

SKILLSOFT PUBLIC LIMITED CO

Form 10-Q

September 08, 2006

**Table of Contents**

**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 JULY 31, 2006  
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 August 31, 2006, the registrant had outstanding 108,193,405 Ordinary Shares (issued or issuable in exchange for the registrant's outstanding American Depository Shares).

SKILLSOFT PLC  
FORM 10-Q  
FOR THE QUARTER ENDED JULY 31, 2006  
INDEX

	<b>PAGE NO.</b>
<u>PART I FINANCIAL INFORMATION</u>	3
<u>Item 1. Condensed Consolidated Financial Statements:</u>	3
<u>Condensed Consolidated Balance Sheets as of July 31, 2006 and January 31, 2006</u>	3
<u>Condensed Consolidated Income Statements for the Three and Six Months Ended July 31, 2006 and 2005</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended July 31, 2006 and 2005</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>Item 3. Quantitative and Qualitative Disclosure about Market Risk</u>	24
<u>Item 4. Controls and Procedures</u>	24
<u>PART II OTHER INFORMATION</u>	24
<u>Item 1. Legal Proceedings</u>	24
<u>Item 1A. Risk Factors</u>	24
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	32
<u>Item 3. Defaults Upon Senior Securities</u>	32
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	32
<u>Item 5. Other Information</u>	32
<u>Item 6. Exhibits</u>	32
<u>SIGNATURE</u>	33
<u>EXHIBIT INDEX</u>	34
<u>EX-10.1 Loan and Security Agreement, dated 7/23/04</u>	
<u>EX-31.1 Section 302 Certification of C.E.O.</u>	
<u>EX-31.2 Section 302 Certification of C.F.O.</u>	
<u>EX-32.1 Section 906 Certification of C.E.O.</u>	
<u>EX-32.2 Section 906 Certification of C.F.O.</u>	

**Table of Contents**

## PART I

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

	<b>JULY 31, 2006</b>	<b>JANUARY 31, 2006</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 47,972	\$ 51,937
Short-term investments	49,084	21,632
Restricted cash	4,723	5,039
Accounts receivable, net	47,883	85,681
Prepaid expenses and other current assets	16,622	22,006
Total current assets	166,284	186,295
Property and equipment, net	10,078	10,231
Intangible assets, net	4,420	8,711
Goodwill	88,912	93,929
Long-term investments	3,517	
Deferred tax assets, net	694	694
Other assets	44	42
Total assets	\$ 273,949	\$ 299,902
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,703	\$ 3,819
Accrued expenses	41,808	53,795
Deferred revenue	109,572	136,699
Total current liabilities	154,083	194,313
Long term liabilities	2,837	3,317
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Ordinary shares, E0.11 par value: 250,000,000 shares authorized; 108,122,290 and 107,344,243 shares issued at July 31, 2006 and January 31, 2006, respectively	11,882	11,773
Additional paid-in capital	567,797	562,052
Treasury share, at cost, 6,533,884 ordinary shares	(24,524)	(24,524)
Deferred compensation		(465)
Accumulated deficit	(436,937)	(445,814)
Accumulated other comprehensive loss	(1,189)	(750)
Total shareholders' equity	117,029	102,272
Total liabilities and shareholders' equity	\$ 273,949	\$ 299,902

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

**Table of Contents**

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

	<b>THREE MONTHS ENDED</b>		<b>SIX MONTHS ENDED</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Revenue	\$ 55,734	\$ 53,604	\$ 110,387	\$ 106,931
Cost of revenue (1)	6,665	6,318	13,116	12,152
Gross profit	49,069	47,286	97,271	94,779
Operating expenses:				
Research and development (1)	9,901	10,236	19,866	20,153
Selling and marketing (1)	23,136	20,884	46,393	45,095
General and administrative (1)	6,824	6,743	14,104	13,027
Legal settlements/(insurance recoveries)		(19,500)		(19,500)
Amortization of intangible assets	2,143	2,307	4,291	4,553
Restructuring	22	(116)	22	587
Restatement SEC investigation	69	834	321	1,084
Total operating expenses	42,095	21,388	84,997	64,999
Operating income	6,974	25,898	12,274	29,780
Other (expense)/income, net	(41)	495	(31)	385
Interest income	1,069	347	1,874	703
Interest expense	(70)	(37)	(136)	(98)
Loss on sale of assets, net				(681)
Income before provision for income taxes	7,932	26,703	13,981	30,089
Provision for income taxes	3,107	3,759	5,103	4,678
Net income	\$ 4,825	\$ 22,944	\$ 8,878	\$ 25,411
Net income per share (Note 9):				
Basic	\$ 0.05	\$ 0.22	\$ 0.09	\$ 0.24
Basic weighted average shares outstanding	101,524,912	103,796,060	101,285,185	104,362,838
Diluted	\$ 0.05	\$ 0.22	\$ 0.09	\$ 0.24
Diluted weighted average shares outstanding	104,050,160	104,222,841	103,460,319	104,895,595

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

expenses:

	<b>THREE MONTHS ENDED July 31,</b>		<b>SIX MONTHS ENDED July 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	Cost of revenue	\$ 11	\$	\$ 17
Research and development	284	46	667	94
Selling and marketing	608	166	1,377	347
General and administrative	630	8	1,253	16
	\$ 1,533	\$ 220	\$ 3,314	\$ 457

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

**Table of Contents**

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

	<b>SIX MONTHS ENDED</b>	
	<b>JULY 31,</b>	
	<b>2006</b>	<b>2005</b>
Cash flows from operating activities:		
Net income	\$ 8,878	\$ 25,411
Adjustments to reconcile net income to net cash provided by operating activities -		
Share-based compensation	3,314	457
Depreciation and amortization	3,032	2,596
Amortization of intangible assets	4,291	4,553
Recovery of bad debts	(363)	(623)
Loss on disposition		681
Provision for income tax non-cash	4,446	4,002
Changes in current assets and liabilities:		
Accounts receivable	38,802	38,117
Prepaid expenses and other current assets	5,867	3,755
Accounts payable	(1,150)	(2,685)
Accrued expenses, including long-term liabilities	(12,642)	(17,447)
Deferred revenue	(28,156)	(27,990)
Net cash provided by operating activities	26,319	30,827
Cash flows from investing activities:		
Purchases of property and equipment	(2,855)	(3,628)
Capitalized software development costs		(1,247)
Purchases of investments	(53,484)	(11,948)
Maturity of investments	22,245	14,673
Release/(designation) of restricted cash	316	(4,840)
Net cash used in by investing activities	(33,778)	(6,990)
Cash flows from financing activities:		
Exercise of share options	1,301	457
Proceeds from employee share purchase plan	1,703	1,336
Payments to acquire treasury share		(20,244)
Net cash provided by / (used in) financing activities	3,004	(18,451)
Effect of exchange rate changes on cash and cash equivalents	490	(1,015)
Net (decrease)/increase in cash and cash equivalents	(3,965)	4,371
Cash and cash equivalents, beginning of period	51,937	34,906
Cash and cash equivalents, end of period	\$ 47,972	\$ 39,277

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



**Table of Contents**

**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 provider of comprehensive e-learning content and technology products for businesses and information technology (IT) professionals within global enterprises. The Company also sells to various government agencies, educational institutions and small to medium sized companies. SkillSoft PLC is the result of a merger between SmartForce PLC and SkillSoft Corporation on September 6, 2002 (the Merger).

**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 July 31, 2006 and, the results of its operations for the three and six months ended July 31, 2006 and 2005 and its cash flows for the six months ended July 31, 2006 and 2005. 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, 2006. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year.

**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 July 31, 2006 and January 31, 2006, cash equivalents consisted mainly of commercial paper, short-term federal agency notes and money market funds. The Company considers the cash held in certificates of deposit with a commercial bank to secure certain facility leases and to secure funds to defend named, former and current executives, and board members of SmartForce PLC for actions arising out of the SEC investigation to be restricted cash. The Company accounts for its investments 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 are reported at market value and are classified as available-for-sale. At July 31, 2006, the Company's investments had an average remaining maturity of approximately 127 days or 4.2 months. These investments are classified as current assets or long-term investments in the accompanying condensed consolidated balance sheets based upon the period over which they will mature.

**4. REVENUE RECOGNITION**

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

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 the Company's SkillChoice multi-modal learning (SMML) 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 SMML license provides customers access to a full range of learning products including courseware,

Referenceware<sup>®</sup>, simulations, mentoring and prescriptive assessment.

**Table of Contents**

A Referenceware license gives users access to a full Referenceware library within one or more Referenceware collections (examples of which include: ExecSummaries , ExecBluePrints , ITPro , BusinessPro , FinancePro , EngineeringPro , GovEssential and OfficeEssentials ) from Books24x7(Books). The pricing for the Company's Referenceware licenses varies based on the collections specified by a customer, the number of users within the customer's organization and the length of the license agreement.

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 its 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. Nearly all of the Company's contractual arrangements are recognized on a subscription or straight-line basis over the 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 cash becomes 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 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, websites and implementation services. The Company typically recognizes professional service revenue as the services are performed.

The Company records reimbursable out-of-pocket expenses in both revenues and as a direct cost of revenues, 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 non-performance 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

**Table of Contents**

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 July 31, 2006, 7,587,479 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, 2006 for a detailed description of the Company's share option plans. On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS Statement No. 123(R) (SFAS 123(R)), Share-Based Payment, which is a revision of SFAS Statement No. 123 (SFAS 123), Accounting for Stock-Based Compensation. SFAS 123(R) supersedes APB Opinion No. 25, (Opinion 25), Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach on SFAS 123(R) is similar to the approach described in SFAS 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee share options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

SFAS 123(R) must be adopted for fiscal years starting after June 15, 2005. As a result, the Company adopted SFAS 123(R) on February 1, 2006.

As permitted by SFAS 123, the Company historically accounted for share-based payments to employees using Opinion 25's intrinsic value method and, as such, generally recognized no compensation cost for employee share options. The Company has adopted the modified prospective method alternative outlined in SFAS 123(R). A modified prospective method is one in which compensation cost is recognized beginning with the effective date of SFAS 123(R) (a) based on the requirements of SFAS 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date. As a result, the Company is recognizing share-based compensation expense related to the portion of share option grants issued prior to the adoption of SFAS 123(R) which are continuing to vest in the current period, whose fair value was calculated utilizing a Black-Scholes Option Pricing Model. In addition, SFAS 123(R) requires companies to utilize an estimated forfeiture rate when calculating the expense for the period, whereas, SFAS 123 permitted companies to record forfeitures based on actual forfeitures, which was the Company's historical policy under SFAS 123.

The share-based compensation expense reduced basic earnings per share by \$0.02 and diluted earnings per share by \$0.01 for the three months ended July 31, 2006 and both basic and diluted earnings per share by \$0.03 for the six months ended July 31, 2006. These results reflect share-based compensation expense of \$1.5 million and no related tax benefit, due to the Company's full valuation allowance on its U.S. deferred tax assets, for the three months ended July 31, 2006 and share-based compensation expense of \$3.3 million and no related tax benefit for the six months ended July 31, 2006. In accordance with the modified-prospective transition method of SFAS 123(R), results for prior periods have not been restated. As of July 31, 2006, there was \$3.7 million of compensation expense related to non-vested share awards that is expected to be recognized over a period of 3.88 years and a weighted-average period of 3.38 years.

Prior to adopting SFAS 123(R), the Company accounted for share-based compensation under Opinion 25. The following table illustrates the effect on net income and earnings per share if the fair value based method had been applied to the three and six month periods ending July 31, 2005 (in thousands, except per share data).

	<b>THREE MONTHS ENDED JULY 31, 2005</b>	<b>SIX MONTHS ENDED JULY 31, 2005</b>
Net income		

Edgar Filing: SKILLSOFT PUBLIC LIMITED CO - Form 10-Q

As reported	\$	22,944	\$	25,411
Add: Share-based compensation expense recognized under Opinion 25		220		457
Less: Total share-based compensation expense determined under fair value based method for all awards		(4,197)		(9,006)
Pro forma net income	\$	18,967	\$	16,862
Basic and diluted net income per share				
As reported	\$	0.22	\$	0.24
Pro forma	\$	0.18	\$	0.16

**Table of Contents**

In anticipation of the adoption of SFAS 123(R), in the fourth quarter of fiscal 2006, the Company's Board of Directors approved the accelerated vesting of all currently outstanding unvested stock options previously awarded to employees effective January 13, 2006. This vesting acceleration did not extend to any options held by executive officers or directors. Vesting was accelerated for options to purchase approximately 1.7 million ordinary shares, or approximately 11% of the Company's total outstanding share options at the time.

The decision to accelerate vesting of these options was made to avoid recognizing compensation cost related to these options in future statements of operations upon the adoption of SFAS 123(R). It is estimated that the maximum future compensation expense that would have been recorded in the Company's statements of operations had the vesting of these options not been accelerated is approximately \$9.1 million, including approximately \$4.7 million of share-based compensation expense in the fiscal year ending January 31, 2007. The amounts were instead reflected in the Company's pro-forma charge as presented in Note 2 of the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K as filed with the SEC on April 13, 2006.

The Company uses the Black-Scholes option pricing model to determine the weighted average fair value of options prior to and after adopting SFAS 123(R). The estimated fair value of employee share options is amortized to expense using the straight-line method over the vesting period. The weighted average information and assumptions used for the grants were as follows:

	<b>THREE MONTHS ENDED</b>		<b>SIX MONTHS ENDED</b>	
	<b>JULY 31,</b>		<b>JULY 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Risk-free interest rates	4.96%	3.86% - 4.06%	4.96% - 5.03%	3.86% - 4.33%
Expected dividend yield				
Volatility factor	60%	71%	60%	73%
Expected lives	4 years	7 years	4 years	7 years
Weighted average fair value of options granted	\$3.02	\$2.61	\$3.01	\$2.66
Weighted average remaining contractual life of options outstanding	5.56 years	6.35 years	5.56 years	6.35 years

The Company's assumed dividend yield of zero is based on the fact that it has never paid cash dividends and has no present intention to pay cash dividends. Since adoption of SFAS 123(R) on February 1, 2006, the expected share-price volatility assumption used by the Company has been based on a blend of implied volatility in conjunction with calculations of the Company's historical volatility determined over a period commensurate with the expected life of its option grants. The implied volatility is based on exchange traded options of the Company's share. The Company believes that using a blended volatility assumption will result in the best estimate of expected volatility. Prior to adoption of SFAS 123(R), the expected volatility was based on historical volatilities of the underlying share only. The assumed risk-free interest rate is the U.S. Treasury security rate with a term equal to the expected life of the option. The assumed expected life is based on company-specific historical experience. With regard to the estimate of the expected life, the Company considers the exercise behavior of past grants and the pattern of aggregate exercises. The Company looked at historical option grant cancellation and termination data in order to determine its assumption of forfeiture rate which was 11.6% as of July 31, 2006. Prior to the adoption of SFAS 123(R), forfeitures were not estimated at the time of award and adjustments were reflected in pro forma net income disclosures as forfeitures occurred.

For shares purchased under the 2004 Employee Share Purchase Plan (ESPP), the Company uses a Black-Scholes option-pricing model, with the following assumptions: an assumed risk-free interest rate of 4.79% for the six months ended July 31, 2006, an expected volatility factor of 39% for the six months ended July 31, 2006 and an expected life of six months, with the assumption that dividends will not be paid.

A summary of activity under the Company's share option plans during the six months ended July 31, 2006 was as follows:

<b>Share Options</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (Years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Outstanding, January 31, 2006	16,239,090	\$ 7.73	5.99	
Granted	985,000	5.96		
Exercised	(379,952)	3.42		
Cancelled	(297,983)	12.77		
Outstanding, July 31, 2006	16,546,155	\$ 7.63	5.56	\$ 14,030
Exercisable, July 31, 2006	15,325,389	\$ 7.78	5.44	\$ 13,818
Vested and Expected to Vest, July 31, 2006 (1)	16,323,000	\$ 7.66	5.54	\$ 14,025



**Table of Contents**

- (1) This represents the number of vested options as of July 31, 2006 plus the number of unvested options expected to vest as of July 31, 2006 based on the unvested outstanding options at July 31, 2006 adjusted for the estimated forfeiture rate of 11.6%.

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 July 31, 2006 of \$5.65 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 July 31, 2006.

The weighted average grant date fair value of options granted during the three and six months ended July 31, 2006 was \$3.02 and \$3.01, respectively. The total intrinsic value of options exercised during the three months ended July 31, 2006 and July 31, 2005 was approximately \$537,000 and 30,000, respectively. The total intrinsic value of options exercised during the six months ended July 31, 2006 and July 31, 2005 was approximately \$811,000 and 349,000, respectively. The total fair value of share options that vested or were expected to vest during the three months ended July 31, 2006 and 2005 was approximately \$1.5 million and \$4.2 million, respectively. The total fair value of share options that vested during the six months ended July 31, 2006 and 2005 was approximately \$3.0 million and \$9.0 million, respectively.

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

Activity in the Company's merger and exit costs, which are included in accrued expenses (see Note 13) and long-term liabilities, was as follows (in thousands):

	<b>EMPLOYEE SEVERANCE AND RELATED COSTS</b>	<b>CLOSEDOWN OF FACILITIES</b>	<b>OTHER</b>	<b>TOTAL</b>
Merger and exit accrual January 31, 2006	\$ 1,186	\$ 3,457	\$ 169	\$ 4,812
Payments made during the six months ended July 31, 2006	(370)	(440)	(47)	(857)
Merger and exit accrual July 31, 2006	\$ 816	\$ 3,017	\$ 122	\$ 3,955

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

Year ended January 31,	
2007 (remaining 6 months)	\$ 2,353
2008	551
2009	493
2010	518
Thereafter	40
 Total	 \$ 3,955

**RESTRUCTURING**

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

	<b>FACILITY LEASE OBLIGATIONS</b>
Total restructuring accrual as of January 31, 2006	\$ 1,987
Payments made during the six months ended July 31, 2006	(207)
Restructuring charges incurred during the six months ended July 31, 2006	22
 Total restructuring accrual as of July 31, 2006	 \$ 1,802

**7. GOODWILL AND INTANGIBLE ASSETS**

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

10

**Table of Contents**

	JULY 31, 2006			JANUARY 31, 2006		
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARRYING AMOUNT	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARRYING AMOUNT
Internally developed software/courseware	\$ 28,257	\$ 26,877	\$ 1,380	\$ 28,257	\$ 23,414	\$ 4,843
Customer contracts	13,018	10,878	2,140	13,018	10,055	2,963
Trademarks and trade names	905	5	900	905		905
	42,180	37,760	4,420	42,180	33,469	8,711
Goodwill	88,912		88,912	93,929		93,929
	\$ 131,092	\$ 37,760	\$ 93,332	\$ 136,109	\$ 33,469	\$ 102,640

The change in goodwill at July 31, 2006 from the amount recorded at January 31, 2006 was due primarily to the Company's utilization of the tax benefit of net operating loss carryforwards assumed as part of the Merger.

	<b>Total</b>
Gross carrying amount of goodwill, January 31, 2006	\$ 93,929
Utilization of tax benefit	(4,446)
Other	(571)
Gross carrying amount of goodwill, July 31, 2006	\$ 88,912

Amortization expense for the remainder of fiscal 2007 and the following fiscal years is expected to be as follows (in thousands):

<b>Fiscal Year</b>	<b>Amortization Expense</b>
2007	\$ 1,883
2008	1,625
2009	12
Total	\$ 3,520

The Company will be conducting its annual impairment test of goodwill for fiscal 2007 in the fourth quarter.

**8. 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 six months ended July 31, 2006 and 2005 was as follows (in thousands):

<b>THREE MONTHS ENDED JULY 31,</b>		<b>SIX MONTHS ENDED JULY 31,</b>	
<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>

Comprehensive income:				
Net income	\$ 4,825	\$ 22,944	\$ 8,878	\$ 25,411
Other comprehensive income/(loss)				
Foreign currency adjustment	(167)	560	(465)	547
Unrealized holding gains/(losses)	(49)	(12)	26	(39)
Comprehensive income	\$ 4,609	\$ 23,492	\$ 8,439	\$ 25,919

Accumulated other comprehensive income as of July 31, 2006 and January 31, 2006 was as follows (in thousands):

	<b>SIX MONTHS ENDED JULY 31, 2006</b>	<b>YEAR ENDED JANUARY 31, 2006</b>
Unrealized holding gains/(losses)	\$ 12	\$ (15)
Foreign currency adjustment	(1,201)	(735)
Total accumulated other comprehensive loss	\$ (1,189)	\$ (750)

9. NET INCOME PER SHARE

**Table of Contents**

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 JULY 31,</b>		<b>SIX MONTHS ENDED JULY 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Basic weighted average shares outstanding	101,524,912	103,796,060	101,285,185	104,362,838
Effect of dilutive shares outstanding	2,525,248	426,781	2,175,134	532,757
Weighted average shares outstanding, as adjusted	104,050,160	104,222,841	103,460,319	104,895,595

The following share equivalents have been excluded from the computation of diluted weighted average shares outstanding for the three and six months ended July 31, 2006 and 2005, respectively, as they would be anti-dilutive:

	<b>THREE MONTHS ENDED JULY 31,</b>		<b>SIX MONTHS ENDED JULY 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Options to purchase shares	14,005,126	17,308,246	14,355,240	17,202,269

**10. 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 Internal Revenue Code.

The provision for income tax in the three and six months ended July 31, 2006 was approximately \$3.1 million and \$5.1 million, respectively. Of these amounts, approximately \$2.7 million and \$4.4 million for the three and six months ended July 31, 2006, respectively, relate to the expected utilization of acquired NOL carryforwards, which do not alleviate tax burden in the statement of income, and are recorded as an adjustment to goodwill. The \$2.7 million and \$4.4 million of utilized acquired NOL carryforwards do not require cash payments to the taxing authorities. In addition, there is income generated in foreign countries, which cannot be offset through NOL carryforwards.

The Company's effective tax rates for the three months ended July 31, 2006 and 2005 were 39.2% and 14.1%, respectively, and for the six months ended July 31, 2006 and 2005 were 36.5% and 15.5%, respectively, which were higher than the Irish statutory rate of 12.5%. For the three and six months ended July 31, 2006, the higher effective rate was due primarily to earnings in high tax jurisdictions outside of Ireland and the effects of SFAS 123(R). This increase in tax rate was partially offset by the utilization of previously unrecognized NOLs. The Company's effective tax rates for the three and six months July 31, 2005 were higher than the Irish statutory rate primarily due to earnings in high tax jurisdictions outside of Ireland. This increase in tax rate was partially offset by the tax free gain from the insurance settlement benefit and the utilization of previously unrecognized NOLs.

**11. COMMITMENTS AND CONTINGENCIES**

On or about February 4, 2003, the SEC informed the Company that it is the subject of a formal order of private investigation relating to its November 19, 2002 announcement that it would restate the financial statements of SmartForce PLC for the period 1999 through June 2002. The Company understands that the SEC's investigation concerns SmartForce's financial disclosure and accounting during that period, other related matters, compliance with rules governing reports required to be filed with the SEC, and the conduct of those responsible for such matters. On June 2, 2005, the Boston District Office of the SEC informed the Company that it had made a preliminary determination to recommend that the SEC bring a civil injunctive action against the Company. Under the SEC's rules,

the Company is permitted to make a so-called Wells Submission in which the Company seeks to persuade the SEC that no such action should be commenced. If the Company cannot resolve the SEC's potential claims by agreement, the Company intends to make such a submission. The Company continues to cooperate with the SEC in this matter. At the present time the Company is unable to predict the outcome of this action and as such has not determined what, if any, impact it may have on its financial statements.

Six class action lawsuits have been filed against the Company and certain of its current and former officers and directors captioned: (1) Gianni Angeloni v. SmartForce PLC d/b/a SkillSoft, William McCabe and Greg Priest; (2) Ari R. Schloss v. SkillSoft PLC f/k/a SmartForce PLC, Gregory M. Priest, Patrick E. Murphy, David C. Drummond and William G. McCabe; (3) Joseph J. Bish v. SmartForce PLC d/b/a SkillSoft, Gregory M. Priest, William G. McCabe, David C. Drummond,

**Table of Contents**

John M. Grillos, John P. Hayes and Patrick E. Murphy; (4) Stacey Cohen v. SmartForce PLC d/b/a SkillSoft, William G. McCabe and Greg Priest; (5) Daniel Schmelz v. SmartForce PLC d/b/a SkillSoft, William G. McCabe and Greg Priest; and (6) John O. Donoghue v. SmartForce PLC d/b/a SkillSoft, William G. McCabe and Greg Priest. Each lawsuit was filed in the United States District Court for the District of New Hampshire. In March 2004, the Company reached a settlement of this litigation for total settlement payments of \$30.5 million, with \$15.25 million paid in August 2004 and the remaining \$15.25 million expected to be paid in fiscal 2007. In July 2005, the Company received \$19.5 million, which resulted from the final settlement with the insurance carriers regarding the 2002 securities class action lawsuit settlement of \$30.5 million in March 2004 and the related litigation and SEC investigation. The Company recorded the aggregate settlement with the plaintiffs as a charge in its fiscal 2004 fourth quarter; and the settlement with its insurers was recorded in the fiscal 2006 second quarter.

**12. DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE**

The Company follows the provisions of SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information (SFAS No. 131). SFAS No. 131 established standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to shareholders. SFAS No. 131 also established standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, when making decisions with respect to how to allocate resources and assess performance. The Company's chief operating decision makers, as defined under SFAS No. 131, are the Chief Executive Officer and the Chief Financial Officer. The Company views its operations and manages its business as principally two operating segments—Multi-Modal Learning (MML) and Retail Certification. On April 29, 2005, the Company sold certain assets and transferred certain liabilities related to its Retail Certification business and incurred a \$681,000 loss on disposition. The sale did not have a negative impact on Retail Certification revenue for the quarter ended April 30, 2005, but did result in a reduction in revenue in subsequent fiscal quarters. That trend will continue for the remainder of fiscal 2007 when compared to fiscal 2006.

The following tables set forth the Company's statements of operations for the three and six months ended July 31, 2006 and 2005:

	<b>Three Months Ended July 31, 2006</b>		
		<b>Retail</b>	
	<b>Multi-Modal</b>	<b>Certification</b>	<b>Combined</b>
		<b>(In thousands)</b>	
Revenue	\$54,210	\$ 1,524	\$55,734
Net income	\$ 4,792	\$ 33	\$ 4,825

	<b>Three Months Ended July 31, 2005</b>		
		<b>Retail</b>	
	<b>Multi-Modal</b>	<b>Certification</b>	<b>Combined</b>
		<b>(In thousands)</b>	
Revenue	\$49,707	\$ 3,897	\$53,604
Net income	\$22,867	\$ 77	\$22,944

	<b>Six Months Ended July 31, 2006</b>		
		<b>Retail</b>	
	<b>Multi-Modal</b>	<b>Certification</b>	<b>Combined</b>
		<b>(In thousands)</b>	
Revenue	\$107,132	\$ 3,255	\$110,387
Net income	\$ 8,772	\$ 106	\$ 8,878

**Six Months Ended July 31, 2005**

		<b>Retail</b>	
	<b>Multi-Modal</b>	<b>Certification</b>	<b>Combined</b>
		<b>(In thousands)</b>	

Revenue	\$97,756	\$ 9,175	\$106,931
Net income/(loss)	\$26,569	\$ (1,158)	\$ 25,411

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 six month periods ended July 31, 2006 and 2005 were as follows (in thousands):

	<b>THREE MONTHS</b>		<b>SIX MONTHS ENDED</b>	
	<b>ENDED</b>		<b>JULY 31,</b>	
	<b>JULY 31,</b>		<b>JULY 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Revenue:				
United States	\$ 43,603	\$ 41,609	\$ 86,466	\$ 83,581
United Kingdom (UK)	6,260	5,690	12,321	11,277
Canada	2,354	2,214	4,716	4,386
Europe, excluding UK	518	1,570	1,041	2,908
Australia/New Zealand	2,058	1,811	4,296	3,681
Other	941	710	1,547	1,098
<b>Total revenue</b>	<b>\$ 55,734</b>	<b>\$ 53,604</b>	<b>\$ 110,387</b>	<b>\$ 106,931</b>



**Table of Contents**

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

**13. ACCRUED EXPENSES**

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

	<b>JULY 31, 2006</b>	<b>JANUARY 31, 2006</b>
Accrued compensation and benefits	\$ 8,426	\$ 15,984
Course development fees	1,347	1,170
Professional fees	3,079	2,989
Accrued payables	517	1,254
Accrued miscellaneous taxes	368	395
Accrued merger related costs*	2,407	2,977
Sales tax payable/VAT payable	3,081	4,193
Accrued royalties	3,311	3,129
Accrued litigation settlements	15,250	17,040
Accrued restructuring	805	810
Other accrued liabilities	3,217	3,854
<b>Total accrued expenses</b>	<b>\$ 41,808</b>	<b>\$ 53,795</b>

\* Includes \$1,214 and \$1,584 of accrued payroll taxes in July 31, 2006 and January 31, 2006, respectively.

**14. LINE OF CREDIT**

The Company has a \$25 million line of credit with a bank, which expires on October 20, 2006. Under the terms of the line of credit, the bank holds a first security interest in all domestic business assets. All borrowings under the line of credit bear interest at the bank's prime rate. The facility is subject to a commitment fee of \$50,000 to secure the line of credit and unused commitment fees of 0.125% based upon the daily average of un-advanced amounts under the line of credit. In addition, the line of credit contains certain financial and non-financial covenants. The Company is currently in compliance with all covenants. Also, the line of credit provides that in the event of a Material Adverse Change (as defined in the line of credit), the lender has the ability to call amounts outstanding under the line of credit. As of July 31, 2006, there were no borrowings under the line of credit; however, the Company had an outstanding letter of credit of \$15.5 million that reduced the availability under the line of credit. Letters of credit are subject to commission fees of 0.75% and administrative costs. The Company paid approximately \$64,000 in letters of credit fees in the six months ended July 31, 2006.

**15. SHARE REPURCHASE PROGRAM**

In fiscal 2005, the Company's shareholders approved the repurchase by the Company of up to an aggregate of 7,000,000 ADSs. The Company repurchased 6,533,884 shares under this program through the fiscal year ended January 31, 2006. The program expired on March 24, 2006. On March 23, 2006, the Company's shareholders approved the renewal and extension of the program and the repurchase by the Company of up to an aggregate of 3,500,000 ADSs. Currently, none of the shares under the renewed program have been repurchased. As a result 3,500,000 are available for repurchase, subject to certain limitations, under the shareholder approved program. The current share repurchase program authorization expires on September 22, 2007.

16. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued Financial Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes , which applies to all tax positions related to income taxes subject to SFAS No. 109 (SFAS 109), Accounting for Income Taxes . This includes tax positions considered to be routine as well as those with a high degree of uncertainty. FIN 48 utilizes a two-step approach for

**Table of Contents**

evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, that is more-likely-than-not to be realized upon ultimate settlement. FIN 48's use of the term "more-likely-than-not" in steps one and two is consistent with how that term is used in SFAS 109 (i.e., a likelihood of occurrence greater than 50 percent).

Those tax positions failing to qualify for initial recognition are recognized in the first subsequent interim period in which they meet the more-likely-than-not standard, or are resolved through negotiation or litigation with the taxing authority, or upon expiration of the statute of limitations. Derecognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for derecognition of tax positions.

In addition, FIN 48 includes expanded disclosure requirements, which include a tabular rollforward of the beginning and ending aggregate, unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. These disclosures are required in each annual reporting period unless a significant change occurs in an interim period.

FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company expects to adopt FIN 48 in its first quarter of fiscal 2008, which begins on February 1, 2007. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The cumulative effect adjustment would not apply to those items that would not have been recognized in earnings, such as the effect of adopting FIN 48 on tax positions related to business combinations.

The Company is currently evaluating the impact of the adoption of FIN 48, but does not believe the adoption will have a material impact on its results of operation or financial position.

**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 provider of content resources and complementary technologies for integrated enterprise learning. Our multi-modal learning solutions support and enhance the speed and effectiveness of both formal and informal learning processes and integrate SkillsSoft's in-depth content resources, learning management system, virtual classroom technology and support services.

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 and certain infrastructure and occupancy expenses. We generally recognize these costs as incurred. 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. We account for software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of

**Table of Contents**

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. In the fiscal year ended January 31, 2006, we capitalized approximately \$1.7 million in software development costs of which \$0.3 million was amortized in the six months ended July 31, 2006. 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 intangibles represents the amortization of intangible assets, such as customer value and content, from our acquisitions of Books and GoTrain Corp. (GoTrain) and the Merger, as well as the amortization of those assets capitalized under SFAS No. 86.

Restructuring primarily consists of charges associated with international restructuring activities as well as activities related to our fiscal 2005 content development restructuring.

Restatement SEC investigation primarily consists of charges 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.

**BUSINESS OUTLOOK**

In the three and six months ended July 31, 2006, we generated revenue of \$55.7 million and \$110.4 million, respectively, as compared to \$53.6 million and \$106.9 million in the three and six months ended July 31, 2005, respectively. We reported net income in the three and six months ended July 31, 2006 of \$4.8 million and \$8.9 million, respectively, as compared to \$22.9 million and \$25.4 million in the three and six months ended July 31, 2005, respectively. Both the three and six months ended July 31, 2005 included a \$19.5 million benefit from a litigation settlement with our insurance carriers related to our settlement of the 2002 securities class action litigation. 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 IT spending by our current and potential customers and (iii) price competition 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 Books24x7 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 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 the fourth quarter of fiscal 2005, we restructured our content development organization to more efficiently manage costs and capitalize further on the flexibility inherent in our existing outsourcing model. The goal of the restructuring was to enable us to meet our existing content production targets at a reduced cost and with greater flexibility with respect to the product offerings in which we elect to make investments. The restructuring involved the elimination of 119 jobs in Dublin, Ireland and 12 in Nashua, New Hampshire within our research and development organization as well as facilities consolidation in Dublin. We shifted the remainder of our IT skills content development activities to our outsourcing suppliers, while continuing to maintain project management and quality control internally. This same restructuring included a reduction of an additional 15 jobs in Nashua, New Hampshire for a rightsizing of our inside sales operation and 9 jobs in Germany related to the shutdown of our German facility. As a result, we incurred restructuring charges related to payments to terminated employees, facilities consolidation and the repayment of grants previously awarded by Irish agencies. These charges totaled approximately \$13.0 million and were incurred in the fourth quarter of fiscal 2005. We believe that the restructuring has resulted in content development cost savings which afforded us more flexibility to reinvest in an outsourcing model for other research and development initiatives and to increase profitability of the organization.

In the first quarter of fiscal 2006, in order to more fully focus on the MML business (which includes informal learning), we sold certain assets of our retail IT certification business, SmartCertify (the Retail Certification business). The Retail Certification business was focused on direct-to-consumer business and contributed less revenue than

expected. This action has allowed us to fully focus our attention and resources on our core enterprise business. We maintain the customer contracts in place on April 28, 2005 and will service those contracts until the contractual obligations have been fulfilled. We have been recognizing revenue from the deferred revenue balance related to direct-to-consumer business over the 18 to 24 months subsequent to the date of sale. Substantially all of the sales, marketing and administrative costs of our Retail Certification business were eliminated. We maintain a reseller arrangement with the acquiring organization.

**Table of Contents**

During fiscal 2007, we continue to focus on revenue and earnings growth primarily by acquiring new customers, continuing to execute on our new product and telesales distribution initiatives, and by making a higher priority the evaluation of 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 and income taxes. 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* and in Note 2 of the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K as filed with the SEC on April 13, 2006. The policies set forth in our Form 10-K have not changed, except that the critical accounting policy for share-based compensation, which is discussed below, has been modified since the filing of our Form 10-K as a result of the adoption of SFAS 123(R) on February 1, 2006.

**Share Based Compensation**

During the first quarter of fiscal 2006, we adopted the provisions of and accounted for share-based compensation in accordance with SFAS No. 123 (revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123,

*Accounting for Stock Based Compensation*. SFAS 123(R) requires employee share-based compensation awards to be accounted for under the fair value method and eliminates the ability to account for these instruments under the intrinsic value method as prescribed by Accounting Principles Board, or APB, Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. See Note 5 of the Notes to the Condensed Consolidated Financial Statements in Item 1 for more information regarding SFAS 123(R).

As permitted under SFAS No. 123 and SFAS 123(R), we use the Black-Scholes option pricing model to estimate the fair value of share option grants. The Black-Scholes model relies on a number of key assumptions to calculate estimated fair values. The estimated fair value of employee share options is amortized to expense using the straight-line method over the vesting period. Our assumed dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends. Since adoption of SFAS 123(R) on February 1, 2006, our expected share-price volatility assumption been based on a blend of implied volatility in conjunction with calculations of our historical volatility determined over a period commensurate with the expected life of our option grants. The implied volatility is based on exchange traded options of our share. We believe that using a blended volatility assumption will result in the best estimate of expected volatility. Prior to adoption of SFAS 123(R), for the pro-forma basis only presentation, the expected volatility was based on historical volatilities of the underlying share only. The assumed risk-free interest rate is the U.S. Treasury security rate with a term equal to the expected life of the option. The assumed expected life is based on Company-specific historical experience. With regard to the estimate of the expected life, we consider the exercise behavior of past grants and the pattern of aggregate exercises. We looked at historical option grant cancellation and termination data in order to determine our assumption of forfeiture rate. Prior to the adoption of SFAS 123(R), forfeitures were not estimated at the time of award and adjustments were reflected in pro forma net income disclosures as forfeitures occurred.

If factors change and we employ different assumptions for estimating share-based compensation expense in future periods, or if we decide to use a different valuation model, the share-based compensation expense we recognize in future periods may differ significantly from what we have recorded in the current period and could materially affect our operating income, net income and earnings per share. It may also result in a lack of comparability with other companies that use different models, methods and assumptions. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. These characteristics are not present in our option grants. Existing valuation models, including the Black-Scholes model, may not provide reliable measures of the fair values of our share-based compensation. Consequently, there is a risk that our estimates of the fair values of our share-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination or forfeiture of those share-based payments in the future. Certain share-based payments, such as employee share options,

may expire with little or no intrinsic value compared to the fair values originally estimated on the grant date and reported in our financial statements. Alternatively, the value realized from these instruments may be significantly higher than the fair values originally estimated on the grant date and reported in our financial statements. Currently, there is no market-based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models, nor is there a means to compare and adjust the estimates to actual values. The guidance in SFAS 123(R) is relatively new from an application perspective and the application of these principles may be



**Table of Contents**

subject to further interpretation and refinement over time. See Note 5 of the Condensed Consolidated Financial Statements in Item 1 for further information regarding our adoption of SFAS 123(R).

**RESULTS OF OPERATIONS**

THREE MONTHS ENDED JULY 31, 2006 VERSUS THREE MONTHS ENDED JULY 31, 2005

	<b>DOLLAR</b> <b>INCREASE/(DECREASE)</b>	<b>THREE MONTHS</b> <b>ENDED JULY 31,</b> <b>PERCENT</b> <b>CHANGE</b>		<b>PERCENTAGE OF</b> <b>REVENUE</b>	
		<b>2005/2006</b>	<b>INCREASE/(DECREASE)</b>	<b>2006</b>	<b>2005</b>
		<b>(IN</b> <b>THOUSANDS)</b>	<b>2005/2006</b>		
Revenue	\$ 2,130	4%	100%	100%	
Cost of revenue	347	5%	12%	12%	
Gross margin	1,783	4%	88%	88%	
Operating expenses:					
Research and development	(335)	(3%)	18%	19%	
Selling and marketing	2,252	11%	42%	39%	
General and administrative	81	1%	12%	13%	
Amortization of intangible assets	(164)	(7%)	4%	4%	
(Insurance recoveries)	19,500	*		(36%)	
Restructuring	138	*			
Restatement SEC investigation	(765)	(92%)		2%	
Total operating expenses	20,707	97%	76%	40%	
Operating income	(18,924)	(73%)	13%	48%	
Other income/(expense) , net	(536)	*		1%	
Interest income	722	208%	2%	1%	
Interest expense	(33)	89%			
Income before provision for income taxes	(18,771)	(70%)	14%	50%	
Provision for income taxes	(652)	(17%)	6%	7%	
Net income	\$ (18,119)	(79%)	9%	43%	

\* Not meaningful  
REVENUE

<b>(IN THOUSANDS)</b>	<b>THREE MONTHS ENDED JULY 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>CHANGE</b>
Revenue:			
Multi-Modal Learning	\$ 54,210	\$ 49,707	\$ 4,503

Retail Certification	1,524	3,897	(2,373)
Total	\$ 55,734	\$ 53,604	\$ 2,130

In the three months ended April 30, 2005, we sold certain assets related to SmartCertify, our Retail Certification business. The sale resulted in a reduction in revenue of \$2.4 million in our Retail Certification business for the three months ended July 31, 2006 as compared to the three months ended July 31, 2005. This reduction was more than offset by a 9% increase in MML revenue from our informal learning product lines and additional reseller revenues. We expect revenues from our Retail Certification business to be approximately \$5.0 million in fiscal 2007 as compared to \$14.3 million in fiscal 2006. We expect this decrease in revenue to be offset in fiscal 2007 by increased MML revenue generated from existing customers and new business.

(IN THOUSANDS)	THREE MONTHS ENDED JULY 31,		
	2006	2005	CHANGE
Revenue:			
United States	\$ 43,603	\$ 41,609	\$ 1,994
International	12,131	11,995	136
Total	\$ 55,734	\$ 53,604	\$ 2,130

**Table of Contents**

Revenue increased by 5% and 1% in the United States and internationally, respectively, in the three months ended July 31, 2006 as compared to the three months ended July 31, 2005 as a result of increased MML revenue offset by the decrease in Retail Certification revenue as discussed above.

We exited the fiscal year ended January 31, 2006 with non-cancelable backlog of approximately \$171 million as compared to \$168 million at January 31, 2005. This amount is calculated by combining the amount of deferred revenue at our fiscal year end with the amounts to be added to deferred revenue throughout the next twelve months as a result of committed customer contracts and determining how much of these amounts are scheduled to amortize into revenue during fiscal 2007. The amount scheduled to amortize into revenue during fiscal 2007 is disclosed as backlog as of January 31, 2006. Amounts to be added to deferred revenue during fiscal 2007 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, 2006 reflects a reduction of approximately \$10.6 million in SmartCertify backlog when compared to January 31, 2005, and SmartCertify will not contribute new contracts during fiscal 2007. 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 2007 revenue.

**COSTS AND EXPENSES**

The increase in cost of revenue in the three months ended July 31, 2006 versus the three months ended July 31, 2005 was primarily due to a higher mix of our Books 24x7 Referenceware royalty-bearing product line.

The decrease in research and development expenses in the three months ended July 31, 2006 versus the three months ended July 31, 2005 was primarily due to a reduction of \$0.7 million in outsourcing activity due to incremental costs incurred in the three months ended July 31, 2005 to introduce the SkillSoft Dialogue product offering. This decrease was partially offset by share-based compensation expense of \$0.2 million. In fiscal 2007, we anticipate that research and development expenses will be between 18% and 19% of revenue.

The increase in selling and marketing expenses in the three months ended July 31, 2006 versus the three months ended July 31, 2005 was primarily due to the following factors: \$0.7 million additional investment in our marketing programs, \$0.5 million additional investment in our Books 24x7 sales force, \$0.4 million increase in share-based compensation expense and \$0.3 million additional investment in our direct sales force focusing on acquiring new customers. In fiscal 2007, we anticipate that selling and marketing expenses will be between 40% and 41% of revenue.

The increase in general and administrative expenses in the three months ended July 31, 2006 versus the three months ended July 31, 2005 was primarily due to share-based compensation expense of \$0.6 million. This increase was partially offset by a reduction in legal and accounting fees of \$0.5 million. In fiscal 2007, we anticipate that general and administrative expense will be between 12% and 13% of revenue.

Within legal settlements/(insurance recoveries), we received an insurance settlement benefit of \$19.5 million in the three months ended July 31, 2005, which resulted from the final settlement with our insurance carriers regarding the 2002 securities class action lawsuit settlement of \$30.5 million in March 2004 and the ongoing related litigation and SEC investigation.

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

The change in other income/(expense), net in the three months ended July 31, 2006 versus the three months ended July 31, 2005 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 increase in interest income in the three months ended July 31, 2006 versus the three months ended July 31, 2005 was primarily due to more funds being available for investment and higher interest rates on our cash and cash equivalents and investments.

**PROVISION FOR INCOME TAXES**

**Table of Contents**

We increased our effective tax rate in the three months ended July 31, 2006 compared to the three months ended April 30, 2006 as a result of our revised fiscal 2007 financial expectations. We are using an effective tax rate of 36.5% for fiscal 2007 compared to 15.5% for fiscal year 2006. The increase in the rate reflects nontaxable insurance proceeds received in fiscal 2006 and the Company's increased utilization of acquired NOL carryforwards in the U.S. in fiscal 2007.

SIX MONTHS ENDED JULY 31, 2006 VERSUS SIX MONTHS ENDED JULY 31, 2005

	DOLLAR INCREASE/(DECREASE)	SIX MONTHS ENDED JULY 31, PERCENT CHANGE		PERCENTAGE OF REVENUE	
		2005/2006 (IN THOUSANDS)	INCREASE/(DECREASE) 2005/2006	2006	2005
Revenue	\$ 3,456		3%	100%	100%
Cost of revenue	964		8%	12%	11%
Gross margin	2,492		3%	88%	89%
Operating expenses:					
Research and development	(287)		(1%)	18%	19%
Selling and marketing	1,298		3%	42%	42%
General and administrative	1,077		8%	13%	12%
Amortization of intangible assets	(262)		(6%)	4%	4%
(Insurance recoveries)	19,500		*		(18%)
Restructuring	(565)		(96%)		1%
Restatement SEC investigation	(763)		(70%)		1%
Total operating expenses	19,998		31%	77%	61%
Operating income	(17,506)		(59%)	11%	28%
Other income/(expense), net	(416)		*		
Interest income	1,171		167%	2%	1%
Interest expense	(38)		39%		
Loss on sale of assets, net	681		*		(1%)
Income before provision for income taxes	(16,108)		(54%)	13%	28%
Provision for income taxes	425		9%	5%	4%
Net income	\$ (16,533)		(65%)	8%	24%

\* Not meaningful.  
REVENUE

SIX MONTHS ENDED JULY 31,

<b>(IN THOUSANDS)</b>	<b>2006</b>	<b>2005</b>	<b>CHANGE</b>
Revenue:			
Multi-Modal Learning	\$ 107,131	\$ 97,756	\$ 9,375
Retail Certification	3,256	9,175	(5,919)
Total	\$ 110,387	\$ 106,931	\$ 3,456

The sale of certain assets related to SmartCertify, our Retail Certification business, resulted in a reduction in revenue of \$5.9 million in our Retail Certification business for the six months ended July 31, 2006 as compared to the six months ended July 31, 2005. This reduction was more than offset by a 10% increase in MML revenue from our informal learning product lines and additional reseller revenues.

<b>(IN THOUSANDS)</b>	<b>SIX MONTHS ENDED JULY 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>CHANGE</b>
Revenue:			
United States	\$ 86,467	\$ 83,580	\$ 2,887
International	23,920	23,351	569
Total	\$ 110,387	\$ 106,931	\$ 3,456

**Table of Contents**

Revenue increased by 3% and 2% in the United States and internationally, respectively, in the six months ended July 31, 2006 as compared to the six months ended July 31, 2005 due to the increased MML revenue offset by the decrease in Retail Certification revenue as discussed above.

**COSTS AND EXPENSES**

The increase in cost of revenue in the six months ended July 31, 2006 versus the six months ended July 31, 2005 was primarily due to a higher mix of our Books 24x7 Referenceware royalty-bearing product line.

The decrease in research and development expenses in the six months ended July 31, 2006 versus the six months ended July 31, 2005 was primarily due to a reduction of \$1.1 million in outsourcing activity due to incremental costs incurred in the six months ended July 31, 2005 to introduce the SkillSoft Dialogue product offering. This decrease was partially offset by share-based compensation expense of \$0.6 million.

The increase in selling and marketing expenses in the six months ended July 31, 2006 versus the six months ended July 31, 2005 was primarily due to \$1.2 million additional investment in our Books sales force, \$1.0 million increase in share-based compensation expense, \$0.8 million additional investment in our marketing programs and \$0.6 million additional investment in our direct sales force, targeted at new customers. This was partially offset by the expense reduction of \$2.8 million resulting from the sale of certain assets related to SmartCertify, our Retail Certification business, at the end of our fiscal 2006 first quarter.

The increase in general and administrative expenses in the six months ended July 31, 2006 versus the six months ended July 31, 2005 was primarily due to share-based compensation expense of \$1.2 million. This increase was partially offset by the expense reduction of \$0.4 million resulting from the sale of certain assets of SmartCertify at the end of our fiscal 2006 first quarter.

Within legal settlements/(insurance recoveries), we received an insurance settlement benefit of \$19.5 million in the three months ended July 31, 2005, which resulted from the final settlement with our insurance carriers regarding the 2002 securities class action lawsuit settlement of \$30.5 million in March 2004 and the ongoing related litigation and SEC investigation.

The decrease in restructuring expenses in the six months ended July 31, 2006 versus the six months ended July 31, 2005 was due to the restructuring of our Retail Certification business in the three months ended April 30, 2005. We did not incur any significant restructuring charges in the six months ended July 31, 2006.

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

The change in other income/ (expense), net in the six months ended July 31, 2006 versus the six months ended July 31, 2005 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 increase in interest income in the six months ended July 31, 2006 versus the six months ended July 31, 2005 was primarily due to more funds being available for investment and higher interest rates on our cash and cash equivalents and investments.

**LOSS ON SALE OF ASSETS, NET**

We recorded a loss of \$681,000 in the three months ended April 30, 2005. This loss is primarily the result of investment banking and professional fees associated with the sale of certain assets of the Retail Certification business.

**PROVISION FOR INCOME TAXES**

We are using an effective tax rate of 36.5% for fiscal 2007 compared to 15.5% for fiscal year 2006. The increase in the rate reflects nontaxable insurance proceeds received in fiscal 2006 and the Company's increased utilization of acquired NOL carryforwards in the U.S. in fiscal 2007.

**Table of Contents**

Our effective tax rate of 36.5% at July 31, 2006 for fiscal 2007 increased from 33.0% at April 30, 2006 for fiscal 2007 due to our revised financial expectations for the year which may result in higher taxable income in jurisdictions that do not have NOL s able to be offset against that income.

**LIQUIDITY AND CAPITAL RESOURCES**

As of July 31, 2006, our principal source of liquidity was our cash and cash equivalents and short-term investments, which totaled \$97.1 million. This compares to \$73.6 million at January 31, 2006.

Net cash provided by operating activities of \$26.3 million for the six months ended July 31, 2006, was primarily due to net income of \$8.9 million which includes depreciation and amortization and amortization of intangible assets of \$7.3 million, share-based compensation expense of \$3.3 million, and non-cash income tax provision of \$4.4 million. Net cash from operating activities was also provided from a decrease in prepaid expenses of \$5.9 million and a reduction of accounts receivable of \$38.8 million. These amounts were partially offset by a decrease in deferred revenue of \$28.2 million as well as a decrease in accrued expenses and accounts payable of \$13.8 million. The decreases in accounts receivable, deferred revenue and accrued expenses 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 \$33.8 million for the six months ended July 31, 2006, which includes the purchase of investments, net of maturities, generating a net cash outflow of approximately \$31.2 million in the six months ended July 31, 2006. In addition, purchases of capital assets, primarily related to additional investments in our hosting infrastructure, totaled approximately \$2.9 million.

Net cash provided by financing activities was \$3.0 million for the six months ended July 31, 2006. This was the result of proceeds from the exercise of share options and share purchases under our 2004 Employee Share Purchase Plan. We had working capital of approximately \$12.2 million as of July 31, 2006 and a working capital deficit of approximately \$8.0 million as of January 31, 2006. The increase in our working capital was primarily due to our net income of \$8.9 million which includes depreciation and amortization and amortization of intangible assets of \$7.3 million, share-based compensation expense of \$3.3 million, and a non-cash provision for income tax of \$4.4 million and \$3.0 million of proceeds from the exercise of share options and share purchases under our 2004 Employee Share Purchase Plan, which were partially offset by the purchase of long-term investments of \$3.5 million and the purchase of property and equipment of \$2.9 million.

We have a \$25 million line of credit with a bank, which expires on October 20, 2006. Under the terms of the line of credit, the bank holds a first security interest in all domestic business assets. All borrowings under the line of credit bear interest at the bank s prime rate. The facility is subject to a commitment fee of \$50,000 to secure the line of credit and unused commitment fees of 0.125% based upon the daily average of un-advanced amounts under the line of credit. In addition, the line of credit contains certain financial and non-financial covenants. We are currently in compliance with all covenants. Also, the line of credit provides that in the event of a Material Adverse Change (as defined in the line of credit), the lender has the ability to call amounts outstanding under the line of credit. As of July 31, 2006, there were no borrowings under the line of credit; however, we had an outstanding letter of credit of \$15.5 million that reduced the availability under the line of credit. Letters of credit are subject to commission fees of 0.75% and administrative costs. We paid approximately \$64,000 in letters of credit fees in the six months ended July 31, 2006.

As of January 31, 2006, we had U.S. federal net operating loss (NOLs) carryforwards of approximately \$314.0 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 \$314.0 million are approximately \$200.1 million of U.S. NOL carryforwards that were acquired in the Merger and the purchase of Books. We will realize the benefits of these acquired NOL s through reductions to goodwill and non-goodwill intangibles. Also included in the \$314.0 million at January 31, 2006 is approximately \$28.0 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 Merger and the purchase of Books. As with the acquired NOLs, we will realize the benefits of these credit carryforwards through reductions to goodwill and non-goodwill intangibles. Additionally, we had approximately \$99.7 million of NOL carryforwards in

jurisdictions outside of the U.S. If not utilized, these NOL carryforwards expire at various dates through the year ending January 31, 2025. In addition, included in the \$99.7 million is approximately \$61.1 million of NOL carryforwards in jurisdictions outside the U.S. acquired in the Merger and the purchase of Books. We will realize the benefits of these acquired NOLs through reductions to goodwill and non-goodwill intangibles We also had U.S. federal tax credit carryforwards of approximately \$5.6 million at January 31, 2006.



**Table of Contents**

We lease certain of our facilities and certain equipment and furniture under operating lease agreements that expire at various dates through 2023. Future minimum lease payments, net of estimated rentals, under these agreements are as follows (in thousands):

	<b>Total</b>	<b>Payments Due by Period</b>			
		<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	<b>More Than 5 Years</b>
<b>Contractual Obligations</b>					
Operating Lease Obligations	\$ 30,988	\$ 5,645	\$ 8,571	\$ 3,566	\$ 13,206

We have no future contracted obligations related to long-term debt, capital leases or purchase obligations.

We have a remaining payout to be made in the fiscal year ending January 31, 2007 of \$15.25 million relating to the settlement of the 2002 securities class action litigation described in Note 8(c) of the Notes to the Consolidated Financial Statements in our Form 10-K filed on April 13, 2006.

We expect to experience similar spending related to capital expenditures in the fiscal year ending January 31, 2007, as compared to the fiscal year ended January 31, 2006, and we will continue to invest in our 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 sales, we expect to experience corresponding increases in deferred revenue, cash flow and prepaid expenses. Capital expenditures for the fiscal year ending January 31, 2007 are expected to be approximately \$7.0 million. We purchased 6,533,884 shares under our shareholder approved repurchase plan during fiscal 2005 and 2006. This plan expired on March 24, 2006 with 466,116 shares available for repurchase under the original plan. Our shareholders have approved the renewal and extension of the plan and as a result we currently have the ability to purchase, subject to certain limitations, up to 3,500,000 of our outstanding shares under the approved shareholder plan. Under the plan, there are limitations on our ability to purchase shares up to this level, which include, but are not limited to, the availability of distributable profits under Irish regulations and available cash. We expect that the principal sources of funding for our operating expenses, capital expenditures, litigation settlement payments 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 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 significant acquisitions. 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) and insurance settlements (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 recognizes that non-GAAP financial results are not a substitute for GAAP results, and believes that non-GAAP measures are helpful in assisting them in understanding and managing our business.

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 comparisons.

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

**Table of Contents**

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

As of July 31, 2006, 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 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.

**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 pound sterling relative to the U.S. dollar, which could adversely affect our business and the results of operations. During the six months ended July 31, 2006 and 2005, we incurred foreign currency exchange gains/ (losses) of (\$110,000) and \$214,000, 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 July 31, 2006. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (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 July 31, 2006, 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 July 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II**

**ITEM 1. LEGAL PROCEEDINGS**

Not applicable.

**ITEM 1A. RISK FACTORS**

Investors should carefully consider the risks described below before making an investment decision with respect to shares of the Company.

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, 2006, there have been no material changes to the risk factors included in that report.

**Table of Contents**

**RISKS RELATED TO LEGAL PROCEEDINGS**

**IN CONNECTION WITH OUR RESTATEMENT OF THE HISTORICAL FINANCIAL STATEMENTS OF SMARTFORCE, CLASS ACTION LAWSUITS HAVE BEEN FILED AGAINST US AND ADDITIONAL LAWSUITS MAY BE FILED, AND WE ARE THE SUBJECT OF A FORMAL ORDER OF PRIVATE INVESTIGATION ENTERED BY THE SEC.**

While preparing the closing balance sheet of SmartForce as at September 6, 2002, the date on which we closed our merger with SkillSoft Corporation (the Merger), certain accounting matters were identified relating to the historical financial statements of SmartForce (which, following the Merger, are no longer our historical financial statements). On November 19, 2002, we announced our intent to restate the SmartForce financial statements for 1999, 2000, 2001 and the first two quarters of 2002. We have settled several class action lawsuits that were filed following the announcement of the restatement.

We are the subject of a formal order of private investigation entered by the SEC. We may incur substantial costs in connection with the SEC investigation, which could cause a diversion of management time and attention. In addition, we could be subject to substantial 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, which could adversely affect our business and operating results.

On June 2, 2005, the Boston District Office of the SEC informed us that it had made a preliminary determination to recommend that the SEC bring a civil injunctive action against us. Under the SEC's rules, we are permitted to make a so-called Wells Submission in which we seek to persuade the SEC that no such action should be commenced. In the event we are unable to resolve the SEC's potential claims by agreement, we intend to make such a submission. We continue to cooperate with the SEC in this matter. At the present time we are unable to predict the outcome of this action and as such have not determined what, if any, impact it may have on our financial statements.

**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.

RISKS RELATED TO THE OPERATION OF OUR BUSINESS

25

---

**Table of Contents**

**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.

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

We recorded a net loss of \$113.3 million for the fiscal year ended January 31, 2004, a net loss of \$20.1 million for the fiscal year ended January 31, 2005 and net income of \$35.2 million for the fiscal year ended January 31, 2006. While we achieved profitability in the fiscal year ending January 31, 2006 and the first two quarters of fiscal 2007, we cannot guarantee that our business will sustain profitability in any future period.

**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;

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, including the costs related to the restatement of the SmartForce financial statements;

non-recurring charges related to acquisitions;

growing competition that may result in price reductions; and

26

---

**Table of Contents**

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.

**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 REVENUES 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.

**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 (Books) relies on third



**Table of Contents**

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 is having a negative impact on revenue for these product lines and may have a continued or increased adverse impact in the future.

**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.

**Table of Contents**

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.

**POTENTIAL FUTURE ACQUISITIONS 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. However, we may not be successful in identifying or consummating attractive acquisition opportunities. Moreover, any acquisitions we do consummate may not produce benefits commensurate with the purchase price we pay or our expectations for the acquisition. In addition, acquisitions involve numerous risks, including:

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

difficulties in transitioning customers 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 problems of the acquired company; and

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.

**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 revenues 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 is 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 customers 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 customers' internal networks. Consequently, the emergence and growth of the market for our

**Table of Contents**

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 revenues may suffer.

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.

**OUR RESTRUCTURING PLANS MAY BE INEFFECTIVE OR MAY LIMIT OUR ABILITY TO COMPETE.**

In the fiscal year ended January 31, 2005 we recorded approximately \$13.4 million of restructuring charges related to the reorganization of our content development organization as well as the shut down of our German facility. There are several risks inherent in these efforts to transition to a new cost structure. These include the risk that we will not be successful in maintaining profitability, and hence we may have to undertake further restructuring initiatives that would entail additional charges and create additional risks. In addition, there is the risk that cost-cutting initiatives will impair our ability to effectively develop and market products and remain competitive. Each of the above measures could have long-term effects on our business by reducing our pool of talent, decreasing or slowing improvements in our products, making it more difficult for us to respond to customers, limiting our ability to increase production quickly if and when the demand for our products increases and limiting our ability to hire and retain key personnel. These circumstances could cause our earnings to be lower than they otherwise might be.

**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.

**CHANGES IN ACCOUNTING STANDARDS REGARDING STOCK OPTION PLANS COULD LIMIT THE DESIRABILITY OF GRANTING SHARE OPTIONS, WHICH COULD HARM OUR ABILITY TO ATTRACT AND RETAIN EMPLOYEES, AND COULD ALSO REDUCE OUR PROFITABILITY.**

The Financial Accounting Standards Board has determined to require all companies to treat the value of share options granted to employees as an expense commencing in our first quarter of fiscal 2007. The Company adopted this accounting in the quarter ended April 30, 2006 and recorded approximately \$3.3 million of share-based compensation expense for the six months ended July 31, 2006. This change requires companies to record a compensation expense equal to the value of each share option granted. This expense will be spread over the vesting period of the share option. Due to the fact that we are required to expense share option grants, it could reduce the attractiveness of granting share options because the additional expense associated with these grants would reduce our profitability. However, share options are an important employee recruitment and retention tool, and we may not be able to attract and retain key personnel if we reduce the scope of our employee share option program. Accordingly, either our profitability, or our ability to use share options as an employee recruitment and retention tool would be adversely impacted.

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

Due to our multi-national operations, our operating results are subject to fluctuations based upon changes in the exchange rates between the currencies in which revenues are collected or expenses are paid. In particular, the value of the U.S. dollar against the euro

**Table of Contents**

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.

**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.

**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



**Table of Contents**

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.

**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 revenues 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 revenues, 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.

**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**

Not applicable

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

See the Exhibit Index attached hereto.

**Table of Contents**

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: September 8, 2006

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

33

---

**Table of Contents**

EXHIBIT INDEX

- 10.1 Loan and Security Agreement, dated July 23, 2004, as amended, by and between Silicon Valley Bank, SkillSoft Corporation, SmartCertify Direct Inc. and Books24x7.com, Inc.
- 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.