$ 29,006     |
| International         | 43,572                               | 36,366      | 7,206         |
| Total                 | \$ 203,733                           | \$ 167,521  | \$ 36,212     |

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Revenue increased by 22% and 20% in the United States and internationally, respectively, in the nine months ended October 31, 2007 as compared to the nine months ended October 31, 2006 as a result of increased MML revenue generated from the NETg and TLC acquisitions and from existing customers and new business.

**COSTS AND EXPENSES**

The increase in cost of revenue in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 was primarily due to increased revenue as well as costs associated with legacy NETg revenue transactions.

The decrease in cost of revenue amortization of intangible assets in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 was primarily due to certain intangible assets related to capitalized software development costs and technology acquired in business combinations becoming fully amortized during the previous fiscal year. This decrease was partially offset by the addition of the amortization of the intangible assets acquired from the acquisition of NETg.

The increase in research and development expenses in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 was primarily due to expenses of \$3.9 million associated with maintaining multiple platforms as a result of the NETg acquisition, fulfilling obligations of acquired customer contracts and product commitments assumed in the acquisition of NETg. In addition we incurred an increase in compensation and benefits of \$1.7 million as a result of our increased headcount.

The increase in selling and marketing expenses in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 was primarily due to an increase in compensation and benefits of \$1.9 million as a result of our increased headcount, which include additional direct sales, telesales and field support personnel required to service our increased customer base as a result of the NETg acquisition. In addition we incurred incremental marketing costs of \$1.0 million to support the increased customer base.

The increase in general and administrative expenses in the nine months ended October 31, 2007 versus the nine months ended October 31, was primarily due to an increase of \$3.1 million in costs associated with the inclusion of additional headcount, contractors and professional services required to support the increase in customer contracts and the transitional activities undertaken as a result of the NETg acquisition. In addition, we incurred an incremental \$1.3 million of depreciation and facility related costs due to acquired assets and leased office space from the NETg acquisition, as well as approximately \$0.5 million of consulting expense paid to a member of our board of directors related to the NETg acquisition.

The increase in amortization of intangible assets in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 was primarily due to the amortization of intangible assets acquired as a result of the NETg acquisition.

In the nine months ended October 31, 2007, we incurred approximately \$11.1 million of merger and integration related expenses as a result of efforts undertaken to integrate NETg's operations into ours. Included in these costs are approximately \$7.7 million of salary and benefits for NETg employees conducting transition activities as well as approximately \$3.4 million of charges related to facilities, systems and process integration activities.

Restatement SEC investigation charges increased in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 due to an increase in legal expenses related to the SEC's informal inquiry into the pre-merger option granting practices at SmartForce.

**OTHER INCOME/(EXPENSE), NET**

The change in other income/ (expense), net in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 was primarily due to foreign currency fluctuations. Due to our multi-national operations,

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our business is subject to fluctuations based upon changes in the exchange rates between the currencies used in our business.

**INTEREST INCOME**

Interest income in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 remained relatively unchanged. Although more funds were available for investment and higher interest rates on our cash and cash equivalents and investments during the first three months of fiscal 2008, this increase was offset by the reduction of funds available for investment as a result of cash used for the acquisition of NETg in May 2007.

**INTEREST EXPENSE**

The increase in interest expense in the nine months ended October 31, 2007 versus the nine months ended October 31, 2006 was primarily due to the interest expense recognized as a result of the debt incurred for the acquisition of NETg as well as the amortization of prepaid debt financing costs as interest expense.

**PROVISION FOR INCOME TAXES**

For the nine months ended October 31, 2007, we had a tax benefit of \$7.9 million versus a tax provision of \$9.2 million for the nine months ended October 31, 2006. The tax benefit for the nine months ended October 31, 2007 has been significantly influenced by the release of approximately \$49.1 million of U.S. valuation allowance on net operating loss (NOL) carryforwards, partially offset by a provision for income taxes based on the projected effective tax rate for the fiscal year ended January 31, 2008 prior to the valuation allowance adjustment. Approximately \$25 million of the valuation allowance release was recorded through a reduction to tax expense and \$24.1 million was recorded through an adjustment to goodwill. Additionally, the projected annual tax provision is impacted by the effects of certain tax adjustments required in purchase accounting for the NETg acquisition.

**DISCONTINUED OPERATIONS**

In connection with the NETg acquisition, we decided to discontinue four product lines acquired from NETg because we believe these product offerings do not represent areas that can grow or be consistent with our profit model. The product lines that have been identified as discontinued operations are Wave, NETg Press, Interact Now and Financial Campus. We recorded income from discontinued operations, net of tax, of \$173,000 in the nine months ended October 31, 2007.

**LIQUIDITY AND CAPITAL RESOURCES**

As of October 31, 2007, our principal source of liquidity was our cash and cash equivalents and short-term investments, which totaled \$50.6 million. This compares to \$104.1 million at January 31, 2007.

Net cash provided by operating activities of \$8.5 million for the nine months ended October 31, 2007 was primarily due to net income from continuing operations of \$25.5 million, which included the impact of non-cash expenses for depreciation and amortization and amortization of intangible assets of \$17.1 million and share-based compensation expense of \$4.0 million. Net cash provided by operating activities was also a result of a decrease in accounts receivable of \$36.3 million as well as a decrease in prepaid and other current assets of \$14.1 million. These amounts were partially offset by a decrease in accrued expenses of \$45.6 million, a decrease in deferred revenue of \$33.7 million and a non-cash income tax benefit of \$9.0 million. The decreases in accounts receivable, accrued expenses and deferred revenue are primarily a result of the seasonality of our operations, with the fourth quarter of our fiscal year historically generating the most activity.

Net cash used in investing activities was \$232.2 million for the nine months ended October 31, 2007, which includes cash used to acquire NETg of \$275 million, net of cash acquired and cash used to acquire TLC of \$3.9 million, net of cash acquired. In addition we had disposition of net assets of \$6.0 million related to the sale of NETg Press and Financial Campus in which we received only nominal cash on the close of the sale of these businesses. This was partially offset by the maturity of investments generating a cash inflow of approximately \$38.8 million, net of purchases, in the nine months ended October 31, 2007. In addition, approximately \$16.2 million of cash was

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released from restricted cash as a result of making the final payment related to the settlement of the 2002 class action lawsuit in April 2007. Prior to making that payment, we were required to place a restriction on this cash to secure an outstanding letter of credit of \$15.5 million.

Net cash provided by financing activities was \$204.7 million for the nine months ended October 31, 2007. This was the result of borrowing under long-term debt of \$194.1 million net of debt acquisition costs, as well as proceeds of \$11.1 million we received from both of the exercise of share options under our various share option programs and share purchases under our 2004 Employee Share Purchase Plan.

We had a working capital deficit of approximately \$35.7 million as of October 31, 2007 and had working capital of approximately \$38.1 million as of January 31, 2007. The decrease in our working capital was primarily due to cash used to acquire NETg of \$77.0 million and cash used to acquire TLC of \$4.1 million. This was partially offset by proceeds of \$11.1 million we received from both of the exercise of share options under our various share option programs and share purchases under our 2004 Employee Share Purchase Plan.

As of January 31, 2007, we had U.S. federal net operating loss (NOL) carryforwards of approximately \$284.2 million. These NOL carryforwards, which are subject to potential limitations based upon change in control provisions of Section 382 of the Internal Revenue Code, are available to reduce future taxable income, if any, through 2025.

Included in the \$284.2 million are approximately \$157.1 million of U.S. NOL carryforwards that were acquired in the SmartForce Merger and the purchase of Books 24x7. As a result of the release of the U.S. valuation allowance in the nine months ended October 31, 2007, we realized the benefits of approximately \$69 million of these acquired NOL carryforwards through a reduction to goodwill and approximately \$71 million of these NOL carryforwards through a reduction to the provision for income taxes. We will realize the remaining benefits of these acquired NOL carryforwards through reductions to goodwill and non-goodwill intangible assets. Also included in the \$284.2 million are approximately \$127.1 million of U.S. NOL carryforwards that relate to our operations. Additionally, included in the \$284.2 million at January 31, 2007 is approximately \$30.8 million of NOL carryforwards in the United States resulting from disqualifying dispositions. We will realize the benefit of these losses through increases to shareholder s equity in the periods in which the losses are utilized to reduce tax payments. We also acquired \$365,000 of U.S. tax credit carryforwards in the SmartForce Merger and the purchase of Books 24x7. As with the acquired NOL carryforwards, we will realize the benefits of these credit carryforwards through reductions to goodwill and non-goodwill intangible assets. Additionally, we had approximately \$93.5 million of NOL carryforwards in jurisdictions outside of the U.S. In addition, included in the \$93.5 million is approximately \$88.1 million of NOL carryforwards in jurisdictions outside the U.S. which were acquired in the SmartForce Merger and the purchase of Books 24x7. We will realize the benefits of these acquired NOL carryforwards through reductions to goodwill and non-goodwill intangible assets. We also had U.S. federal tax credit carryforwards of approximately \$6.8 million at January 31, 2007.

We lease certain of our facilities and certain equipment and furniture under operating lease agreements that expire at various dates through 2023. In addition, we have a note payable related to the acquisition of NETg which will be paid out over the next 6 years. Future minimum lease payments, net of estimated rentals, under these agreements and the debt repayments schedule are as follows (in thousands):

|                                | Total      | Payments Due by Period |           |           |                   |
|--------------------------------|------------|------------------------|-----------|-----------|-------------------|
|                                |            | Less Than 1 Year       | 1-3 Years | 3-5 Years | More Than 5 Years |
| <b>Contractual Obligations</b> |            |                        |           |           |                   |
| Operating Lease Obligations    | \$ 22,834  | \$ 7,745               | \$ 6,538  | \$ 2,060  | \$ 6,491          |
| Debt Obligations               | 199,500    | 2,000                  | 4,000     | 4,000     | 189,500           |
| Total Obligations              | \$ 222,334 | \$ 9,745               | \$ 10,538 | \$ 6,060  | \$ 195,991        |

On February 9, 2007, we acquired the assets of TLC for approximately \$4.1 million with additional consideration of up to \$0.5 million payable to the shareholders of TLC based upon the achievement of certain integration milestones prior to February 2008. As of October 31, 2007, \$0.3 million of this additional consideration had been paid.



We used approximately \$77.0 million of our cash on May 14, 2007 for the purchase price and related expenses of the NETg acquisition. In connection with the closing of the NETg acquisition, we (and our subsidiary SkillSoft Corporation) entered into a Credit Agreement with Credit Suisse, as agent, and certain other parties. The Credit Agreement provides for a \$225 million senior secured credit facility comprised of a \$200 million term loan facility

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and a \$25 million revolving credit facility. Proceeds of the term loan facility were used to finance the NETg acquisition and the revolving credit facility may be used for general corporate purposes. In connection with the NETg acquisition, SkillSoft Corporation borrowed the entire \$200 million available under the term loan facility. The term loan bears interest at a rate per annum equal to, at our election, (i) an alternative base rate plus a margin of 1.75% or (ii) adjusted LIBOR plus a margin of 2.75%, and revolving loans bear interest at a rate per annum equal to, at our election, (i) an alternative base rate plus a margin of 1.50% to 1.75% or (ii) adjusted LIBOR plus a margin of 2.50% to 2.75%. The alternative base rate is the greater of Credit Suisse's prime rate and the federal funds effective rate plus 0.50%. Overdue amounts under the Credit Agreement bear interest at a rate per annum equal to 2.00% plus the rate otherwise applicable to such loan.

We are required to pay the lenders a commitment fee at a rate per annum of 0.50% on the average daily unused amount of the revolving credit facility commitments of the lenders during the period for which payment is made, payable quarterly in arrears. The term loan is payable in 24 consecutive quarterly installments of (i) \$500,000 in the case of each of the first 23 installments, on the last day of each of September, December, March, and June commencing September 30, 2007 and ending on March 31, 2013, and (ii) the balance due on May 14, 2013. The revolving credit facility terminates on May 14, 2012, at which time all outstanding borrowings under the revolving credit facility are due. We may optionally prepay loans under the Credit Agreement at any time, without penalty. The loans are subject to mandatory prepayment in certain circumstances.

The Credit Agreement contains customary representations and warranties as well as affirmative and negative covenants. Affirmative covenants include, among others, with respect to us and our subsidiaries, maintenance of existence, financial and other reporting, payment of obligations, maintenance of properties and insurance, maintenance of a credit rating, and interest rate protection. Negative covenants include, among others, with respect to us and our subsidiaries, limitations on incurrence or guarantees of indebtedness, limitations on liens, limitations on sale and lease-back transactions, limitations on investments, limitations on mergers, consolidations, asset sales and acquisitions, limitations on dividends, share redemptions and other restricted payments, limitations on affiliate transactions, limitations on hedging transactions, and limitations on capital expenditures. The Credit Agreement also includes a leverage ratio covenant and an interest coverage ratio covenant (the ratio of our consolidated EBITDA to our consolidated interest expense as calculated pursuant to the Credit Agreement).

The Credit Agreement contains customary events of default, including, among others, inaccuracy of representations and warranties in any material respect, non-payment of principal, interest or other amounts when due, violation of covenants, cross-defaults with other material indebtedness, certain undischarged judgments, the occurrence of certain ERISA or bankruptcy or insolvency events and the occurrence of a Change in Control (as defined in the Credit Agreement). Upon the occurrence and during the continuance of an event of default under the Credit Agreement, the lenders may declare the loans and all other obligations under the Credit Agreement immediately due and payable. A bankruptcy or insolvency event of default causes such obligations automatically to become immediately due and payable.

Within the definitions of the Credit Agreement, a material adverse effect shall mean a material adverse condition or material adverse change in or materially and adversely affecting (a) the business, assets, liabilities, operations or financial condition of Holdings, the Borrower and the Subsidiaries, taken as a whole, or (b) the validity or enforceability of any of the loan Documents or the rights and remedies of Administrative Agent, the Collateral Agent or the Secured Parties there under. No event, change or condition has occurred since January 31, 2007 that has caused, or could reasonably be expected to cause, a material adverse effect and as of October 31, 2007 we were in compliance with all other covenants under the Credit Agreement.

The loans and our other obligations under the Credit Agreement and related loan documents are secured by substantially all of our tangible and intangible assets.

In conjunction with the Credit Agreement we entered into a \$159.6 million Hedge Contract at a rate of 5.1015% to limit our exposure to the possible fluctuations of the LIBOR. Under the terms of the Credit Agreement we are required to hedge a minimum of 50% of the Term Loan for a period of two years.

We will continue to invest in research and development and sales and marketing in order to execute our business plan and achieve expected revenue growth. To the extent that our execution of the business plan results in increased



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sales, we expect to experience corresponding increases in deferred revenue, cash flow and prepaid expenses. Capital expenditures for the fiscal year ending January 31, 2008 are expected to be approximately \$5.0 to \$7.0 million. We expect that the principal sources of funding for our operating expenses, capital expenditures, debt payment obligations and other liquidity needs will be a combination of our available cash and cash equivalents and short-term investments, and funds generated from future cash flows from operating activities. We believe our current funds and expected cash flows from operating activities will be sufficient to fund our operations, including our debt repayment obligations, for at least the next 12 months. However, there are several items that may negatively impact our available sources of funds. In addition, our cash needs may increase due to factors such as unanticipated developments in our business or the marketplace for our products in general or significant acquisitions (in addition to and including NETg). The amount of cash generated from operations will be dependent upon the successful execution of our business plan. Although we do not foresee the need to raise additional capital, any unanticipated economic or business events could require us to raise additional capital to support operations.

**EXPLANATION OF USE OF NON-GAAP FINANCIAL RESULTS**

In addition to our audited financial results in accordance with United States generally accepted accounting principles (GAAP), to assist investors we may on occasion provide certain non-GAAP financial results as an alternative means to explain our periodic results. The non-GAAP financial results typically exclude non-cash or one-time charges or benefits.

Our management uses the non-GAAP financial results internally as an alternative means for assessing our results of operations. By excluding non-cash charges such as share-based compensation, amortization of purchased intangible assets, impairment of goodwill and purchased intangible assets, management can evaluate our operations excluding these non-cash charges and can compare its results on a more consistent basis to the results of other companies in our industry. By excluding charges such as restructuring charges/(benefits), our management can compare our ongoing operations to prior quarters where such items may be materially different and to ongoing operations of other companies in our industry who may have materially different one-time charges.

Our management believes that the non-GAAP financial results may also provide useful information to investors. Non-GAAP results may also allow investors and analysts to more readily compare our operations to prior financial results and to the financial results of other companies in the industry who similarly provide non-GAAP results to investors and analysts. Investors may seek to evaluate our business performance and the performance of our competitors as they relate to cash. Excluding one-time and non-cash charges may assist investors in this evaluation and comparison.

In addition, certain covenants in our Credit Agreement are based on non-GAAP financial measures and evaluating and presenting these measures allows us and our investors to assess our compliance with the covenants in our Credit Agreement and thus our liquidity situation.

Our management recognizes that non-GAAP financial results are not a substitute for GAAP results, but believes that non-GAAP measures are helpful in assisting them in understanding and managing our business.

We intend to continue to assess the potential value of reporting non-GAAP results consistent with applicable rules and regulations.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As of October 31, 2007, we did not use derivative financial instruments for speculative or trading purposes.

**INTEREST RATE RISK**

Our general investing policy is to limit the risk of principal loss and to ensure the safety of invested funds by limiting market and credit risk. We currently use a registered investment manager to place our investments in highly liquid money market accounts and government-backed securities. All highly liquid investments with original maturities of three months or less are considered to be cash equivalents. Interest income is sensitive to changes in

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the general level of U.S. interest rates. Based on the short-term nature of our investments, we have concluded that there is no significant market risk exposure.

In order to limit our exposure to interest rate changes, we entered into an interest rate swap agreement with an initial notional amount of \$160 million which amortizes over a period consistent with our anticipated payment schedule. This strategy uses an interest rate swap to effectively convert \$160 million in variable rate borrowings into fixed rate liabilities at 5.1015% effective interest rate. The interest rate swap is considered to be a hedge against changes in the amount of future cash flows associated with interest payments on a variable rate loan.

**FOREIGN CURRENCY RISK**

Due to our multi-national operations, our business is subject to fluctuations based upon changes in the exchange rates between the currencies in which we collect revenues or pay expenses and the U.S. dollar. Our expenses are not necessarily incurred in the currency in which revenue is generated, and, as a result, we are required from time to time to convert currencies to meet our obligations. These currency conversions are subject to exchange rate fluctuations, in particular changes to the value of the Euro, Canadian dollar, Australian dollar, New Zealand dollar, Singapore dollar, and United Kingdom pound sterling relative to the U.S. dollar, which could adversely affect our business and the results of operations. During the nine months ended October 31, 2007 and 2006, we incurred foreign currency exchange losses of \$546,000 and \$252,000, respectively.

**ITEM 4. CONTROLS AND PROCEDURES**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of October 31, 2007. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of October 31, 2007, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended October 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II****ITEM 1. LEGAL PROCEEDINGS**

See Part II Item 1 of our Quarterly Report on Form 10-Q for the fiscal quarter ended July 31, 2007 for a discussion of legal proceedings. There were no material developments in these proceedings during the quarter ended October 31, 2007.

**ITEM 1A. RISK FACTORS**

Investors should carefully consider the risks described below before making an investment decision with respect to our shares. While the following risk factors have been updated to reflect developments subsequent to the filing of our Annual Report on Form 10-K for the fiscal year ended January 31, 2007, there have been no material changes to the risk factors included in that report, except that the risk related to the ongoing investigation by the SEC has been revised to reflect developments in that investigation.

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**RISKS RELATED TO LEGAL PROCEEDINGS**

**WE ARE THE SUBJECT OF AN ONGOING INVESTIGATION BY THE SEC.**

We had been the subject of a formal investigation by the United States Securities and Exchange Commission ( SEC ) into the events and circumstances giving rise to the 2003 restatement of SmartForce PLC s accounts (the Restatement Investigation ). On July 19, 2007, the SEC announced that three former officers and one former employee of SmartForce had settled SEC claims in connection with the Restatement Investigation. The former officers/employee have made payments in connection with their settlements. It is possible that they may seek to require us to indemnify them for such payments. We understand that the Restatement Investigation has now been concluded without any claim being brought against us.

The Boston District Office of the SEC informed us in January 2007 that we are the subject of an informal investigation concerning options granting practices at SmartForce for the period beginning April 12, 1996 through July 12, 2002. These grants were made prior to the September 6, 2002 merger with SmartForce PLC. We have produced documents in response to requests from the SEC.

We continue to cooperate with the SEC in this matter. At the present time, we are unable to predict the outcome of this matter or its potential impact on our operating results or financial position. However, we may incur substantial costs in connection with the SEC investigation, and this investigation could cause a diversion of management time and attention. In addition, we could be subject to penalties, fines or regulatory sanctions or claims by our former officers, directors or employees for indemnification of costs they may incur in connection with the SEC investigation. Any or all of those issues could adversely affect our business, operating results and financial position.

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**CLAIMS THAT WE INFRINGE UPON THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS COULD RESULT IN COSTLY LITIGATION OR ROYALTY PAYMENTS TO THIRD PARTIES, OR REQUIRE US TO REENGINEER OR CEASE SALES OF OUR PRODUCTS OR SERVICES.**

Third parties have in the past and could in the future claim that our current or future products infringe their intellectual property rights. Any claim, with or without merit, could result in costly litigation or require us to reengineer or cease sales of our products or services, any of which could have a material adverse effect on our business. Infringement claims could also result in an injunction in the use of our products or require us to enter into royalty or licensing agreements. Licensing agreements, if required, may not be available on terms acceptable to the combined company or at all.

From time to time we learn of parties that claim broad intellectual property rights in the e-learning area that might implicate our offerings. These parties or others could initiate actions against us in the future.

**WE COULD INCUR SUBSTANTIAL COSTS RESULTING FROM PRODUCT LIABILITY CLAIMS RELATING TO OUR CUSTOMERS' USE OF OUR PRODUCTS AND SERVICES.**

Many of the business interactions supported by our products and services are critical to our customers' businesses. Any failure in a customer's business interaction or other collaborative activity caused or allegedly caused in the future by our products and services could result in a claim for substantial damages against us, regardless of our responsibility for the failure. Although we maintain general liability insurance, including coverage for errors and omissions, there can be no assurance that existing coverage will continue to be available on reasonable terms or will be available in amounts sufficient to cover one or more large claims, or that the insurer will not disclaim coverage as to any future claim.

**WE COULD BE SUBJECTED TO LEGAL ACTIONS BASED UPON THE CONTENT WE OBTAIN FROM THIRD PARTIES OVER WHOM WE EXERT LIMITED CONTROL.**

It is possible that we could become subject to legal actions based upon claims that our course content infringes the rights of others or is erroneous. Any such claims, with or without merit, could subject us to costly litigation and the diversion of our financial resources and management personnel. The risk of such claims is exacerbated by the fact that our course content is provided by third parties over whom we exert limited control. Further, if those claims are successful, we may be required to alter the content, pay financial damages or obtain content from others.

**SOME OF OUR INTERNATIONAL SUBSIDIARIES HAVE NOT COMPLIED WITH REGULATORY REQUIREMENTS RELATING TO THEIR FINANCIAL STATEMENTS AND TAX RETURNS.**

We operate our business in various foreign countries through subsidiaries organized in those countries. Due to our restatement of the historical SmartForce financial statements, some of our subsidiaries have not filed their audited statutory financial statements and have been delayed in filing their tax returns in their respective jurisdictions. As a result, some of these foreign subsidiaries may be subject to regulatory restrictions, penalties and fines and additional taxes.

**RISKS RELATED TO THE OPERATION OF OUR BUSINESS**

**OUR QUARTERLY OPERATING RESULTS MAY FLUCTUATE SIGNIFICANTLY. THIS LIMITS YOUR ABILITY TO EVALUATE HISTORICAL FINANCIAL RESULTS AND INCREASES THE LIKELIHOOD THAT OUR RESULTS WILL FALL BELOW MARKET ANALYSTS' EXPECTATIONS, WHICH COULD CAUSE THE PRICE OF OUR ADSs TO DROP RAPIDLY AND SEVERELY.**

We have in the past experienced fluctuations in our quarterly operating results, and we anticipate that these fluctuations will continue. As a result, we believe that our quarterly revenue, expenses and operating results are likely to vary significantly in the future. If in some future quarters our results of operations are below the expectations of public market analysts and investors, this could have a severe adverse effect on the market price of our ADSs.

Our operating results have historically fluctuated, and our operating results may in the future continue to fluctuate, as a result of factors, which include (without limitation):

the size and timing of new/renewal agreements and upgrades;

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royalty rates;

the announcement, introduction and acceptance of new products, product enhancements and technologies by us and our competitors;

the mix of sales between our field sales force, our other direct sales channels and our telesales channels;

general conditions in the U.S. or the international economy;

the loss of significant customers;

delays in availability of new products;

product or service quality problems;

seasonality due to the budget and purchasing cycles of our customers, we expect our revenue and operating results will generally be strongest in the second half of our fiscal year and weakest in the first half of our fiscal year;

the spending patterns of our customers;

litigation costs and expenses;

non-recurring charges related to acquisitions;

growing competition that may result in price reductions; and

currency fluctuations.

Most of our expenses, such as rent and most employee compensation, do not vary directly with revenue and are difficult to adjust in the short-term. As a result, if revenue for a particular quarter is below our expectations, we could not proportionately reduce operating expenses for that quarter. Any such revenue shortfall would, therefore, have a disproportionate effect on our expected operating results for that quarter.

**PAST AND FUTURE ACQUISITIONS, INCLUDING THE RECENT ACQUISITION OF NETG, MAY NOT PRODUCE THE BENEFITS WE ANTICIPATE AND COULD HARM OUR CURRENT OPERATIONS.**

One aspect of our business strategy is to pursue acquisitions of businesses or technologies that will contribute to our future growth. On May 14, 2007, we acquired NETg from The Thomson Corporation. However, we may not be successful in identifying or consummating future attractive acquisition opportunities. Moreover, any acquisitions we do consummate, including the NETg acquisition, may not produce benefits commensurate with the purchase price we pay or our expectations for the acquisition. In addition, acquisitions, including the NETg acquisition, involve numerous risks, including:

difficulties in integrating the technologies, operations, financial controls and personnel of the acquired company;

difficulties in retaining or transitioning customers and employees of the acquired company;

diversion of management time and focus;

the incurrence of unanticipated expenses associated with the acquisition or the assumption of unknown liabilities or unanticipated financial, accounting or other problems of the acquired company; and





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accounting charges related to the acquisition, including restructuring charges, write-offs of in-process research and development costs, and subsequent impairment charges relating to goodwill or other intangible assets acquired in the transaction.

**WE HAVE EXPERIENCED NET LOSSES IN THE PAST, AND WE MAY BE UNABLE TO MAINTAIN PROFITABILITY.**

We recorded a net loss of \$20.1 million for the fiscal year ended January 31, 2005, net income of \$35.2 million for the fiscal year ended January 31, 2006 and net income of \$24.2 million for the fiscal year ended January 31, 2007. While we achieved profitability in the last two fiscal years, we cannot guarantee that our business will sustain profitability in any future period.

**DEMAND FOR OUR PRODUCTS AND SERVICES MAY BE ESPECIALLY SUSCEPTIBLE TO ADVERSE ECONOMIC CONDITIONS.**

Our business and financial performance may be damaged by adverse financial conditions affecting our target customers or by a general weakening of the economy. Companies may not view training products and services as critical to the success of their businesses. If these companies experience disappointing operating results, whether as a result of adverse economic conditions, competitive issues or other factors, they may decrease or forego education and training expenditures before limiting their other expenditures or in conjunction with lowering other expenses.

**INCREASED COMPETITION MAY RESULT IN DECREASED DEMAND FOR OUR PRODUCTS AND SERVICES, WHICH MAY RESULT IN REDUCED REVENUE AND GROSS PROFITS AND LOSS OF MARKET SHARE.**

The market for corporate education and training solutions is highly fragmented and competitive. We expect the market to become increasingly competitive due to the lack of significant barriers to entry. In addition to increased competition from new companies entering into the market, established companies are entering into the market through acquisitions of smaller companies, which directly compete with us, and this trend is expected to continue. We may also face competition from publishing companies, vendors of application software and HR outsourcers, including those vendors with whom we have formed development and marketing alliances.

Our primary sources of direct competition are:

third-party suppliers of instructor-led information technology, business, management and professional skills education and training;

technology companies that offer learning courses covering their own technology products;

suppliers of computer-based training and e-learning solutions;

internal education, training departments and HR outsourcers of potential customers; and

value-added resellers and network integrators.

Growing competition may result in price reductions, reduced revenue and gross profits and loss of market share, any one of which would have a material adverse effect on our business. Many of our current and potential competitors have substantially greater financial, technical, sales, marketing and other resources, as well as greater name recognition, and we expect to face increasing price pressures from competitors as managers demand more value for their training budgets. Accordingly, we may be unable to provide e-learning solutions that compare favorably with new instructor-led techniques, other interactive training software or new e-learning solutions.

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**WE RELY ON A LIMITED NUMBER OF THIRD PARTIES TO PROVIDE US WITH EDUCATIONAL CONTENT FOR OUR COURSES AND REFERENCEWARE, AND OUR ALLIANCES WITH THESE THIRD PARTIES MAY BE TERMINATED OR FAIL TO MEET OUR REQUIREMENTS.**

We rely on a limited number of independent third parties to provide us with the educational content for a majority of our courses based on learning objectives and specific instructional design templates that we provide to them. We do not have exclusive arrangements or long-term contracts with any of these content providers. If one or more of our third party content providers were to stop working with us, we would have to rely on other parties to develop our course content. In addition, these providers may fail to develop new courses or existing courses on a timely basis. We cannot predict whether new content or enhancements would be available from reliable alternative sources on reasonable terms. In addition, our subsidiary, Books 24x7.com relies on third party publishers to provide all of the content incorporated into its Referenceware products. If one or more of these publishers were to terminate their license with us, we may not be able to find substitute publishers for such content. In addition, we may be forced to pay increased royalties to these publishers to continue our licenses with them.

In the event that we are unable to maintain or expand our current development alliances or enter into new development alliances, our operating results and financial condition could be materially adversely affected.

Furthermore, we will be required to pay royalties to some of our development partners on products developed with them, which could reduce our gross margins. We expect that cost of revenues may fluctuate from period to period in the future based upon many factors, including the revenue mix and the timing of expenses associated with development alliances. In addition, the collaborative nature of the development process under these alliances may result in longer development times and less control over the timing of product introductions than for e-learning offerings developed solely by us. Our strategic alliance partners may from time to time renegotiate the terms of their agreements with us, which could result in changes to the royalty or other arrangements, adversely affecting our results of operations.

The independent third party strategic partners we rely on for educational content and product marketing may compete with us, harming our results of operations. Our agreements with these third parties generally do not restrict them from developing courses on similar topics for our competitors or from competing directly with us. As a result, our competitors may be able to duplicate some of our course content and gain a competitive advantage.

**OUR SUCCESS DEPENDS ON OUR ABILITY TO MEET THE NEEDS OF THE RAPIDLY CHANGING MARKET.**

The market for education and training software is characterized by rapidly changing technology, evolving industry standards, changes in customer requirements and preferences and frequent introductions of new products and services embodying new technologies. New methods of providing interactive education in a technology-based format are being developed and offered in the marketplace, including intranet and Internet offerings. In addition, multimedia and other product functionality features are being added to educational software. Our future success will depend upon the extent to which we are able to develop and implement products which address these emerging market requirements on a cost effective and timely basis. Product development is risky because it is difficult to foresee developments in technology coordinate technical personnel and identify and eliminate design flaws. Any significant delay in releasing new products could have a material adverse effect on the ultimate success of our products and could reduce sales of predecessor products. We may not be successful in introducing new products on a timely basis. In addition, new products introduced by us may fail to achieve a significant degree of market acceptance or, once accepted, may fail to sustain viability in the market for any significant period. If we are unsuccessful in addressing the changing needs of the marketplace due to resource, technological or other constraints, or in anticipating and responding adequately to changes in customers' software technology and preferences, our business and results of operations would be materially adversely affected. We, along with the rest of the industry, face a challenging and competitive market for IT spending that has resulted in reduced contract value for our formal learning product lines. This pricing pressure has a negative impact on revenue for these product lines and may have a continued or increased adverse impact in the future.

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**THE E-LEARNING MARKET IS A DEVELOPING MARKET, AND OUR BUSINESS WILL SUFFER IF E-LEARNING IS NOT WIDELY ACCEPTED.**

The market for e-learning is a new and emerging market. Corporate training and education have historically been conducted primarily through classroom instruction and have traditionally been performed by a company's internal personnel. Many companies have invested heavily in their current training solutions. Although technology-based training applications have been available for several years, they currently account for only a small portion of the overall training market.

Accordingly, our future success will depend upon the extent to which companies adopt technology-based solutions for their training activities, and the extent to which companies utilize the services or purchase products of third-party providers. Many companies that have already invested substantial resources in traditional methods of corporate training may be reluctant to adopt a new strategy that may compete with their existing investments. Even if companies implement technology-based training or e-learning solutions, they may still choose to design, develop, deliver or manage all or part of their education and training internally. If technology-based learning does not become widespread, or if companies do not use the products and services of third parties to develop, deliver or manage their training needs, then our products and service may not achieve commercial success.

**NEW PRODUCTS INTRODUCED BY US MAY NOT BE SUCCESSFUL.**

An important part of our growth strategy is the development and introduction of new products that open up new revenue streams for us. Despite our efforts, we cannot assure you that we will be successful in developing and introducing new products, or that any new products we do introduce will meet with commercial acceptance. The failure to successfully introduce new products will not only hamper our growth prospects but may also adversely impact our net income due to the development and marketing expenses associated with those new products.

**THE SUCCESS OF OUR E-LEARNING STRATEGY DEPENDS ON THE RELIABILITY AND CONSISTENT PERFORMANCE OF OUR INFORMATION SYSTEMS AND INTERNET INFRASTRUCTURE.**

The success of our e-learning strategy is highly dependent on the consistent performance of our information systems and Internet infrastructure. If our Web site fails for any reason or if it experiences any unscheduled downtimes, even for only a short period, our business and reputation could be materially harmed. We have in the past experienced performance problems and unscheduled downtime, and these problems could recur. We currently rely on third parties for proper functioning of computer infrastructure, delivery of our e-learning applications and the performance of our destination site. Our systems and operations could be damaged or interrupted by fire, flood, power loss, telecommunications failure, break-ins, earthquake, financial patterns of hosting providers and similar events. Any system failures could adversely affect customer usage of our solutions and user traffic results in any future quarters, which could adversely affect our revenue and operating results and harm our reputation with corporate customers, subscribers and commerce partners. Accordingly, the satisfactory performance, reliability and availability of our Web site and computer infrastructure are critical to our reputation and ability to attract and retain corporate customers, subscribers and commerce partners. We cannot accurately project the rate or timing of any increases in traffic to our Web site and, therefore, the integration and timing of any upgrades or enhancements required to facilitate any significant traffic increase to the Web site are uncertain. We have in the past experienced difficulties in upgrading our Web site infrastructure to handle increased traffic, and these difficulties could recur. The failure to expand and upgrade our Web site or any system error, failure or extended down time could materially harm our business, reputation, financial condition or results of operations.

**BECAUSE MANY USERS OF OUR E-LEARNING SOLUTIONS WILL ACCESS THEM OVER THE INTERNET, FACTORS ADVERSELY AFFECTING THE USE OF THE INTERNET OR OUR CUSTOMERS NETWORKING INFRASTRUCTURES COULD HARM OUR BUSINESS.**

Many of our customer's users access our e-learning solutions over the Internet or through our customer's internal networks. Any factors that adversely affect Internet usage could disrupt the ability of those users to access our e-learning solutions, which would adversely affect customer satisfaction and therefore our business.

For example, our ability to increase the effectiveness and scope of our services to customers is ultimately limited by the speed and reliability of both the Internet and our customer's internal networks. Consequently, the emergence and growth of the market for our products and services depends upon the improvements being made to the entire Internet

as well as to our individual customers networking infrastructures to alleviate overloading and congestion. If these improvements are not made, and the quality of networks degrades, the ability of our customers to use our products and services will be hindered and our revenue may suffer.

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Additionally, a requirement for the continued growth of accessing e-learning solutions over the Internet is the secure transmission of confidential information over public networks. Failure to prevent security breaches into our products or our customers' networks, or well-publicized security breaches affecting the Internet in general could significantly harm our growth and revenue. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise of technology we use to protect content and transactions, our products or our customers' proprietary information in our databases. Anyone who is able to circumvent our security measures could misappropriate proprietary and confidential information or could cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against such security breaches or to address problems caused by security breaches. The privacy of users may also deter people from using the Internet to conduct transactions that involve transmitting confidential information.

**WE DEPEND ON A FEW KEY PERSONNEL TO MANAGE AND OPERATE THE BUSINESS AND MUST BE ABLE TO ATTRACT AND RETAIN HIGHLY QUALIFIED EMPLOYEES.**

Our success is largely dependent on the personal efforts and abilities of our senior management. Failure to retain these executives, or the loss of certain additional senior management personnel or other key employees, could have a material adverse effect on our business and future prospects. We are also dependent on the continued service of our key sales, content development and operational personnel and on our ability to attract, train, motivate and retain highly qualified employees. In addition, we depend on writers, programmers, Web designers and graphic artists. We may be unsuccessful in attracting, training, retaining or motivating key personnel. The inability to hire, train and retain qualified personnel or the loss of the services of key personnel could have a material adverse effect upon our business, new product development efforts and future business prospects.

**OUR BUSINESS IS SUBJECT TO CURRENCY FLUCTUATIONS THAT COULD ADVERSELY AFFECT OUR OPERATING RESULTS.**

Due to our multinational operations, our operating results are subject to fluctuations based upon changes in the exchange rates between the currencies in which revenue is collected or expenses are paid. In particular, the value of the U.S. dollar against the euro and related currencies will impact our operating results. Our expenses will not necessarily be incurred in the currency in which revenue is generated, and, as a result, we will be required from time to time to convert currencies to meet our obligations. These currency conversions are subject to exchange rate fluctuations, and changes to the value of the euro, pound sterling and other currencies relative to the U.S. dollar could adversely affect our business and results of operations.

**WE MAY BE UNABLE TO PROTECT OUR PROPRIETARY RIGHTS. UNAUTHORIZED USE OF OUR INTELLECTUAL PROPERTY MAY RESULT IN DEVELOPMENT OF PRODUCTS OR SERVICES THAT COMPETE WITH OURS.**

Our success depends to a degree upon the protection of our rights in intellectual property. We rely upon a combination of patent, copyright, and trademark laws to protect our proprietary rights. We have also entered into, and will continue to enter into, confidentiality agreements with our employees, consultants and third parties to seek to limit and protect the distribution of confidential information. However, we have not signed protective agreements in every case. Although we have taken steps to protect our proprietary rights, these steps may be inadequate. Existing patent, copyright, and trademark laws offer only limited protection. Moreover, the laws of other countries in which we market our products may afford little or no effective protection of our intellectual property. Additionally, unauthorized parties may copy aspects of our products, services or technology or obtain and use information that we regard as proprietary. Other parties may also breach protective contracts we have executed or will in the future execute. We may not become aware of, or have adequate remedies in the event of, a breach. Litigation may be necessary in the future to enforce or to determine the validity and scope of our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Even if we were to prevail, such litigation could result in substantial costs and diversion of management and technical resources.

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**OUR NON-U.S. OPERATIONS ARE SUBJECT TO RISKS WHICH COULD NEGATIVELY IMPACT OUR FUTURE OPERATING RESULTS.**

We expect that international operations will continue to account for a significant portion of our revenues. Operations outside of the United States are subject to inherent risks, including:

difficulties or delays in developing and supporting non-English language versions of our products and services;

political and economic conditions in various jurisdictions;

difficulties in staffing and managing foreign subsidiary operations;

longer sales cycles and account receivable payment cycles;

multiple, conflicting and changing governmental laws and regulations;

foreign currency exchange rate fluctuations;

protectionist laws and business practices that may favor local competitors;

difficulties in finding and managing local resellers;

potential adverse tax consequences; and

the absence or significant lack of legal protection for intellectual property rights.

Any of these factors could have a material adverse effect on our future operations outside of the United States, which could negatively impact our future operating results.

**OUR SALES CYCLE MAY MAKE IT DIFFICULT TO PREDICT OUR OPERATING RESULTS.**

The period between our initial contact with a potential customer and the purchase of our products by that customer typically ranges from three to twelve months or more. Factors that contribute to our long sales cycle, include:

our need to educate potential customers about the benefits of our products;

competitive evaluations by customers;

the customers' internal budgeting and approval processes;

the fact that many customers view training products as discretionary spending, rather than purchases essential to their business; and

the fact that we target large companies, which often take longer to make purchasing decisions due to the size and complexity of the enterprise.

These long sales cycles make it difficult to predict the quarter in which sales may occur. Delays in sales could cause significant variability in our revenue and operating results for any particular period.

**OUR BUSINESS COULD BE ADVERSELY AFFECTED IF OUR PRODUCTS CONTAIN ERRORS.**

Software products as complex as ours contain known and undetected errors or "bugs" that result in product failures. The existence of bugs could result in loss of or delay in revenue, loss of market share, diversion of product development resources, injury to reputation or damage to efforts to build brand awareness, any of which could have a material adverse effect on our business, operating results and financial condition.

**Table of Contents****RISKS RELATED TO OUR ADSs****THE MARKET PRICE OF OUR ADSs MAY FLUCTUATE AND MAY NOT BE SUSTAINABLE.**

The market price of our ADSs has fluctuated significantly since our initial public offering and is likely to continue to be volatile. In addition, in recent years the stock market in general, and the market for shares of technology stocks in particular, have experienced extreme price and volume fluctuations, which have often been unrelated to the operating performance of affected companies. The market price of our ADSs may continue to experience significant fluctuations in the future, including fluctuations that are unrelated to our performance. As a result of these fluctuations in the price of our ADSs, it is difficult to predict what the price of our ADSs will be at any point in the future, and you may not be able to sell your ADSs at or above the price that you paid for them.

**SALES OF LARGE BLOCKS OF OUR ADSs COULD CAUSE THE MARKET PRICE OF OUR ADSs TO DROP SIGNIFICANTLY, EVEN IF OUR BUSINESS IS DOING WELL.**

Some shareholders own 5% or more of our outstanding shares. We cannot predict the effect, if any, that public sales of these shares will have on the market price of our ADSs. If our significant shareholders, or our directors and officers, sell substantial amounts of our ADSs in the public market, or if the public perceives that such sales could occur, this could have an adverse impact on the market price of our ADSs, even if there is no relationship between such sales and the performance of our business.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

Not applicable.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

We held our 2007 annual general meeting of shareholders (the AGM) on September 27, 2007. Under the terms of our arrangements with The Bank of New York, The Bank of New York is entitled to vote or cause to be voted all of our ordinary shares represented by ADSs on behalf of, and in accordance with the instructions received from, the ADS holders. There were no broker non-votes or votes withheld with respect to any matter submitted to a vote of the ordinary shareholders at the AGM.

The following is a brief description of each matter submitted to a vote of the ordinary shareholders and a summary of the votes tabulated with respect to each such matter at the AGM, as well as a summary of the votes cast by The Bank of New York based on the ADR facility:

(1) Receipt and consolidation of the consolidated financial statements for the fiscal year ended January 31, 2007 and the Report of Directors and Auditors thereon.

|                       | Votes FOR   | AGAINST | ABSTAIN |
|-----------------------|-------------|---------|---------|
| Ordinary Shareholders | 4           | 0       | 0       |
| ADS Holders           | 109,956,979 | 4,075   | 3,432   |

(2A) Re-election of Mr. James S. Krzywicki, who retired by rotation, as a director.

|                       | Votes FOR   | AGAINST | ABSTAIN |
|-----------------------|-------------|---------|---------|
| Ordinary Shareholders | 4           | 0       | 0       |
| ADS Holders           | 109,815,852 | 133,718 | 14,916  |

(2B) Re-election of Mr. William F. Meagher, Jr., who retired by rotation, as a director.



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|                       | Votes FOR   | AGAINST   | ABSTAIN |
|-----------------------|-------------|-----------|---------|
| Ordinary Shareholders | 4           | 0         | 0       |
| ADS Holders           | 103,837,950 | 6,112,070 | 14,466  |

The term of office for each of Charles Moran, Stewart K.P. Gross, P. Howard Edelstein and Ferdinand von Prondyniski continued after the AGM.

(3) Authorization of the Audit Committee of the Board of Directors to fix the remuneration of our auditor for the fiscal year ending January 31, 2008.

|                       | Votes FOR   | AGAINST | ABSTAIN |
|-----------------------|-------------|---------|---------|
| Ordinary Shareholders | 4           | 0       | 0       |
| ADS Holders           | 109,640,395 | 319,157 | 4,934   |

(4) Amendment of the 2004 employee share purchase plan to increase the total number of shares reserved for issuance thereunder by 1,000,000 ordinary shares of 0.11 each (to 3,500,000 ordinary shares of 0.11 each).

|                       | Votes FOR   | AGAINST | ABSTAIN |
|-----------------------|-------------|---------|---------|
| Ordinary Shareholders | 4           | 0       | 0       |
| ADS Holders           | 109,422,049 | 209,050 | 333,387 |

(5) Amendment of the 2001 outside director option plan to increase (i) the number of shares underlying the initial option granted to non-employee directors ( Outside Directors ) from 25,000 ordinary shares of 0.11 each to 50,000 ordinary shares of 0.11 each and (ii) the number of shares underlying the annual option granted to Outside Directors from 10,000 ordinary shares of 0.11 each to 20,000 ordinary shares of 0.11 each.

|                       | Votes FOR  | AGAINST    | ABSTAIN   |
|-----------------------|------------|------------|-----------|
| Ordinary Shareholders | 4          | 0          | 0         |
| ADS Holders           | 75,123,205 | 30,998,444 | 3,842,837 |

(6) Effective as of November 1, 2007 and continuing until further adjustment, (i) the annual remuneration of each of our Outside Directors for their services as directors shall remain at \$30,000 plus, for each such director, an additional \$2,000 per each meeting of the Board of Directors or a committee of the Board of Directors which he/she participates and which is not a regularly scheduled meeting, up to a maximum of \$20,000 per annum, (ii) the Outside Director serving as chair of the Audit Committee shall be paid additional annual remuneration of \$20,000, (iii) the Outside Director serving as chair of the Compensation Committee shall continue to be paid additional annual remuneration of \$7,500 and (iv) the Outside Director serving as chair of the Nominating and Corporate Governance Committee shall be paid additional annual remuneration of \$7,500.

|                       | Votes FOR   | AGAINST | ABSTAIN |
|-----------------------|-------------|---------|---------|
| Ordinary Shareholders | 4           | 0       | 0       |
| ADS Holders           | 109,687,824 | 239,089 | 37,573  |

(6) Subject to the confirmation of the High Court of Ireland pursuant to Section 72 of the Companies Act 1963, the Company's share capital be reduced by the cancellation of the whole amount standing to the credit of the Company's share premium account at the date of this meeting (or such part thereof as the High Court of Ireland may determine).

|                       | Votes FOR   | AGAINST | ABSTAIN |
|-----------------------|-------------|---------|---------|
| Ordinary Shareholders | 4           | 0       | 0       |
| ADS Holders           | 109,915,101 | 18,468  | 30,917  |

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

See the Exhibit Index attached hereto.



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SIGNATURE

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

SKILLSOFT PUBLIC LIMITED  
COMPANY

Date: December 10, 2007

By: /s/ Thomas J. McDonald  
Thomas J. McDonald  
Chief Financial Officer

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EXHIBIT INDEX

- 10.1 2001 Outside Director Option Plan, as amended
- 31.1 Certification of SkillSoft PLC's Chief Executive Officer pursuant to Rule 13a-14(a)/Rule 15(d)-14(a) under the Securities Exchange Act of 1934.
- 31.2 Certification of SkillSoft PLC's Chief Financial Officer pursuant to Rule 13a-14(a)/Rule 15(d)-14(a) under the Securities Exchange Act of 1934.
- 32.1 Certification of SkillSoft PLC's Chief Executive Officer pursuant to Rule 13a-14(b)/Rule 15d-14(b) under the Securities Exchange Act of 1934, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of SkillSoft PLC's Chief Financial Officer pursuant to Rule 13a-14(b)/Rule 15d-14(b) under the Securities Exchange Act of 1934, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.