

SKILLSOFT PUBLIC LIMITED CO

Form 10-Q

September 10, 2007

**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, 2007  
OR**

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

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

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

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

03062  
(ZIP CODE)

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

Not Applicable

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

On August 31, 2007, the registrant had outstanding 111,245,599 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, 2007  
INDEX

	<b>PAGE NO.</b>
<u>PART I FINANCIAL INFORMATION</u>	3
<u>Item 1. Unaudited Consolidated Financial Statements:</u>	3
<u>Condensed Consolidated Balance Sheets as of July 31, 2007 and January 31, 2007</u>	3
<u>Condensed Consolidated Income Statements for the Three and Six Months Ended July 31, 2007 and 2006</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended July 31, 2007 and 2006</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>	22
<u>Item 3. Quantitative and Qualitative Disclosure about Market Risk</u>	33
<u>Item 4. Controls and Procedures</u>	34
<u>PART II OTHER INFORMATION</u>	34
<u>Item 1. Legal Proceedings</u>	34
<u>Item 1A. Risk Factors</u>	35
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	44
<u>Item 3. Defaults Upon Senior Securities</u>	44
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	44
<u>Item 5. Other Information</u>	44
<u>Item 6. Exhibits</u>	44
<u>SIGNATURE</u>	45
<u>EXHIBIT INDEX</u>	46
<u>Ex-31.1 Section 302 Certification of the Chief Executive Officer</u>	
<u>Ex-31.2 Section 302 Certification of the Chief Financial Officer</u>	
<u>Ex-32.1 Section 906 Certification of the Chief Executive Officer</u>	
<u>Ex-32.2 Section 906 Certification of the Chief Financial Officer</u>	

**Table of Contents**

## PART I

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

	<b>JULY 31, 2007 (Unaudited)</b>	<b>JANUARY 31, 2007</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 35,550	\$ 48,612
Short-term investments	22,042	55,505
Restricted cash	4,009	20,095
Accounts receivable, net	86,250	94,343
Assets held for sale	8,007	
Prepaid expenses and other current assets	21,749	22,215
Total current assets	177,607	240,770
Property and equipment, net	9,038	9,672
Intangible assets, net	40,285	2,638
Goodwill	304,007	83,171
Long-term investments		3,598
Deferred tax assets, net	56,183	159
Other assets	6,069	2,962
Total assets	\$ 593,189	\$ 342,970
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,553	\$ 3,327
Accrued compensation	21,201	17,870
Accrued expenses	51,459	35,427
Current maturities of long-term debt	2,000	
Liabilities of asset groups held for sale	1,838	
Deferred revenue	143,720	146,012
Total current liabilities	223,771	202,636
Long term debt	198,000	
Other long term liabilities	2,507	2,405
Total long term liabilities	200,507	2,405
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Ordinary shares, Euro 0.11 par value: 250,000,000 shares authorized; 111,207,193 and 109,255,366 shares issued at July 31, 2007 and January 31, 2007, respectively	12,326	12,039
Additional paid-in capital	584,947	573,394

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

Treasury stock, at cost, 6,533,884 ordinary shares	(24,524)	(24,524)
Accumulated deficit	(401,784)	(421,661)
Accumulated other comprehensive loss	(2,054)	(1,319)
Total shareholders' equity	168,911	137,929
Total liabilities and shareholders' equity	\$ 593,189	\$ 342,970

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>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenue	\$ 71,469	\$ 55,734	\$ 128,609	\$ 110,387
Cost of revenue amortization of intangible assets	1,744	1,732	1,942	3,463
Cost of revenue (1)	8,718	6,665	15,546	13,116
Gross profit	61,007	47,337	111,121	93,808
Operating expenses:				
Research and development (1)	11,364	9,901	21,605	19,866
Selling and marketing (1)	23,714	23,136	46,262	46,392
General and administrative (1)	8,998	6,846	16,126	14,127
Amortization of intangible assets	3,741	411	4,320	828
Merger and integration related expenses	8,493		8,528	
Restatement SEC investigations	351	69	1,223	321
Total operating expenses	56,661	40,363	98,064	81,534
Operating income	4,346	6,974	13,057	12,274
Other expense, net	(251)	(41)	(383)	(31)
Interest income	728	1,069	2,336	1,874
Interest expense	(3,762)	(70)	(3,814)	(136)
Income before (benefit) / provision for income taxes from continuing operations	1,061	7,932	11,196	13,981
(Benefit) / provision for income taxes	(10,803)	3,107	(8,157)	5,103
Income from continuing operations	11,864	4,825	19,353	8,878
Income from operations of businesses to be disposed, net of income tax of \$387	524		524	
Net income	\$ 12,388	\$ 4,825	\$ 19,877	\$ 8,878
Net income per share (Note 10):				
Basic continuing operations	\$ 0.11	\$ 0.05	\$ 0.19	\$ 0.09
Basic discontinued operations	\$ 0.01	\$	\$ 0.01	\$
	\$ 0.12	\$ 0.05	\$ 0.19	\$ 0.09
Basic weighted average shares outstanding	104,400,895	101,524,912	103,848,299	101,285,185

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

Diluted continuing operations	\$	0.11	\$	0.05	\$	0.18	\$	0.09
Diluted discontinued operations	\$	0.00	\$		\$	0.00	\$	
	\$	0.11	\$	0.05	\$	0.18	\$	0.09
Diluted weighted average shares outstanding		108,423,593		104,050,160		107,739,609		103,460,319

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

	<b>THREE MONTHS ENDED</b>		<b>SIX MONTHS ENDED</b>	
	<b>July 31,</b>		<b>July 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Cost of revenue	\$ 48	\$ 11	\$ 65	\$ 17
Research and development	225	284	433	667
Selling and marketing	369	608	867	1,377
General and administrative	631	630	1,264	1,253

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>2007</b>	<b>2006</b>
Cash flows from operating activities from continuing operations:		
Net income, continuing operations	\$ 19,353	\$ 8,878
Adjustments to reconcile net income from continuing operations to net cash provided by operating activities:		
Share-based compensation	2,629	3,314
Depreciation and amortization	4,009	3,032
Amortization of intangible assets	6,262	4,291
Provision for/(recovery of) bad debts	54	(363)
Non-cash interest expense	226	
(Benefit)/provision for income tax non-cash	(9,164)	4,446
Changes in current assets and liabilities, net of acquisitions:		
Accounts receivable	41,818	38,802
Prepaid expenses and other current assets	4,942	5,867
Accounts payable	(50)	(1,150)
Accrued expenses, including long-term liabilities	(29,610)	(12,642)
Deferred revenue	(30,463)	(28,156)
Net cash provided by operating activities from continuing operations	10,006	26,319
Cash flows from investing activities from continuing operations:		
Purchases of property and equipment	(1,888)	(2,855)
Cash used in purchase of businesses, net of cash acquired	(278,923)	
Purchases of investments	(1,000)	(53,484)
Maturity of investments	37,973	22,245
Release of restricted cash	16,090	316
Net cash used in investing activities from continuing operations	(227,748)	(33,778)
Cash flows from financing activities from continuing operations:		
Borrowings under long-term debt, net of debt financing costs	194,133	
Exercise of share options	8,122	1,301
Proceeds from employee share purchase plan	1,088	1,703
Net cash provided by financing activities from continuing operations	203,343	3,004
Change in cash from discontinued operations	240	
Effect of exchange rate changes on cash and cash equivalents	1,097	490
Net decrease in cash and cash equivalents	(13,062)	(3,965)
Cash and cash equivalents, beginning of period	48,612	51,937
Cash and cash equivalents, end of period	\$ 35,550	\$ 47,972

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

**2. BASIS OF PRESENTATION**

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

Certain reclassifications have been made to the consolidated financial statements for the three and six month periods ended July 31, 2006 to conform to current year classifications. Included in cost of revenues is the amortization of intangible assets related to acquired technology and capitalized software development costs of approximately \$1.7 million and \$3.5 million for the three and six months ended July 31, 2006, respectively. These costs were previously recorded within operating expense under the caption amortization of intangible assets.

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

The Company considers all highly liquid investments with original maturities of 90 days or less at the time of purchase to be cash equivalents. At July 31, 2007 and January 31, 2007, cash equivalents consisted mainly of commercial paper. The Company considers the cash held in certificates of deposit with a commercial bank (i) to secure certain facility leases and (ii) to secure funds to defend named former executives and board members of SmartForce PLC for actions arising out of the SEC investigation to be restricted cash. At July 31, 2007, the Company had approximately \$4.0 million of restricted cash: approximately \$2.9 million is held voluntarily to defend named former executives and board members of SmartForce PLC for actions arising out of the SEC investigation and litigation related to the 2002 securities class action and approximately \$1.1 million is held to secure certain facilities leases. In the quarter ended April 30, 2007, the Company made the final payment with respect to the 2002 securities class action settlement of approximately \$15.5 million, which amount had previously been recorded as restricted cash. The Company accounts for certain investments in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115). Under SFAS No. 115, securities that the Company does not intend to hold to maturity or for trading purposes are reported at market value, and are classified as available for sale. At July 31, 2007, the Company's investments were classified as available for sale and had an average maturity of approximately 79 days. These investments are classified as current assets or long-term investments in the accompanying condensed consolidated balance sheets based upon maturity date.

**Table of Contents****4. REVENUE RECOGNITION**

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

The Company follows the provisions of the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended by SOP 98-4 and SOP 98-9 to account for revenue derived pursuant to license agreements under which customers license the Company's products and services. The pricing for the Company's courses varies based upon the number of course titles or the courseware bundle licensed by a customer, the number of users within the customer's organization and the length of the license agreement (generally one, two or three years). License agreements permit customers to exchange course titles, generally on the contract anniversary date. Additional product features, such as hosting and online mentoring services, are separately licensed for an additional fee.

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

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

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

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

The Company typically recognizes revenue from resellers when both the sale to the end user has occurred and the collectibility of cash from the reseller is probable. With respect to reseller agreements with minimum commitments, the Company recognizes revenue related to the portion of the minimum commitment that exceeds the end user sales at the expiration of the commitment period provided the Company has received payment. If a definitive service 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. If the Company determines that the professional services are not separable from an



**Table of Contents**

existing customer arrangement, revenue from these services is recognized over the existing contractual terms with the customer; otherwise the Company typically recognizes professional service revenue as the services are performed.

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

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

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

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

The Company has several share-based compensation plans under which employees, officers, directors and consultants may be granted options to purchase the Company's ordinary shares, generally at the market price on the date of grant. The options become exercisable over various periods, typically four years, and have a maximum term of up to ten years. As of July 31, 2007, 2,573,263 ordinary shares remain available for future grant under the Company's share option plans. Please see Note 9 of the Notes to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K as filed with the SEC on April 13, 2007 for a detailed description of the Company's share option plans. A summary of share option activity under the Company's plans during the three months ended July 31, 2007 is as follows:

		<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (Years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
<b>Share Options</b>	<b>Shares</b>			
Outstanding, April 30, 2007	19,173,432	\$ 7.61	5.23	
Granted	90,000	9.31		
Exercised	(763,981)	5.26		
Cancelled	(420,546)	15.34		
Outstanding, July 31, 2007	18,078,905	\$ 7.60	5.02	\$ 43,965
Exercisable, July 31, 2007	12,425,559	\$ 8.14	4.41	\$ 32,015
Vested and Expected to Vest, July 31, 2007 (1)	17,164,965	\$ 7.67	4.95	\$ 42,042

(1) This represents the number of

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

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the closing price of the shares on July 31, 2007 of \$8.51 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, 2007.

**Table of Contents**

The weighted average grant date fair value of options granted, as calculated by applying the Black Scholes method, during each of the three and six months ended July 31, 2007 was \$4.69 per share. The total intrinsic value of options exercised during the three months ended July 31, 2007 and 2006 was approximately \$2.6 million and \$536,708, respectively. The total intrinsic value of options exercised during the six months ended July 31, 2007 and 2006 was approximately \$5.7 million and \$811,021, respectively.

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

On May 14, 2007, the Company completed its acquisition of NETg from The Thomson Corporation for approximately \$270 million in cash, subject to customary post-closing adjustments. The combined entity offers a more robust multi-modal solution that includes online courses, simulations, digitized books and an on-line video library as well as complementary learning technologies. The acquisition supports SkillSoft's mission to deliver comprehensive and high quality learning solutions and positions the Company to serve the demands of this growing marketplace. As a result of the acquisition \$254.6 million and \$43.1 million of the purchase price have been allocated to goodwill and identified intangible assets, respectively. Intangible assets consist of (i) a non-compete agreement valued at \$6.9 million, which will be amortized over a period of 30 months; (ii) customer relationships valued at \$22.5 million, which will be amortized over a period of 4 years; (iii) customer contracts valued at \$1.0 million, which will be amortized over a period of one year; (iv) course content valued at \$10.0 million, which will be amortized over a period of 18 months and (v) the NETg tradename valued at \$2.7 million which will be amortized over a period of 2 years. Useful lives were determined based on Company estimates.

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

Cash paid	\$ 269,738
Transaction costs incurred	7,249
<b>Total purchase price</b>	<b>\$ 276,987</b>

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

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

<b>Description</b>	<b>Amount</b>
Current assets	\$ 48,494
Property and equipment	4,639
Goodwill	254,590
Amortizable intangible assets	43,050
Current liabilities*	(48,301)
Deferred revenue	(25,485)
<b>Total</b>	<b>\$ 276,987</b>

Includes exit  
costs of  
\$15.8 million



**Table of Contents**

The acquisition resulted in allocations of the purchase price to goodwill and identified intangible assets of \$254.6 million and \$43.1 million, respectively. Intangible assets and their estimated useful lives consist of the following (in thousands):

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

The non-compete agreement, trademark/tradename and customer relationships were valued using the income approach and the developed software/courseware was valued using the cost approach. Values and useful lives assigned to intangible assets were determined using management's estimates which in part were based on valuation reports prepared by a third party specialist.

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

The acquired intangible assets and goodwill are subject to review for impairment as indicators of impairment develop and otherwise at least annually.

The Company assumed certain liabilities in the acquisition including deferred revenue that was ascribed a fair value of \$25.5 million using a cost-plus profit approach in accordance with Emerging Issues Task Force (EITF) 01-03,

*Accounting in a Business Combination for Deferred Revenue of an Acquiree.* The Company is amortizing deferred revenue over the average remaining term of the contracts, which reflects the estimated period to satisfy these customer obligations. In allocating the preliminary purchase price, the Company recorded an adjustment to reduce the carrying value of NETg's deferred revenue by \$22.2 million. Approximately \$14.7 million of acquired NETg deferred revenue remained at July 31, 2007.

In connection with the acquisition, the Company's management approved and initiated plans to integrate NETg into its operations and to eliminate redundant facilities and headcount, reduce cost structure and better align operating expenses with existing economic conditions and the Company's operating model. In accordance with EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination*, the Company has accrued for certain liabilities incurred directly related to the NETg acquisition and accounted for those in the allocation of the purchase price. The items accounted for in accordance with EITF Issue No. 95-3 primarily relate to severance related costs incurred in association with workforce reductions and totaled approximately \$9.3 million for employee separation costs for approximately 360 employees. The Company also estimated a liability of \$1.8 million representing the estimated fair value of abandoned lease obligations. The Company made severance payments of \$6.1 million during the quarter ended July 31, 2007 and expects to pay out the balance by the end of the second quarter of fiscal 2009. As of July 31, 2007, \$3.2 million of the liability for accrued severance was unpaid and included in accrued expenses in the accompanying balance sheet. The Company's outstanding liability for abandoned leases at July 31, 2007 was \$1.8 million, which is included in the accrued expense balance on the accompanying balance sheet as of July 31, 2007 (see Note 7). The Company's outstanding liability for NETg content re-branding and legal and outplacement services was \$4.0 million and \$0.7 million, respectively which is included in the accrued expense balance on the accompanying balance sheet as of July 31, 2007.



**Table of Contents**

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

	<b>THREE MONTHS ENDED JULY 31,</b>		<b>SIX MONTHS ENDED JULY 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(in thousands except per share data)</b>			
Revenue	\$ 102,719	\$ 92,925	\$ 191,109	\$ 184,769
Net loss	(7,684)	(17,426)	(24,625)	(31,266)
Net loss per share basic	\$ (0.07)	\$ (0.17)	\$ (0.24)	\$ (0.31)
Net loss per share diluted	\$ (0.07)	\$ (0.17)	\$ (0.23)	\$ (0.30)

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

**(b) Targeted Learning Corporation**

On February 9, 2007, the Company acquired the assets of Targeted Learning Corporation (TLC), an on-line video library business, for approximately \$4.1 million in cash plus liabilities assumed of \$0.8 million. Additional consideration of up to \$0.5 million is payable to the shareholders of TLC at various times prior to February 2008 contingent upon achievement of certain integration milestones. As of July 31, 2007, approximately \$0.1 million of this contingent consideration had been paid. The acquisition resulted in an allocation of the purchase price to goodwill and identified intangible assets of \$3.2 million and \$0.9 million, respectively. Intangible assets consist of internally developed software, comprised of learning content valued at \$510,000, which will be amortized over a period of 4 years, customer contracts and relationships valued at \$330,000, which will be amortized over 3 years and the TLC tradename valued at \$20,000 which will be amortized over 2 years. Values and useful lives assigned to intangible assets were determined using management's estimates which in part were based on valuation reports prepared by a third party specialist. The Company has concluded that the acquisition of TLC does not represent a material business combination and therefore no pro forma financial information has been provided herein.

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

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

The reductions in employee headcount will total approximately 360 employees from the administrative, sales, marketing and development functions, and amounted to a liability of approximately \$9.3 million. Approximately \$6.1 million was paid against the exit plan accrual through July 31, 2007, and the remaining amount of \$3.2 million, net of adjustments for foreign currency translation, is expected to be paid by the end of the second quarter of fiscal 2009.

In connection with the exit plan, the Company intends to abandon certain leased facilities resulting in a facilities consolidation liability of \$1.8 million as of July 31, 2007, consisting of lease termination costs, broker commissions

and other facility costs. As part of the plan, two sites will be vacated. The fair value of the lease termination costs was calculated with certain assumptions related to the Company's estimated cost recovery efforts from subleasing

**Table of Contents**

vacated space, including (i) the time period over which the property will remain vacant, (ii) the sublease terms and (iii) the sublease rates

The Company's merger and exit liabilities which include previous merger and acquisition transactions are recorded in accrued expenses (see Note 14) and long-term liabilities. Activity in the six month period ended July 31, 2007 is 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, 2007	\$ 878	\$ 2,278	\$ 121	\$ 3,277
Provision for merger and exit costs as of the date of acquisition of NETg (May 14, 2007) accounted for in the allocation of purchase price	9,335	1,836	4,657	15,828
Payments made during the six months ended July 31, 2007	(6,057)	(348)	(95)	(6,500)
Merger and exit accrual July 31, 2007	\$ 4,156	\$ 3,766	\$ 4,683	\$ 12,605

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

Year ended January 31, 2008 (remaining 6 months)	\$ 11,129
2009	493
2010	332
2011	651
Total	\$ 12,605

Certain of the former NETg employees continued employment during a transition period and certain of the former NETg facilities being vacated are being used as the Company transitions operations to other locations. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, such costs are being expensed as incurred and are included in merger and integration related expenses in the accompanying statements of income. The Company recorded \$8.5 million of merger and integration related expenses in the three months ended July 31, 2007.

**DISCONTINUED OPERATIONS**

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

As a result, the assets and liabilities of NETg Press Now, Interact Now and Financial Campus have been classified as held for sale and qualify for held for disposal treatment under Statement of Financial Accounting Standards ( SFAS ) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The Company sold Financial Campus in August 2007 and expects to sell the NETg Press Now and Interact Now business lines by the end of fiscal 2008. The Company intends to shut down the Wave operations.

The Company has accounted for all of the business units as discontinued operations, in accordance with the provisions of SFAS No. 144. The results for all periods presented since the acquisition are included in the financial statements as discontinued operations. The components of discontinued operations are as follows (in thousands):

	<b>JULY 31, 2007</b>
Balance Sheet	
Current assets:	
Accounts receivable, net	\$ 2,112
Inventory	2,357
Fixed assets	3,353
Other current assets	185

**Table of Contents**

	<b>JULY 31, 2007</b>
Total current assets	\$ 8,007
Current liabilities:	
Accounts payable and accruals	\$ 812
Deferred revenue	1,026
Total current liabilities	\$ 1,838
Income Statement	<b>THREE AND SIX MONTHS ENDED JULY 31, 2007</b>
Revenue from discontinued operations	\$ 3,629
Income from discontinued operations before income taxes	911
Income taxes	387
Income from discontinued operations	\$ 524

**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, 2007	\$ 1,421
Payments made during the six months ended July 31, 2007	(506)
Restructuring charges incurred during the six months ended July 31, 2007	228
Total restructuring accrual as of July 31, 2007	\$ 1,143

**8. GOODWILL AND INTANGIBLE ASSETS**

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

	<b>JULY 31, 2007</b>			<b>JANUARY 31, 2007</b>		
	<b>GROSS CARRYING AMOUNT</b>	<b>ACCUMULATED AMORTIZATION</b>	<b>NET CARRYING AMOUNT</b>	<b>GROSS CARRYING AMOUNT</b>	<b>ACCUMULATED AMORTIZATION</b>	<b>NET CARRYING AMOUNT</b>
Internally developed software/ courseware	\$ 38,716	\$ 29,778	\$ 8,938	\$ 28,257	\$ 27,836	\$ 421
Customer contracts	36,848	14,988	21,860	13,018	11,701	1,317
Non-compete	6,900	690	6,210			

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

Trademarks and trade names	3,625	348	3,277	905	5	900
	86,089	45,804	40,285	42,180	39,542	2,638
Goodwill	304,007		304,007	83,171		83,171
	\$ 390,096	\$ 45,804	\$ 344,292	\$ 125,351	\$ 39,542	\$ 85,809

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

	<b>Total</b>
Gross carrying amount of goodwill, January 31, 2007	\$ 83,171
Utilization of tax benefit	(36,829)
Acquisition of TLC	3,233
Acquisition of NETg	254,590



**Table of Contents**

Other	<b>Total</b> (158)
Gross carrying amount of goodwill, July 31, 2007	\$ 304,007

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

<b>Fiscal Year</b>	<b>Amortization Expense</b>
2008	\$ 10,397
2009	16,415
2010	8,245
2011	3,712
2012	616
Total	\$ 39,385

**9. COMPREHENSIVE INCOME (LOSS)**

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

	<b>THREE MONTHS ENDED JULY 31,</b>		<b>SIX MONTHS ENDED JULY 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Comprehensive income:				
Net income	\$ 12,388	\$ 4,825	\$ 19,877	\$ 8,878
Other comprehensive income/(loss) Foreign currency adjustment	(263)	(167)	(415)	(465)
Change in fair value of interest rate hedge	(232)		(232)	
Unrealized holding gains/(losses)	(8)	(49)	(86)	26
Comprehensive income	\$ 11,885	\$ 4,609	\$ 19,144	\$ 8,439

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

	<b>SIX MONTHS ENDED JULY 31, 2007</b>	<b>YEAR ENDED JANUARY 31, 2007</b>
Unrealized holding (losses)/gains on available for sale securities	\$ (22)	\$ 67
Change in fair value of interest rate hedge	(232)	

Foreign currency adjustment		(1,800)		(1,386)
Total accumulated other comprehensive loss	\$	(2,054)	\$	(1,319)

10. NET INCOME PER SHARE

Basic net income per share was computed using the weighted average number of shares outstanding during the period. Diluted net income per share was computed by giving effect to all dilutive potential shares outstanding. The weighted average number of shares outstanding used to compute basic net income per share and diluted net income per share was as follows:

**Table of Contents**

	<b>THREE MONTHS ENDED</b>		<b>SIX MONTHS ENDED</b>	
	<b>JULY 31,</b>		<b>JULY 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Basic weighted average shares outstanding	104,400,895	101,524,912	103,848,299	101,285,185
Effect of dilutive shares outstanding	4,022,698	2,525,248	3,891,310	2,175,134
Weighted average shares outstanding, as adjusted	108,423,593	104,050,160	107,739,609	103,460,319

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, 2007 and 2006, respectively, as they would be anti-dilutive:

	<b>THREE MONTHS ENDED</b>		<b>SIX MONTHS ENDED</b>	
	<b>JULY 31,</b>		<b>JULY 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Options to purchase shares	14,056,207	14,005,126	14,187,595	14,355,240

**11. INCOME TAXES**

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

The Company has significant net operating loss (NOL) carryforwards, some of which are subject to potential limitations based upon the change in control provisions of Section 382 of the United States Internal Revenue Code. Under SFAS No. 109 *Accounting for Income Taxes*, the Company can only recognize a deferred tax asset for future benefit of our tax loss, temporary differences and tax credit carryforwards to the extent that it is more likely than not that these assets will be realized. In determining the realizability of these assets, the Company considered numerous factors, including historical profitability, estimated future taxable income and the industry in which the Company operates. Based on current and preceding years' results of operations and anticipated profit levels, the Company believes that certain of its deferred tax assets are more likely than not realizable. Accordingly, the Company reduced the valuation allowance during the three months ended July 31, 2007 as a result of this assessment. For the six months ended July 31, 2007, the Company recorded a tax benefit of \$8.2 million. The tax benefit is largely attributable to the release of approximately \$49.1 million of U.S. valuation allowance on NOL carryforwards, which will more likely than not, be realized in future periods. Approximately \$25.0 million of this asset was recorded through reductions to tax expense and \$24.1 million was recorded through reductions to goodwill. Also, included in the tax benefit of \$8.2 million is the expected utilization of approximately \$5.5 million of acquired NOL carryforwards in 2008, which do not alleviate tax burden in the statement of income, and are recorded as an adjustment to goodwill. In addition, there is income generated in foreign countries, which cannot be offset through the utilization of NOL carryforwards. For the six months ended July 31, 2007 and 2006, the Company's effective tax rates were (72.9%) and 36.5% respectively. For the six month period ended July 31, 2007, the tax benefit of \$8.2 million (72.9%) is the result of a \$25.0 million deferred tax benefit related to the reduction in the Company's deferred tax asset valuation allowance, offset by a provision for income taxes based on the Company's projected effective tax rate for the fiscal year, exclusive of the valuation allowance adjustment. The projected provision for income taxes is impacted by the effects of certain tax adjustments required in purchase accounting for the NETg acquisition. The tax rate benefit of 72.9% is comprised of a non-cash benefit of approximately \$9.2 million or 81.9% offset by a cash tax payable of approximately \$1.0 million, or 9.0%.

*Deferred Taxes*

As a result of purchase accounting for the NETg acquisition, the Company recorded a \$10.2 million deferred tax asset on certain deferred revenue that has previously been recognized for tax purposes which is included in current assets in the allocation of purchase price (See Note 6). At July 31, 2007, the value of this deferred tax asset is \$7.3 million.



**Table of Contents**

The goodwill created in the NETg acquisition is tax deductible and the resulting tax amortization will reduce the Company's tax basis in the acquired goodwill, thereby creating a deferred tax liability. As of July 31, 2007, the amount of this liability was \$1.3 million. The goodwill that creates the taxable temporary difference is infinite lived and; as such, makes it impossible to schedule the reversal of the deferred tax liability.

Correspondingly, the amortization of goodwill, for tax purposes, increases the Company's NOL carryforwards and results in an increase to deferred tax assets. Given the indefinite reversal status of the deferred tax liability and the absence of other positive evidence, the Company feels that it is more likely than not that the incremental NOL carryforwards will not be realized and has provided a full valuation allowance on the NOL carryforwards resulting from the goodwill tax amortization.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on February 1, 2007. On the date of adoption of FASB Interpretation No. 48, the Company had total unrecognized tax benefits of approximately \$3.6 million (including interest and penalties of \$1.1 million) that, if recognized, would impact the Company's effective tax rate. During the three months ended July 31, 2007, the Company continued to assess recognition and measurement for new and existing uncertain positions and monitor tax developments in relevant jurisdictions for potential changes in the sustainability or measurement of positions. At July 31, 2007 the Company had \$4.1 million of unrecognized tax benefits. The Company recognizes interest and penalties accrued related to unrecognized tax benefits as income tax expense. As of July 31, 2007 the Company had approximately \$0.5 million of accrued interest related to uncertain tax positions.

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

**12. COMMITMENTS AND CONTINGENCIES**

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, 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 one-half paid in August 2004 and the remainder paid in April 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 ongoing 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 has been recorded in the fiscal 2006 second quarter.

The Company has been the subject of a formal investigation by the United States Securities and Exchange Commission (SEC) into the events and circumstances giving rise to the 2003 restatement of SmartForce PLC's accounts (the Restatement Investigation). On July 19, 2007, the SEC announced that three former officers and one former employee of SmartForce had settled SEC claims in connection with the Restatement Investigation. The SEC staff did not ask that any claims be brought against the Company, or request that the Company enter into any

**Table of Contents**

settlement, and the Company does not believe that the SEC will make any claim against the Company in connection with the Restatement Investigation, including any claim for payment by the Company.

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

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

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

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

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

**13. GEOGRAPHICAL DISTRIBUTION OF REVENUES**

The Company attributes revenues to different geographical areas on the basis of the location of the customer.

Revenues by geographical area for the three and six month periods ended July 31, 2007 and 2006 were as follows (in thousands):

	<b>THREE MONTHS ENDED JULY 31,</b>		<b>SIX MONTHS ENDED JULY 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenue:				
United States	\$ 57,261	\$ 43,603	\$ 101,080	\$ 86,466
United Kingdom (UK)	7,319	6,260	14,259	12,321
Canada	2,575	2,354	5,129	4,716
Europe, excluding UK	626	518	1,024	1,041
Australia/New Zealand	3,077	2,058	5,838	4,296
Other	611	941	1,279	1,547
Total revenue	\$ 71,469	\$ 55,734	\$ 128,609	\$ 110,387

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

**14. ACCRUED EXPENSES**

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



**Table of Contents**

	<b>JULY 31, 2007</b>	<b>JANUARY 31, 2007</b>
Course development fees	\$ 1,472	\$ 1,860
Professional fees	5,917	2,639
Accrued payables	2,395	415
Accrued miscellaneous taxes	485	385
Account payable other	8,355	
Accrued merger related costs*	11,242	1,892
Sales tax payable/VAT payable	4,649	4,405
Accrued royalties	7,846	3,693
Accrued interest	1,499	
Accrued litigation settlements		15,250
Accrued restructuring	504	659
Other accrued liabilities	7,095	4,229
<b>Total accrued expenses</b>	<b>\$ 51,459</b>	<b>\$ 35,427</b>

\* Includes \$1,431 and \$1,188 of accrued payroll taxes in July 31, 2007 and January 31, 2007, respectively.

**15. LINE OF CREDIT**

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

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

The Credit Agreement contains customary representations and warranties as well as affirmative and negative covenants. Affirmative covenants include, among others, with respect to the Company and its subsidiaries, maintenance of existence, financial and other reporting, payment of obligations, maintenance of properties and



insurance, maintenance of a credit rating, and interest rate protection. Negative covenants include, among others, with respect to the Company and its subsidiaries, limitations on incurrence or guarantees of indebtedness, limitations

**Table of Contents**

on liens, limitations on sale and lease-back transactions, limitations on investments, limitations on mergers, consolidations, asset sales and acquisitions, limitations on dividends, share redemptions and other restricted payments, limitations on affiliate transactions, limitations on hedging transactions, and limitations on capital expenditures. The Credit Agreement also includes a leverage ratio covenant and an interest coverage ratio covenant (the ratio of the Company's consolidated EBITDA to its consolidated interest expense as calculated pursuant to the Credit Agreement). Within the definitions of the Credit Agreement, a material adverse effect shall mean a material adverse condition or material adverse change in or materially and adversely affecting (a) the business, assets, liabilities, operations or financial condition of Holdings, the Borrower and the Subsidiaries, taken as a whole, or (b) the validity or enforceability of any of the Loan Documents or the rights and remedies of Administrative Agent, the Collateral Agent or the Secured Parties there under. No event, change or condition has occurred since January 31, 2007 that has caused, or could reasonably be expected to cause, a material adverse effect and as of July 31, 2007 the Company was in compliance with all other covenants under the Credit Agreement.

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

In connection with the Credit Agreement, the Company incurred debt financing costs of \$5.9 million. The Company capitalized these fees and amortizes them to interest expense over the term of the loans. During the three and six months ended July 31, 2007, the Company paid approximately \$2.1 million in interest and recorded \$226,000 of amortized interest expense related to the capitalized debt financing costs.

The Lenders required the Company to enter into an interest rate swap agreement for at least 50% of the term loan, or \$100 million, as a means of reducing the Company's interest rate exposure. Accordingly, the Company entered into an interest rate swap agreement with an initial notional amount of \$160 million which amortizes over a period consistent with the Company's anticipated payment schedule. This strategy uses an interest rate swap to effectively convert \$160 million in variable rate borrowings into fixed rate liabilities at 5.1015% effective interest rate. The interest rate swap is considered to be a hedge against changes in the amount of future cash flows associated with interest payments on a variable rate loan (see Note 16).

#### 16. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

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

The Company's objective in using derivatives is to add stability to interest expense and to manage its exposure to interest rate movements or other identified risks. To accomplish this objective, the Company primarily uses interest

**Table of Contents**

rate swaps as part of its cash flow hedging strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts in exchange for fixed-rate payments over the life of the agreements without exchange of the underlying principal amount. During the three months ended July 31, 2007, an interest rate swap was used to hedge the variable cash flows associated with \$160 million of existing variable-rate debt.

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

At July 31, 2007, the interest rate swap was designated as a cash flow hedge with a fair value of \$232,000 which was included in other liabilities. No hedge ineffectiveness on the cash flow hedge was recognized in earnings during the three months ended July 31, 2007.

Amounts reported in accumulated other comprehensive income related to the interest rate swap will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. For the three months ended July 31, 2007, the change in net unrealized losses on the cash flow hedge reflects a reclassification of (\$83,000) of net unrealized losses from accumulated other comprehensive income to interest expense. For the year ending January 31, 2008, the Company estimates that an additional \$7,000 of net unrealized losses will be reclassified from accumulated other comprehensive income to interest expense.

**Table of Contents**

17. RELATED PARTY TRANSACTION

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

**Table of Contents**

**18. SHARE REPURCHASE PROGRAM**

On March 23, 2006, the Company's shareholders approved a program for the repurchase by the Company of up to an aggregate of 3,500,000 ADSs. Currently, none of these shares have been repurchased and 3,500,000 remain available for repurchase, subject to certain limitations, under the shareholder approved repurchase program, which expires on September 22, 2007. On May 14, 2007, in connection with the closing of the NETg acquisition, the Company entered into a Credit Agreement that contains customary negative covenants that place limitations on the repurchase of the Company's shares.

**19. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

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

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

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

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

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

**OVERVIEW**

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

We derive revenue primarily from agreements under which customers license our products and purchase our services. The pricing for our courses varies based upon the number of course titles or the courseware bundle licensed by a customer, the number of users within the customer's organization and the length of the license agreement (generally one, two or three years). Our agreements permit customers to exchange course titles, generally on the contract anniversary date. Additional services, such as hosting and online mentoring, are subject to additional fees.

Cost of revenue includes the cost of materials (such as storage media), packaging, shipping and handling, CD duplication, the cost of online mentoring and hosting services, royalties, certain infrastructure and occupancy

**Table of Contents**

expenses and share-based compensation. We generally recognize these costs as incurred. Also included in cost of revenue is amortization expense related to capitalized software development costs and intangible assets related to developed software and courseware acquired in business combinations.

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

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

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

Merger and integration related expenses primarily consist of salaries paid to NETg employees for transitional work assignments and certain consultancy fees.

Restructuring primarily consists of charges associated with international restructuring activities.

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

**BUSINESS OUTLOOK**

In the three and six months ended July 31, 2007, we generated revenue of \$71.5 million and \$128.6 million respectively, as compared to \$55.7 million and \$110.4 million in the three and six months ended July 31, 2006, respectively. We reported net income in the three and six months ended July 31, 2007 of \$12.4 million and \$19.9 million, respectively, as compared to \$4.8 million and \$8.9 million in the three and six months ended July 31, 2006, respectively.

We continue to find ourselves in a challenging business environment due to (i) the overall market adoption rate for e-learning solutions remaining relatively slow, (ii) budgetary constraints on information technology (IT) spending by our current and potential customers and (iii) price competition and value based competitive offerings from a broad array of competitors in the learning market generally. Despite these challenges, we have seen some stability in the marketplace and our core business has performed in accordance with our expectations. Our recent revenue growth and our growth prospects are strongest in our product lines focused on or bundled with informal learning, such as those available from our Books 24x7 subsidiary. As a result, we have increased our sales and marketing investment related to those product lines to help capitalize on the recent growth and potential continued growth for informal learning related products. We have also invested aggressively in research and development in those areas to accelerate the time by which our planned new products will be available to our customers. In order to pursue the small business market we continue to invest in our telesales unit, but we need to see renewal rates consistent with those of our direct sales business to determine its potential. We also will consider investing in a new business direct field sales team and lead generators.

On May 14, 2007, we completed our acquisition of NETg for approximately \$270 million, subject to customary post-closing adjustments. NETg is a global enterprise-learning delivering integrated learning solutions for

**Table of Contents**

businesses, professional associations and government agencies that include instructional content, multiple delivery options, enabling technologies, and a range of expert consulting services. NETg offers many of the same financial and operating characteristics as SkillSoft's business model, including an annual recurring subscription-based licensing model for access to its learning resources library, a direct sales force distribution system complemented by resellers and telesales support, and a Global 2000 client base offering visibility through multi-year contracts and renewal rates. The acquisition added to our existing offerings through the addition of complementary NETg offerings such as live virtual instructor-led training, blended learning, learning content and custom development services among others. The acquisition supports our overall strategy to continually increase the quality, breadth and flexibility of the learning solutions we can make available to our corporate, government, education and small-to-medium size business customers. Also, the addition of NETg's capabilities strengthens our ability to compete for a greater share of the \$13.2 billion corporate training market that includes many larger players with more comprehensive product offerings. In addition to our recent acquisition of NETg, we acquired Targeted Learning Corporation (TLC) on February 9, 2007. Under the terms of the acquisition, we paid approximately \$4.1 million in cash to acquire TLC. Additional consideration of up to \$0.5 million is payable to the shareholders of TLC upon achievement of certain integration milestones prior to February 2008. As of July 31, 2007, \$0.1 million of this additional consideration has been paid. The acquisition provides us with a new offering that includes an on-line library of over 300 video-based programs featuring organizational and leadership experts, CEOs and best-selling authors. Programs range in length from two minutes to two hours, and much of this content is presented as 3 to 5 minute segments, or Quick Talks, for easy access. Selected programs as indicated on the course profile page are available for offline use with portable devices that support video, including the Apple iPod®. Users can search the content by Leadership Model category or by title, speaker/author or topic. This product offers many of the same financial and operating characteristics as our business model, including an annual recurring subscription-based licensing model for access to its video-based resource library to be sold through our direct sales force, complemented by resellers and telesales.

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

**CRITICAL ACCOUNTING POLICIES**

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

Critical Accounting Policies in Note 2 of the Notes to the Consolidated Financial Statements and under Management's Discussion and Analysis of Financial Conditions and Results of Operations - Critical Accounting Policies in our Annual Report on Form 10-K as filed with the SEC on April 13, 2007. The policies set forth in our Form 10-K have not changed, except that the critical accounting policy for business combinations described below is a new critical accounting policy in light of the NETg acquisition and the income tax policy has been modified as a result of the adoption of FASB Interpretation (FIN) 48 on February 1, 2007, as described in our Form 10-Q filed with the SEC on June 11, 2007.

**BUSINESS COMBINATIONS**

When we acquire new businesses, we allocate the purchase price of businesses acquired to the assets acquired, including intangible assets, and the liabilities assumed based on their estimated fair values, with any amount in excess of such allocations designated as goodwill. Significant management judgments and assumptions are required in determining the fair value of acquired assets and liabilities, particularly acquired intangible assets. The valuation of purchased intangible assets is based upon estimates of the future performance and cash flows from the acquired





**Table of Contents**

business. If different assumptions are used, it could materially impact the purchase price allocation and our financial position and results of operations.

**RESULTS OF OPERATIONS**

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

	<b>Three Months Ended July 31,</b>			
	<b>Dollar</b>	<b>Percent</b>	<b>Percentage of</b>	
	<b>Increase/(Decrease)</b>	<b>Change</b>	<b>2007</b>	<b>2006</b>
	<b>2006/2007</b>	<b>2006/2007</b>	<b>Revenue</b>	
	<b>(In thousands)</b>			
Revenue	\$ 15,735	28%	100%	100%
Cost of revenue amortization of intangible assets	12	1%	2%	3%
Cost of revenue	2,053	31%	12%	12%
Gross profit	13,670	29%	85%	85%
Research and development	1,463	15%	16%	18%
Selling and marketing	578	3%	33%	42%
General and administrative	2,152	31%	13%	12%
Amortization of intangible assets	3,330	810%	5%	1%
Merger related integration expenses	8,493	*	11%	
Restatement SEC investigation	282	409%	1%	
Total operating expenses	16,298	40%	79%	72%