

SKILLSOFT PUBLIC LIMITED CO

Form 10-K

April 13, 2006

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-K**  
**ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

**For the fiscal year ended January 31, 2006**

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

**For the transition period from            to**

**Commission file: 0-25674**

**SkillSoft Public Limited Company**

*(Exact name of registrant as specified in its charter)*

**Republic of Ireland**

*(State or other jurisdiction of incorporation or organization)*

**107 Northeastern Boulevard**

**Nashua, New Hampshire**

*(Address of principal executive offices)*

**None**

*(I.R.S. Employer Identification No.)*

**03062**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**(603) 324-3000**

**Securities registered pursuant to section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act:**

**(Title of Class)**

**Ordinary Shares, 0.11**

**Subscription Rights**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this

Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The approximate aggregate market value of voting shares held by non-affiliates of the registrant as of July 31, 2005 was \$404,192,398

On March 31, 2006, the registrant had outstanding 107,493,534 ordinary shares (issued or issuable in exchange for the registrant's outstanding American Depository Shares (ADSs)).

**DOCUMENTS INCORPORATED BY REFERENCE**

None.

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FORM 10-K  
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## PART I

Any statements in this Form 10-K about future expectations, plans and prospects for SkillSoft®, 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 in Item 1A, Risk Factors .

As used in this Form 10-K, we , us , our , SkillSoft and the Company refer to SkillSoft Public Limited Company and its subsidiaries; and references to our fiscal year refer to the fiscal year ending on January 31 of that year (e.g., fiscal 2007 is the fiscal year ending January 31, 2007).

### Item 1. *Business*

#### General

SkillSoft is a leading provider of comprehensive e-learning content and technology products for business and information technology (IT) professionals within global enterprises. 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. Content offerings include our business, IT, desktop and compliance courseware collections and BusinessPro™, ITPro™, OfficeEssentials™, FinancePro™, EngineeringPro™, GovEssentials™, ExecSummaries™ and ExecBlueprints™ collections from Books24x7®. Our complementary technologies include SkillPort®, SkillSoft's learning management system with its powerful Search-and-Learn® technology and premium add-on modules, and SkillSoft Dialogue™ virtual classroom, a tool that allows customers to create and deliver effective blended learning programs using custom content and off-the-shelf learning resources.

Our products and services are designed to connect learning objectives to business strategy and to maximize human capital investments. With a comprehensive learning solution comprised of high-quality learning resources and flexible technology approaches, we help our customers achieve sustainable, measurable business results. These solutions are designed to support all levels of the organization and can easily be adapted to meet strategic business initiatives, on-demand information needs and individual job roles.

On the courseware side of our business, we focus on a variety of business, professional effectiveness, IT and compliance topics that we believe represent important skills required of employees in increasingly dynamic and complex work environments. We also provide informal learning products through our Books24x7 business unit that support on-demand learning and daily information gathering needs. Our IT skills courses give learners the ability to gain the technical knowledge they need to perform their jobs and prepare for many popular IT professional certifications. Our business skills courses (also known as soft skills courses) concentrate on the skills and knowledge that are relevant to various general competencies and functional responsibilities in today's business organizations. These skills are important to a business professional's ability to work effectively with business associates and customers, make sound business decisions and more rapidly achieve his or her most important work-related and career objectives. Our Books24x7 Referenceware collections cover broad business and technical areas of interest, as well as focused areas such as engineering and finance. Generally, our courseware and Books24x7 content solutions are based on open standard Web technologies and flexible, low bandwidth architecture, enabling users to access the material they need via computer, with the specificity or breadth they require, any time or anywhere that they may need it.

Our technology solutions are designed to support a broad range of corporate learning needs and respond quickly to business demands. Our learning management system (LMS), SkillPort, is designed to be a flexible, scalable platform that can be rapidly implemented to meet the needs of the majority of business enterprises. We also work actively with other LMS vendors to ensure interoperability of our content and technology with their systems. In addition to SkillPort, we offer, customization and authoring tools, and other technology assets that allow our customers to tailor our content to be a better fit with their business. SkillSoft Dialogue, a virtual classroom and Web collaboration technology, is focused on the rapid assembly and delivery of effective online learning sessions.

We have a worldwide customer base spanning business, government and education, and more than six million licensed users. Our major products include:

*SkillChoice Multi-Modal Learning Solutions:* These integrated solutions provide a rich array of resources (including courseware, Referenceware, online mentoring, test preparation exams, Express Guides® and SkillSimtm simulations) to support formal training and informal performance support needs. Available as four offerings (Complete, IT, Business and Desktop), SkillChoice solutions provide the necessary depth, breadth, quality and currency to encompass a wide range of corporate learning objectives.

*SkillPort:* SkillPort, our learning management platform, provides a reliable, flexible and cost-effective way for organizations to deploy and manage their e-learning programs. Using SkillPort, customers can leverage the benefits of the multi-modal learning approach and deploy complex solutions rapidly, on a global basis. With Search-and-Learntm, employees view all e-learning assets on the system with a single, unified search. SkillPort is available as a hosted solution, supporting the growing demand for reliable, scalable and secure e-learning with a low-cost, low IT-burden model. Alternatively, customers may choose to deploy SkillPort on their intranet infrastructure. Recently introduced add-on modules for our instructor-led training (ILT) management and advanced reporting functionality support complex, blended learning programs.

*SkillSoft Dialogue:* SkillSoft Dialogue is a virtual classroom platform that has been designed for the rapid assembly and delivery of effective live and on-demand learning sessions. SkillSoft Dialogue provides customers access to an online repository of hundreds of thousands of pages of SkillSoft learning content. This content can be used to enrich live and on-demand learning sessions created in SkillSoft Dialogue. These sessions can also be launched and tracked from SkillPort and other standards-based LMS platforms. SkillSoft Dialogue is another example of SkillSoft leveraging its strong heritage of content development and learning technology to bring a new form of value to the market that directly addresses an unmet need of today's leading learning organizations.

*KnowledgeCenters:* KnowledgeCenters are pre-packaged, user-friendly learning portals that allow learners instant access to trusted, targeted content. Each KnowledgeCenter includes material specifically chosen to help a targeted audience of learners build knowledge around a topic as quickly and efficiently as possible. Components include Books24x7 Referenceware; access to SkillSoft courseware organized into Learning Roadmaps that make it easy for learners to locate and use the most appropriate courses for their needs; simulations (through SkillSims, practice labs, or the Project Center); expert mentoring services (for IT KnowledgeCenters and the PMI KnowledgeCenter); and featured topic spotlights, refreshed regularly, to provide an in-depth focus on particular topical areas.

*Business Skills Courseware Collection:* This includes more than 2,200 courseware titles and simulations encompassing professional effectiveness, management/leadership, project management, sales and customer-facing skills, business strategy/operations, finance and human resources. Our courses feature strong visual design; a focus on instructional objectives at the application and analysis levels; learner interactivity; reinforcement through RolePlays, SkillSims and case studies; and transfer of learning into practice through online Job Aids, Follow-On Activities and SkillBriefs.

*IT Skills and Certification Courseware Collection:* This includes more than 1,600 courseware titles encompassing software development, operating systems and server technologies, Internet and network technologies, enterprise database systems and Web design. Our IT skills collection also supports more than 75 current IT professional certification exams. The IT courses also feature strong visual design, interactivity, and reinforcement of learning transfer via frequent practice questions, simulations and mentored and self-assessed exercises.

*Desktop Skills Courseware Collection:* SkillSoft's Desktop Skills Course Collection offers more than 750 courseware titles to assist professionals who rely upon standard desktop applications. Our desktop solutions are

ideal for day-to-day performance support, as well as supporting major corporate software

migrations. Our Desktop Skills Courseware Collection also supports over 25 industry certifications such as ECDL/ICDL and many of the Microsoft MOS certification exams.

*Legal Compliance, Environmental Safety and Health (ES&H) and Federal Government Compliance Collections:* SkillSoft's Compliance Solution includes three focus areas—Legal Compliance, Environmental Safety and Health (ES&H) Compliance and Federal Government Compliance. SkillSoft's Legal Compliance Solution, which includes more than 35 courses, addresses the needs of our clients as they work toward maintaining compliance with various statutes, regulations, and case law that govern the workplace. The ES&H Compliance Solution addresses key standards mandated by the Occupational Safety and Health Administration (OSHA), Environmental Protection Agency (EPA), and the Department of Transportation (DOT). Our ES&H courses are designed for use by the hardhat and safety glasses industries. SkillSoft has over 200 ES&H courses in four languages. The Federal Government Compliance Solution specifically addresses compliance issues for individuals either working directly for the Federal government or employees doing business with the Federal government. The topics included in this solution are similar to those found in the Legal Compliance Solution; however they are designed to address Federal requirements that govern Federal employees.

*Online Mentoring:* This service is offered for over 100 current certification exams for IT professionals, end-user technologies and project management skills. Our approximately 45 on-staff mentors, averaging over 20 current certifications each, are available 24 hours a day, 7 days a week. Through online chats and e-mail, learners can ask questions, receive clarification and request additional information to help them get the answers and understanding they need to prepare for industry certification exams.

*Books24x7 Referenceware:* This includes more than 10,000 unabridged IT and business books and reports from more than 150 publishers that are available to online subscribers through our subsidiary, Books24x7. Exclusive assets such as Referencepointstm, which are original technology white papers from SkillSoft Press, and more than 200 original digital books, including the Instant Code series. White Papers from SkillSoft Press and Instant Code Books fill gaps not covered by traditional book publishers. A unique, patent-pending search engine gives Books24x7 subscribers the ability to perform multi-level searches to pinpoint information needed for on-the-job performance support and problem-solving.

*Executive Content:* Books24x7 executive level offerings give busy executives the information they value in a form that fits their busy schedules. ExecSummariestm offers concise summaries of today's best-selling business books. Summaries can be read on screen, printed or downloaded in MP3 format for portable listening. ExecBlueprintstm are executive white papers that provide near-term actionable information on key business topics. ExecBlueprints are bylined by leading C-level executives from prominent global companies.

We were incorporated in Ireland on August 8, 1989. On September 6, 2002, we completed a merger with SkillSoft Corporation, a Delaware corporation, and, on November 19, 2002, we changed our corporate name from SmartForce PLC to SkillSoft PLC. Our registered office is located at Belfield Office Park, Clonskeagh, Dublin 4, Ireland, and our telephone number at that address from the United States is (011) 353-1-2181000. Our principal office in the United States is located at 107 Northeastern Boulevard, Nashua, New Hampshire 03062, USA, and our telephone number at that address is (603) 324-3000.

We maintain a Web site with the address [www.SkillSoft.com](http://www.SkillSoft.com). We are not including the information contained on our Web site as part of, or incorporating it by reference into, this annual report on Form 10-K. We make available free of charge through our Web site our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file these materials with, or otherwise furnish them to, the Securities and Exchange Commission.

### **Industry Background**

The corporate training market is large. We believe that a substantial majority of the corporate training market is comprised of business skills, IT skills and compliance training, as well as the complementary





technologies and services for the development and delivery of learning programs. We believe that the growth in corporate training is being driven by:

the evolution of our economy to a service-based and knowledge-based economy, in which the skills of the workforce often represent the most important corporate assets;

the increasing recognition by businesses that it is imperative to continually improve the skills of their employees in order to remain competitive;

the rapidly evolving business environment, which necessitates continual training and education of the employee base;

the increased competition in today's economy for skilled employees and the recognition that effective training can be used to recruit and retain employees; and

the retirement of Baby Boom Generation workers during the coming 15-to-20 years, which will result in industries seeking technically skilled and educated workers to meet the projected shortage of qualified and trained candidates to replace those retiring workers. This phenomenon is widely projected to create a major increase in demand for training in technical and business skills.

Although corporate training has historically been and continues to be dominated by traditional classroom instruction, e-learning solutions are offering another choice in which business enterprises improve the skills of their workforce. By providing real-time accessibility and user-focused specificity, e-learning enables the training and education process to be broadened from a distinct event—often off-site and limited in scope—to a process of continuous learning for employees. Often, we find that our customers combine e-learning resources with traditional classroom training or virtual classroom events. These blended learning programs meet the rising need for training in increasingly complex working environments, and, when properly designed and deployed, blended solutions can effectively address the needs of business organizations seeking to provide comprehensive, enterprise-wide learning solutions to their employees. These solutions can support both the planned formal learning priorities and the day-to-day informal learning activities that comprise the primary means by which business professionals learn the skills needed to do their job and grow their careers.

We believe that e-learning solutions present a significant opportunity for business organizations to cost-effectively deliver training and performance support resources for their employees while maintaining a higher level of productivity of their workforce. E-learning solutions can improve on the inefficiencies associated with classroom training, including travel costs, scheduling difficulties and the opportunity costs of employees' time. In addition, e-learning provides benefits beyond other technology-based training methods that make it more flexible, effective and cost-efficient. For example, e-learning solutions provide more timely and simplified deployment, the flexibility of self-directed and personalized learning, improved ease of use, and enhanced product/user support and administrative functionality. Furthermore, through the use of Web-based technologies, e-learning solutions provide access via computer to content any time, anywhere over the Internet and in the exact amount required by each individual learner.

#### **Content Products**

With over 4,750 courses spanning IT, cross-functional business skills, functional area expertise and workplace compliance subjects, we are well positioned in the e-learning content sector of the market for corporate education and training solutions for today's critical business and IT skills. Through our focus on these critical skills and our track record in fast and effective execution, we strive to deliver e-learning content that excels in terms of depth, breadth, currency, interactive learning design and Web deployment flexibility. Also, through our Books24x7 professional Referenceware offering, we can offer users access to over 10,000 unabridged business and IT titles from more than 150 publishers, as well as summaries of leading business books and reports authored by C-level executives on pressing business topics. Together, these multi-modal e-learning components offer organizations an array of both formal and informal learning based on user needs—whether students need to immerse themselves in the subject matter

or need to quickly reference content for five to ten minutes of on-the-job performance support.

We regularly add new courses to cover new skills and technologies and new subjects requested by our customers or that we believe our customers will want. We also regularly retire courses from our active library as certain skills, subjects or technologies become outdated or used less frequently by our customers, and as we replace older courses with newer and higher quality versions. This combination of adding and retiring courses, which is part of our continuous effort to ensure the currency, relevancy and high quality of our active library, will cause the overall active library size to fluctuate.

***Business Skills Courseware and Simulations***

Our comprehensive business skills library of e-learning courses, simulations and learning objects encompasses a wide array of professional effectiveness skills and business topics. As of January 31, 2006, our business skills library included over 2,200 business skills course and simulation offerings. Our business skills courses and simulations are divided into the following major Solution Areas:

|                            |                                |
|----------------------------|--------------------------------|
| Professional Effectiveness | Business Strategy & Operations |
| Management & Leadership    | Sales & Customer-Facing Skills |
| Project Effectiveness      | Finance, HR & Administration   |

We have more than 700 current English language business skills courses, and over 1,500 versions of these courses that have been localized into a number of languages including UK English, Italian, German, French, Castilian Spanish, Polish, Russian, Japanese, Mandarin Chinese, Traditional Chinese, Cantonese, Latin American Spanish and Brazilian Portuguese to support other geographic markets.

***IT Skills and Certification Courseware***

Our comprehensive IT skills library of e-learning courses and learning objects encompasses a wide array of technologies used by IT professionals and business end-users. As of January 31, 2006, our IT skills library included over 1,600 IT skills course offerings that are divided into the following major Solution Areas:

|                                 |   |
|---------------------------------|---|
| Software Development            | Operating Systems & Server Technologies |
| Internet & Network Technologies | Database Systems                        |
| Web Design                      |   |

The courseware in these Solution Areas address over 75 current technical certifications sought by technical professionals and enterprises providing technical products and services to their customers, including:

|                               |                                     |                              |
|-------------------------------|-------------------------------------|------------------------------|
| <b>Microsoft</b>              | <b>Security</b>                     | <b>Cisco</b>                 |
| MCP                           | CompTIA Security+                   | CCNA                         |
| MCSA 2000                     | CISSP (ISC2)                        | CCDA                         |
| MCSE 2000                     | SSCP (ISC2)                         | CCNP                         |
| MCSD .NET                     | ISSEP (ISC2)                        | CCDP                         |
| MCDBA                         | CCSA (CheckPoint)                   | CCSP                         |
| MCSA 2003                     |                                     |                              |
| MCSE 2003                     |                                     |                              |
| <b>Macromedia</b>             | <b>CompTIA</b>                      | <b>Sun</b>                   |
| ColdFusion MX Developer       | A+                                  | Sun Certified Programmer for |
| Dreamweaver MX Developer      | Net+                                | the Java 2 Platform          |
| Flash MX Developer            | INet+                               |                              |
|                               | Server+                             |                              |
|                               | Linux+                              |                              |
| <b>Project Mgmt Institute</b> | <b>Linux Professional Institute</b> |                              |
| PMP                           | LPI: Level 1                        |                              |

CAPM

**CIW**

CIW Associate

Master Enterprise Developer

CIW Site Designer

LPI: Level II

**Oracle**

OCA 9i

OCP 9i

OCA 10g

OCP 10g

We have more than 1,050 current English language IT skills courses, and over 600 IT skills course titles that have been localized into a number of languages including German, French, Spanish, Japanese and Mandarin Chinese , to support other geographic markets.

***Desktop Skills Courseware Collection.***

SkillSoft's Desktop Skills Courseware Collection offers more than 190 English language Desktop Skills courseware titles and over 570 Desktop Skills courses that have been localized into languages such as French, German, Spanish, Italian, Portuguese, Polish, and Mandarin Chinese. Our Desktop Skills courses are built to assist professionals who rely upon standard desktop applications such as Microsoft Office, Lotus Notes and Crystal Reports. Our desktop solutions are ideal for day-to-day performance support, as well as supporting major corporate software migrations. In addition, SkillSoft's Desktop Skills Courseware Collection supports over 25 popular end user certifications including ECDL/ ICDL and many Microsoft MOS certification exams.

***Compliance Solutions***

SkillSoft's Compliance Solutions provide collections of compliance-based e-learning solutions. Within Compliance Solutions there are three areas of focus: Legal Compliance, Environmental Safety and Health (ES&H) Compliance and Federal Government Compliance.

The Legal Compliance Solution addresses the needs of our clients as they work toward maintaining compliance with various statutes, regulations and case law that govern the workplace. The various topics covered in this solution include Ethics, Code of Conduct, Diversity, Sarbanes Oxley and Harassment. Our Legal Compliance courses are designed for use by virtually everyone in an organization, regardless of job title or position.

The ES&H Compliance Solution addresses key standards mandated by the Occupational Safety and Health Administration (OSHA), Environmental Protection Agency (EPA), and the Department of Transportation (DOT). Our Environmental Safety and Health (ES&H) courses are designed for use by the hardhat and safety glasses industries.

The Federal Government Compliance Solution specifically addresses compliance issues for individuals either working directly for the U.S. Federal government or employees doing business with the Federal government. The topics included in this solution are similar to those found in the Legal Compliance Solution; however, they are designed to address Federal requirements that govern Federal employees.

Compliance Solutions also offers the SkillSoft Academy Learning Management System (LMS). SkillSoft Academy is specifically designed for compliance training management. Academy allows training administrators to track learner status, run up-to-the-minute training compliance reports and set consistent training and re-training requirements. As a cost-effective alternative choice to traditional instructor-led training, a compliance solution consisting of an LMS and courses can help reduce the risks and liability for non-compliance in the workplace. In addition, compliance solution courses are also designed to help reduce risks associated with worker's compensation claims, lawsuits and the expense of increased insurance costs.

***Books24x7***

Books24x7, a SkillSoft company, offers a suite of core, unabridged and topically organized Referenceware collections that provide online subscribers the ability to perform multi-level searches to pinpoint information needed for on-the-job performance support and problem-solving. Referenceware products draw upon leading professional reference books, research reports and documentation. Books24x7 delivers Referenceware via a Web-based platform that enables paying subscribers to browse, read, search, and collaborate anytime, anywhere with a simple Web connection. The Referenceware collections include:

ITPRO COLLECTION is geared toward technology professionals including developers, network administrators, technology executives, information services managers and technical support representatives. This collection consists of content from dozens of IT publishers including industry leaders such as Apress, Microsoft Press, MIT Press, Osborne/ McGraw-Hill, Syngress, and John Wiley & Sons. The

ITPro collection includes original content owned by SkillSoft Press such as ReferencePoints white papers and the Instant Code series of books.

BUSINESSPRO COLLECTION is geared toward professionals whose role requires exercising strong business judgment. This collection contains over 30 business skills and professional development publishers including industry leaders such as AMACOM, ASTD, Berrett-Koehler, Harvard Business School Press, Jossey-Bass, Oxford University Press and John Wiley & Sons.

OFFICEESSENTIALS COLLECTION is a specialty collection geared toward non-technical users who require occasional real-time assistance with common office applications. This collection contains award winning content, including the *for Dummies* series, is written in a comfortable, easy-to-understand tone and can be deployed to desktops to relieve Help Desk congestion, or provided as an end-user safety-net during migration to applications such as Microsoft Office 2003.

FINANCEPRO COLLECTION offers professionals access to relevant information on a variety of financial and accounting topics. FinancePro delivers fully searchable, online content from popular publishers such as AMACOM, John Wiley & Sons, McGraw-Hill and Oxford University Press, and is an essential tool for anyone needing immediate access to financial reference materials including such topics as Generally Accepted Accounting Principals (GAAP), International Accounting Standards, Sarbanes-Oxley, operations management, planning and taxation.

ENGINEERINGPRO COLLECTION is a professional information tool containing reference material covering a wide range of engineering disciplines, and general reference topics important to virtually all engineering professionals. This collection features books from publishers such as John Wiley & Sons, McGraw-Hill, The Institution of Electrical Engineers, EngineeringPress, Industrial Press, Noble Publishing, Artech House, Cambridge University Press, The MIT Press and others.

EXECSUMMARIES COLLECTION provides summaries of leading business books from today's foremost business authors. ExecSummaries expertly encapsulates the salient points and ideas of full-length books into concise, 8-page summaries. Unlike excerpts or reviews, designed for ease-of-use with short passages, bulleted lists, and other useful elements, these thorough, yet high-level overviews provide time-constrained executives with the leading ideas that are shaping today's business environment.

EXECBLUEPRINTS COLLECTION is original content owned by SkillSoft that provides executives with easy-to-absorb, practical information and best practices to help provide them with a framework for taking near-term action on pressing business issues. Authored by top C-level business executives who are regarded as leaders and innovators in their fields, these reports are designed to succinctly convey key issues, metrics, lessons learned, milestones, timelines and action plans required for successful execution.

GOVESENTIALS COLLECTION is a broad reference tool targeted to meet the information needs of government workers, contractors and consultants. By combining the full text of government-focused books from major publishers with carefully selected public domain content, GovEssentials offers a variety of ready-access titles in a broad range of subjects such as Foundations of Government, Security & Homeland Defense, Acquisition & Contracting, E-Gov & Information Technology, and other topics of importance to government workers.

***Express Guides®***

Our Express Guides are targeted at IT professionals who need information immediately upon release of new technologies. Express Guides complement other learning options, such as e-learning courses and books, both of which require longer development cycles to bring to market. Express Guides can be searched, launched and managed

through SkillPort, as well as other third-party learning management systems.

***The SkillSoft Instructional Design Model***

Our instructional design model, which we have used in designing our business and IT skills courses, is based primarily on the concepts of performance-oriented instruction, mastery and the sequencing of



instructional activities and strategies. The model draws heavily from adult learning principles that emphasize learner initiative, self-management, experiential learning and transfer of learning into the workplace. The design of each of our courses starts with the definition of user-focused performance objectives and then proceeds to the selection and implementation of instructional strategies and learning activities appropriate for those objectives. Frequent practice questions or exercises along with assessments measure users' achievement of those objectives. This robust, yet flexible, design methodology creates an instructionally sound framework for the design and development of highly interactive, engaging and instructionally effective courses regardless of the content focus or level of learning.

Our instructional design model is intended to meet the challenge of creating effective and engaging instruction that is easily deployed on our corporate customers' global computer networks or over the Internet. Our design, development and quality assurance standards and processes are all geared toward insuring each course meets our expectations for the best instruction possible.

Our instructional design model is focused on producing courses in all content areas with:

learning outcomes specified by performance goals and objectives;

content and learning activities based on specified objectives;

assessment based on the knowledge and skills specified in the objectives;

options to take assessments in either pre- or post-test mode;

instructional strategies and multimedia elements tailored to the specific course content;

tools to promote the transfer of learning into the workplace, such as online Job Aids and Follow-On Activities;

instructional strategies appropriate for the content and learning level, such as examples, behavior modeling, guided practice, and simulations; and

levels of learning appropriate for the content and the target audience.

The theories and principles embedded within our instructional design model are actualized via:

a friendly, intuitive graphical user interface;

a course structure and navigation that supports self-paced, user-controlled instruction;

unlimited access to instruction and assessments;

a standardized templates to create unified and predictable functionality;

a variety of presentation, practice, and assessment templates supporting high levels of user interactivity and engagement; and

a standardized, yet flexible, flow of instruction.

Starting from this set of common elements and attributes, our courses then include the instructional strategies most suitable for the content and specified objectives. For instance, the approach to teaching communication skills is different from the approach to teaching finance or accounting skills, and the strategies used to teach these two business content areas differ from those used to teach computer and software skills.

#### ***Learning Design for Business Skills***

Our business skills courses cover a broad range of business and professional effectiveness curriculum areas. Some content is factual with predictable, non-variable outcomes, such as finance; other content areas, such as

communication skills, are softer , or more behavioral-oriented, and have highly variable implementation options and outcomes that require a different set of instructional presentation and practice strategies. In addition, we have a strong commitment to reach the highest possible levels of learning in each course

including as much application and analysis level content as possible, supported by strong foundational learning at the knowledge and comprehension levels.

The key instructional features and strategies in our business skills courses and library are:

**ROLEPLAY EXERCISES** RolePlay exercises present users with opportunities for realistic practice of varying aspects of course content within everyday workplace scenarios. RolePlay exercises have multiple possible outcomes based on users' responses to the simulation's interactions. When integrated into course topics, RolePlay exercises allow users to freely explore the impact of handling realistic work situations in different ways. SkillSoft's RolePlay design allows users to experience the exercise in score mode or explore mode. Using score mode lets learners assess their level of skill within the targeted content area. Using explore mode allows the learner to dynamically explore alternative responses to see the impact of those choices. This user-driven exploration is the key to real learning. People learn as much, or more, from their mistakes as from the things they do correctly. RolePlays bring this principle home to e-learning.

**AUDIO-ENABLED LEARNING** Our business skills instruction is audio-enabled. This feature can easily be turned on or off based on user preference and greatly enhances engagement and retention for many users. Audio can be especially key to the instructional effectiveness of behavior modeling, RolePlay exercises and SkillSims.

**SIMULATED DIALOGS** The ability to observe behaviors and their outcomes (positive and negative) is a key strategy for teaching professional and behavioral skills. The simulated dialog strategy gives users an opportunity to observe and listen to the conversations of two or more people. The inclusion of character audio enhances the emotional and tonal qualities of the conversation, while the varying facial expressions and body language offer another layer of interpretation. These features, combined with the spoken words of the characters, provide realistic vignettes or scenarios in which varying aspects of a behavioral skill can be presented.

**CASE STUDIES** A case study strategy describes a complex situation, often in the form of a story or scenario, and then asks the user to explore its characteristics and possible resolutions. Complexity is the primary difference between case studies and examples that can be easily presented and practiced through other types of strategies, such as multiple choice and matching. Case studies are used to achieve learning at the application and analysis levels and to present examples of content within appropriate business contexts.

**ANIMATIONS** Animations are an important element of our leading visual design. We use animations when movement is an important part of the teaching point, when the content requires that the user's eye be drawn to a specific area of the screen or when a key concept can be best presented via animated visuals. Examples of content areas where animations can enhance learning effectiveness include instruction on process and dataflow diagrams, hierarchical and dependency relationships and changes in state or perspective.

**ONLINE JOB AIDS** All of our business skills courses include online Job Aids that help support the use of newly learned skills and knowledge in the workplace. Job Aids are courseware take-aways that can be used as-is, or tailored to meet a user's needs. Each Job Aid can easily be edited to reflect a user's organization-specific information, and users can add organization-specific Job Aids that they have independently developed.

**LEARNING AIDS** Learning aids are tools or documents used in support of course content presentation and practice. They are designed to support specific course context or content, and, therefore, are not available for use outside of the course. Learning aids could appear as worksheets (interactive or passive), reference documents too large to include in a standard template, complex charts or graphs or a variety of other formats. Only the content and the chosen instructional strategies limit the variations.

**SKILLBRIEFS** SkillBriefs are one- to two-page text-based HTML documents that summarize the content in each topic of a course. SkillBriefs are now available as part of course content, as well as

through SkillPort. SkillBriefs can be used to quickly refresh a learner's memory of key teaching points, as instant, just-in-time non-interactive learning when time doesn't allow for more typical instruction and/or as valuable take-aways from a course to support transfer of learning into the workplace. There are currently SkillBriefs for over 5,000 topics.

**PRE- AND POST-TESTING ASSESSMENTS** Assessments are available for use in both pre- and post-testing modes. When Assessments are used in pre-test mode, learners can use the results to tailor their initial path of instruction based on those results. Post-test Assessments can be used to help learners identify areas where review or remediation is necessary.

**SKILLSIMS BUSINESS SKILLS SIMULATIONS** SkillSims are instructional resources that extend the learning advantages of RolePlay into larger, more complex e-learning experiences. SkillSims are designed to give users an opportunity to practice new skills in realistic work situations. Each SkillSims simulation, typically 20-to-40 minutes in duration, provides users with an opportunity to practice application level skills based on content drawn from multiple courses within one of our learning paths or series (a collection of related courses). Users practice these skills by navigating through different scenarios in which they encounter a variety of business problems. As in real life, users have the opportunity to select different courses of action, and the scenario unfolds according to the user's choice of actions. Events such as telephone calls, meetings and interruptions add to the reality of each scenario.

SkillSims, with integrated links to their corresponding SkillSoft course series, provide a powerful learning experience that allows the user to immediately apply newly gained knowledge to challenging business situations in risk-free environments. This results in engaging learning experiences and real skill transfer.

**BLENDED LEARNING TOOLKITS** Like SkillSims, the Blended Learning Toolkits are based on content drawn from multiple courses within a single learning path or series. However, this product is designed to provide our customers with tools for blending and/or transferring e-learning into the workplace as well as the classroom. Each Blended Learning Toolkit consists of multiple layers of content including a Users Guide, approximately 18 to 20 activities or tools, PowerPoint presentations that summarize the key teaching points from each lesson in all the courses within the learning path and short text-based summaries (SkillBriefs) of all the topic content. Blended Learning Toolkits are delivered electronically and can be used as is or customized to meet individual customer requirements. Customers have the freedom to blend the tools into traditional classroom settings, instructional events delivered via collaborative learning platforms, or to hand them over to managers, supervisors, facilitators, and anyone else interested in transferring learning into the workplace. The Blended Learning Toolkit provides multi-layered content with many options for use and implementation. It is adaptable and flexible to support a variety of audiences, content areas, and implementation environments and platforms. The goal of the Blended Learning Toolkit is to effectively reinforce the application of knowledge and skills from our courses. Most of all, it provides our customers with another opportunity to enhance and leverage their investment in e-learning.

#### ***Learning Design for IT Skills***

Like our business skills courses, the instructional strategies chosen for use in an IT skills course are largely dependent on the course content and objectives. Learning the use or function of buttons, menu items and other familiar software elements is largely a knowledge and comprehension task. Learning the steps to complete a specific task is very procedural and best achieved via observation or guided practice, followed by opportunities for more independent practice, with varying degrees of guidance, feedback and support. In support of these and other IT skills-related learning goals, our IT skills courses include static and interactive explanations, step-by-step demonstrations of how to perform specific procedures, guided practice activities and sample coding solutions. Inclusion of frequent review questions in the instructional topics reinforces key teaching points. The availability of Assessments at both the topic and course level provides the learner with an option to assess their performance across the entirety of a course, or with more focused concentration on individual topic level content and objectives.



The key instructional features and strategies in the IT skills courses and library are:

**TEXT AND GRAPHICS** Our IT skills courses use a variety of text and graphic-based strategies to present and explain software features and functions. Interactive text and graphics are particularly useful to explain buttons, menu items, coding or tagging parameters, and syntax. This strategy is also an effective method to break down complex concepts into smaller, graphically represented parts, or to separate lines of code into smaller sections. Clicking or selecting graphically portrayed parts produces additional information or explanation about that specific part. All these features allow learners to review information as often as they want and to ignore something if they choose to.

**DEMONSTRATIONS AND GUIDED PRACTICE** Demos in our IT skills courses are demonstrations of software procedures and tasks. Most typically, the demonstration will divide the procedure or task into specific steps and then sequentially show those steps to the user. As the demo moves from one step to the next, a simulated representation of the software shows what happens next and additional text provides commentary. In addition, learners are frequently given the option of performing the salient steps of the procedure. This feature, called a *Try-It*, prompts the user to perform specific steps, or enter code that achieves a specified end result. If learners decide not to perform the step, they can click forward, which launches an animated sequence of the correct step. A special animation feature, called a *Show Me*, is used to demonstrate a specific sequence step or user action. The steps are outlined in advance, and then the learner is given the option of reviewing those steps in an animated sequence. The automated playback of the demo is optional the learner can opt to view the demo or continue to the next section of instruction.

**PROMPTED ANIMATIONS** Animations help the learner visualize content to draw his or her attention to an area on an interface or conceptual graphic. Prompted animations are initiated by the learner after some other introduction to the content in the instruction. When the animation is launched, it extends or reinforces the instruction that has already taken place. The use of prompted versus *autoplay* animation helps avoid split attention, which can occur when text displays simultaneously with animation. Split attention means a learner is confused about where to focus or watch, and confounds learning.

**INTERACTIVE EXERCISES** There are many types of interactive practice questions and exercises used in our IT skills courses.

*SkillChecks* are a key practice strategy in GUI-based content where it is important for the learner to be able to use the software application. SkillChecks present learners with a task to perform on a simulated interface. If a learner performs all the required steps in the task correctly, the interface responds as it would in the real application. If learners decide not to perform the question, they can click forward or click a *Show-me* button, both of which launch an animated sequence of the correct step.

*User-input questions* enable learners to complete a statement or segment of code by typing the answer into a blank area in the code or statement.

*Multiple-choice, matching, and ranking questions* are used to reinforce newly learned skills and knowledge within an instructional topic, and to practice or assess the huge body of conceptual information related to a complete understanding and implementation of many IT subject areas. Learners are debriefed on their performance on these questions via detailed feedback for every answer choice, regardless of whether they got the question right or wrong.

**ONLINE MENTORING** Is available for over 100 current certification exams for IT professionals, end user technologies and project management skills. We have approximately 45 on-staff mentors, averaging over 20 certifications apiece that are available 24 hours a day, 7 days a week. Through on-line chats and e-mail, learners can ask questions, receive clarification, and request additional information to help them get the answers and

understanding they need.

TESTPREP CERTIFICATION PRACTICE EXAMS Addressing over 65 of the most popular current certification exams from Microsoft, Cisco, Oracle and CompTIA, TestPrep practice exams allow

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learners to test their knowledge in a simulated certification-testing environment. Tests can be taken in two modes study and certification. The un-timed study mode is designed to maximize learning by providing feedback and mapping back to appropriate SkillSoft courses for further study, while the against-the-clock certification mode is designed to mimic a certification exam.

**SIMULATIONS AND EXERCISES** Our IT skills courses contain standalone topics that give learners the opportunity to independently practice or consolidate the most critical procedures and learning taught in the preceding instruction. There are four types of simulations, each focused on developing different skills:

*Software exercises*, which consist of a series of tasks that learners perform in a simulated version of the application being discussed in the course.

*Coding exercises*, which give learners the opportunity to analyze and write code or commands.

*Hardware exercises*, which simulate hardware setup problems.

*Case-Study exercises*, which consist of an interactive review of concepts and information, presented in a real-world scenario.

All of these instructional strategies provide the learner with the opportunity to practice his or her skills at higher learning levels. All types of exercises typically build on skills practiced previously in the course and are designed to cover multiple learning objectives.

**MENTORED EXERCISES AND SELF-ASSESSMENT EXERCISES** These exercises are designed to provide the user with an opportunity to apply new knowledge and skills within a live software application. Mentored exercises are designed to allow learners to carry out complex tasks and exercises and submit them to a mentor for review. Self-assessment exercises afford learners the opportunity to carry out similar tasks and exercises, on which they can then assess themselves from a provided solution. Both of these exercises involve the presentation of a real-world scenario requiring the learner to provide a solution or complete a series of tasks. After completing a series of these activities, users will have a set of documents or products demonstrating proficiency with the skills taught by the course.

#### ***Web-Based Architecture and Deployment Technology***

Our Web-based architecture and deployment strategy enables us to provide a number of features to support users in their learning. These features include:

**Learning Management Platforms.** Learning management platforms are key enabling technologies that permit users to access a wide variety of e-learning content resources over the Web, including courseware, simulations, Referenceware, online mentoring, SkillBriefs, Job Aids and TestPrep Certification Practice Exams. Our SkillPort learning management system provides a rich feature set to support a range of corporate learning needs with a high degree of reliability and scalability. Available as a hosted or intranet solution, SkillPort offers our customers a low-cost, low IT-burden option with fast time-to-learning. As of January 31, 2006, there are over 1,400 active SkillPort installations. In addition to our own platform, we continue to strive for convenient, easy integration of our content into third-party learning management systems through ongoing support of industry standards such as SCORM (Sharable Content Object Reference Model) and AICC (Aviation Industry CBT Committee) standards and through initiatives such as our Strategic Alliance for Integrated Learning (SAIL).

**SkillPort Search-and-Learn Technology.** Search-and-Learn technology, a key component of SkillPort, allows the users to search and access learning resources topically with a single, unified search. For example, a learner searching for resources on Cisco networks can discover the various SkillSoft courses, books, TestPreps, Express Guides and online mentoring services available to the learner with a single search query. From the identified results, the learner can then choose the resource that best meets his or her specific needs, time requirements and learning preferences.

**SkillPort Add-On Modules.** Add-on modules expand the scope of blended learning capabilities supported by SkillPort and allow customers to introduce new content types as an integrated part of their SkillPort learning programs. The SkillPort add-on modules are Instructor-Led Training Module and Advanced Reporting Module.

**SkillPort Customer Content Support.** Customer content support allows customers to track, manage and search custom courses created by SkillSoft's authoring tools, as well as Microsoft Word, PowerPoint and Excel and Adobe PDF documents. This gives organizations the ability to incorporate important information resources such as white papers, launch plans, budget templates and customized training within a comprehensive learning database. SkillPort also supports off-the-shelf and custom courseware from third-party providers, as long as the content is designed to conform to our supported open standards and meets SkillSoft's custom content support guidelines.

**SkillSoft Dialogue.** SkillSoft Dialogue has been developed in response to our customers' need to rapidly assemble and deliver new content that ties to the organization and its goals. Many customers have added a virtual meeting component to their learning programs to deliver company-specific information. They have discovered that online meeting tools can be used to quickly create new materials and are using these tools to deliver information live, as well as recording their presentations for employees to play back on-demand. However, they have also encountered some common challenges. Most online meeting tools do little to support subject matter experts (SMEs) who may not be experienced in how to deliver sessions that are rich in interaction, which can result in a lower level of engagement and knowledge transfer. Additionally, editing these recordings is often cumbersome or impossible. SkillSoft Dialogue builds upon the foundation of this online meeting technology and adapts it to better fit the needs and challenges of the learning community. SkillSoft Dialogue will aid SMEs in creating more interactive presentations, and provide access to SkillSoft content to enrich presentations.

**Assistive Technology Support.** Assistive technology support is designed to address the requirements of Section 508 of the Rehabilitation Act Amendments of 1998, which provides that, as of June, 2001, computer software applications purchased or developed by federal agencies must be designed for accessibility by people who are blind, deaf or have poor motor skills. We have aggressively worked to adapt our online courseware, Books24x7 Referenceware and our SkillPort LMS platform to meet the requirements established by Section 508. This development work is consistent with our general corporate philosophy to help organizations democratize training and give all employees access to training and development opportunities anywhere, anytime through computers. Our Section 508-compliant products provide users in a government or commercial organization with sight, hearing and/or mobility limitations equal access to our courses through the use of leading assistive technologies such as the JAWS screen reader.

**High Performance Web Technology.** Our products incorporate high performing Web technologies that we believe substantially improve our product performance. Our courses and support tools are developed using cross-platform technologies such as HTML, XML, Java, JavaScript, Macromedia Flash and ColdFusion. Our products employ advanced compression and database management techniques, which allow our products to deliver high-quality performance within our customers' bandwidth constraints. This enables us to provide our e-learning solutions to most users, not just those with the most powerful computers, quickest modems and highest resolution monitors.

**Flexible Deployment Options.** We also offer a fully hosted model as a deployment option for companies that prefer to have users access courses from SkillSoft-managed servers via the Internet rather than host the courses on the customer's own intranet. Chosen by the majority of SkillSoft customers, this fully hosted option can significantly simplify and shorten the implementation process.

### ***Product Pricing***

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 and the length of the license agreement (generally one, two or three years). Our license agreements permit customers to exchange course titles, generally on the contract

anniversary date. Some product features, such as SkillPort, the Course Customization Toolkit, Dialogue and courseware hosting, are separately licensed for an additional fee.

The pricing for our SkillChoice Solution license 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. Our SkillChoice Solution license provides customers access to a full range of learning products including courseware, Referenceware, simulations, mentoring, testpreps and Express Guides.

A Referenceware license gives users access to the full library within one or more collections (ITPro, BusinessPro, FinancePro and OfficeEssentials) from Books24x7. The pricing for our 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.

### **Sales and Marketing**

In the fiscal year ended January 31, 2006, our products were sold in 58 countries. Our primary sales channels consist of a direct field sales force for larger accounts, a telesales group for small to medium-sized business accounts and resellers that address certain opportunities in the United States and some international markets.

We believe this strategy enables us to focus our resources on the largest sales opportunities, while simultaneously leveraging the telesales model and reseller channels to address opportunities that may not be cost-effective for us to pursue through the direct field sales organization.

As of January 31, 2006, we employed 282 sales professionals and sales operations, telesales, sales management and solution services personnel. In the field sales organization, each account executive reports to either a regional sales director or an area sales vice president who is responsible for revenue growth and expense control for his or her area. Our sales professionals have significant sales experience, as well as extensive contacts with the corporate customers that we target. The sales process for an initial sale to a large customer typically ranges from three to twelve months and often involves a coordinated effort among a number of groups within our organization.

We use sophisticated sales force automation software to track each prospect and customer through a sales cycle covering the following seven stages: prospect, qualify, discovery, evaluation, proposal, negotiate and close. Each step of the sales cycle has certain exit criteria that must be satisfied before the prospect can progress to the next stage. Our senior sales executives hold review meetings throughout each quarter with our regional sales vice presidents and in some cases their account executives to assess their 90-day forecast, 120-day pipeline development and longer term territory strategy. Our area sales vice presidents, regional sales directors and their account executives typically confer regularly throughout the quarter to review progress toward quarterly goals and longer term business objectives and for coaching sessions.

We have an office in the United Kingdom that serves as the hub of our Europe and Middle East sales operations. We also have an office in Sydney, Australia that serves as the hub for our Asia-Pacific operations. In order to accelerate our worldwide market penetration, our sales strategy includes developing relationships to access indirect sales channels such as reseller and distributor partners. Our indirect sales channels give us access to a more diverse client base, which we otherwise would not be able to reach in a cost-effective manner through our direct sales force. Our development and marketing partners also generally have the right to resell products developed under their alliances with us.

We have a telesales group located in Fredericton, New Brunswick, Canada that has been established to target opportunities with small to medium-sized businesses.

Our marketing organization utilizes a variety of programs to support our global sales team. As of January 31, 2006, our marketing organization consisted of 37 employees. Our marketing programs include:

customer advisory forums and user group events;

product and strategy updates with industry analysts;

public relations activities resulting in articles in trade press and speaking engagements;

print advertising in trade publications;

printed promotional materials and direct mail;

online marketing in the form of web banners, content syndication, email sponsorships, newsletters and key-word buying on search engines; and

events, seminars and trade shows.

No customer accounted for more than 10% of our revenue for the fiscal year ended January 31, 2006. See Note 11 of the Notes to the Consolidated Financial Statements for a discussion of our revenue by geographic area and by segment.

### **Customer Service and Support**

We offer a broad range of support and services to our customers across the e-learning lifecycle through our customer service, application engineering and customer support organization. We believe that providing a high level of customer service and support is necessary to achieve rapid product implementation, full product utilization, customer satisfaction and continued revenue growth.

*Application engineering.* We have application engineers available to assist customers with the technical aspects of installing and deploying our products. These engineers assist in evaluating the network access and bandwidth requirements of the software and courses within the customer's environment to ensure that they run successfully and provide the desired level of performance.

*Account consulting.* We employ account consultants to assist customers in planning and implementing best practices for e-learning program success. These individuals assist with the implementation of pilot programs and offer expertise in establishing training success criteria, planning internal marketing programs and communicating with e-learning end users. Our account consultants work in close coordination with our application engineers and sales representatives and are an important component of our efforts to monitor and ensure customer satisfaction and success.

*Customer support.* We also provide Web-based, live telephone, e-mail and chat support to our customers through our customer service and support organization. They are available to assist customers 7 days per week, 24 hours per day, 365 days per year.

As of January 31, 2006, our customer service and support organization consisted of 183 people globally.

### **Competition**

The market for corporate education and training products is fragmented and highly competitive. We expect that competition in this market will remain intense in the future for the following reasons:

The expected growth of this market.

Our course content providers are often not prohibited from developing courses on similar topics for other companies, provided that they do not use our toolkit or templates.

The tremendously fragmented nature of the competitive landscape, including many competitors in the e-learning segment of the market.

One source of competition for our products is the internal educational and technological personnel of our potential customers. If an organization decides to use external providers to supply some or all of its training, our principal sources of competition in the corporate education and training market are:

Providers of traditional classroom instruction, including American Management Association, AchieveGlobal, ESI, DDI, New Horizons and GlobalKnowledge. Many of the companies in this category are attempting to adapt their courses to e-learning formats suitable for access via Web



browsers or offer e-Learning courses in conjunction with their instructor-led training and, in general, compete for the same training dollars in the customer's budget.

Technology companies such as IBM, Cisco, Oracle and Microsoft that offer e-learning courses.

Suppliers of online corporate education and training courses, including Thomson Learning (through subsidiaries such as NETg and Course Technologies), Element K, MindLeaders, Harvard Business School Publishing, Ninth House and Corpedia. Our Books24x7 business competes with companies such as Safari, a joint venture between Pearson Technology Group and O'Reilly & Associates, which offers aggregated content primarily restricted to its own titles on a subscription basis.

With our entrance into the virtual classroom market, we are competing with companies such as WebEx, Centra, Interwise and Microsoft; and with rapid content development technology suppliers such as Macromedia Breeze, Articulate and Microsoft PowerPoint.

With our SkillPort LMS platform technology, we compete with other suppliers of LMS products such as SumTotal, Saba, Plateau, GeoLearning, Oracle, SAP, IBM and others.

We believe that the principal competitive factors in the corporate education and training market include: the breadth, depth, currency and instructional design quality of the course content;

informal performance support and other features of the training solution;

adaptability, flexibility, reliability, scalability and performance of technology platforms offered;

standards compliance and ease-of-integration with third party systems and customer learning portals;

the deployment options offered to customers, such as hosted, intranet and low bandwidth access;

customer service and support;

price/value relationship;

relationships with the customer; and

corporate reputation.

Although we believe that we currently compete favorably with respect to those factors, we may not be able to maintain or improve our competitive position. Some of our current and potential competitors have greater financial resources than we do. Increased competition may result in lost sales and may force us to lower prices, which may adversely affect our business and financial performance.

### **Product Development**

We believe that the development of effective training content requires the convergence of source material, instructional design methodologies and computer technology. When developing a new learning path or product, we first obtain content from our content partners or other subject matter experts, existing courses and product reference materials. Our design and development teams then define the user-focused performance objectives and select the content, instructional strategies, learning activities and assessments appropriate for the intended learning outcomes. This process includes the creation of design documents, scripts, and in some cases storyboards to document the planned content sequence, instructional flow and interactive presentation and practice strategies. The design and development team includes subject matter experts, learning designers, technical writers and developers, graphic designers, animators, and content editors and quality assurance reviewers. After final assembly or integration of all

course components into a completed course, we test to ensure all functional capabilities work as designed and deliver the desired learning experience and result.

The core element of our learning solution development process is our design and development process and the tools we use to support that process. Our design, development and production tools are comprised of our own proprietary software and off-the-shelf tools. Our combination of development toolsets allows us to quickly and efficiently create and continually update modular learning events and enhance, on an ongoing basis, the

multimedia content of such learning events. Our research and development goal is to further enhance our product development process and tools to facilitate the continual evolution of our offerings and ensure that our instructional products incorporate a wide variety of meaningful and effective instructional elements. We use internal developers as well as external content development partners to produce content for our business and IT skills curriculums. Our current network of external content development partners use the same methods, processes, and tools to develop content as our internal developers, and are held to the same set of instructional design and content quality standards. Course content is supplied by us, by other companies from which we have licensed content, or by the developer, based on an outline jointly defined by the developer and us.

Our research and development efforts also include a focus on the design, development and integration of other key product elements, including online IT mentoring by certified content experts 24 hours a day, 7 days a week, task-based IT simulations and labs, business skills focused SkillSimulations, Certification TestPrep for IT, and online Referenceware for business and IT skills.

Our approach to technology begins with the understanding that the ability of our customers to deploy our e-learning applications and content is a critical factor in their success with our products. To meet our customers' varied needs, we strive to enable our courses to be able to be delivered on-line, using standard Web browsers downloaded for off-line usage, or distributed via CD-ROM.

Through careful technology selection, product design, and exhaustive compatibility testing, we ensure our products can be deployed on the vast majority of corporate desktop computers and without requiring the installation of specialized plug-ins whenever possible, and can be delivered over the varied and complex network infrastructures in existence today. As technologies and standards evolve, we continuously review those changes and consider adapting our products when possible to ensure compatibility.

We employ compression technologies for our media components and design our products to operate effectively over low bandwidth network environments. In this way, we reach a broader number of users with our products and minimize the load on our customers' networks.

Deployment flexibility is also achieved by adhering to industry standards such as AICC and SCORM. Our e-learning course content is designed for integration with third party learning management systems as well as with our e-learning platform products.

The majority of the content for our Referenceware is licensed from third party publishers.

Certain research and development activities are conducted by internal teams located in our main product development centers in Dublin, Ireland; Nashua, New Hampshire; Belfast, Northern Ireland; and Fredericton, New Brunswick, Canada. In addition to our internal efforts, we outsource various aspects of our content development process to third parties.

As of January 31, 2006, the number of employees in our product development organization totaled 326. We intend to continue to make substantial investments in research and development. Product development expenses were \$53.6 million, \$45.6 million and \$39.0 million for the fiscal years ended January 31, 2004, 2005 and 2006, respectively.

### **Proprietary Rights**

We believe that proprietary technology forms an important or valuable part of most of our business skills and IT skills courseware offerings. We further believe that the creative skills of our personnel in developing new products and technologies, our ability to develop and introduce new products rapidly and our responsiveness to customer demands are equally important. We protect our technology by various means, including entering into agreements with employees to protect against disclosure of sensitive business information. We have three United States patents and 23 foreign patents with respect to computer-based training technologies and methods and 10 United States and foreign patent applications pending with respect to computer-based training technologies and methods. We also have two Nationalized International [PCT] Cases. Finally, we currently have one patent application pending with respect to our Books24x7 product offerings.



We attempt to avoid infringing upon intellectual property and proprietary rights of third parties in our product development efforts. However, we do not conduct comprehensive patent searches to determine whether the technology used in our products infringes patents held by third parties. In addition, product development is inherently uncertain in a rapidly evolving technological environment in which there may be numerous patent applications pending, some of which are confidential when filed, with regard to similar technologies. If our products violate third-party proprietary rights, we could be liable for substantial damages. In addition, we may be required to reengineer our products or seek to obtain licenses to continue offering the products, and those efforts may not be successful.

We currently license certain technologies from third parties including data compression technologies and tools for developing Web applications and some course content that we incorporate into our products. We also license content for our Referenceware from third party publishers. This technology and content may not continue to be available to us on commercially reasonable terms. The loss of this technology or content could result in delays in development and introduction of new products or product enhancements, which could have a material adverse effect on our business and financial performance. Moreover, we may face claims from others that the third-party technology or content incorporated in our products violates proprietary rights held by those claimants. We may also face claims for indemnification from our customers resulting from infringement claims against them based on the incorporation of third-party technology or content in our products. Although we are generally indemnified against such claims, in some cases the scope of that indemnification is limited. Even if we receive broad indemnification, third parties contractually obligated to indemnify us are not always well capitalized and may not be able to indemnify us in the event of infringement. In addition, such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources in addition to potential product redevelopment costs and delays, all of which could materially adversely affect our business.

SkillSoft, Books24x7, SkillPort, SkillChoice, RolePlay, Express Guide, Search-and-Learn and Referenceware are registered trademarks and/or service marks of SkillSoft.

### **Employees**

As of January 31, 2006, we employed 979 people globally.

At January 31, 2006, 319 employees were engaged in sales, sales operations, sales management, marketing, solution services, telesales and corporate development, 151 were in management, business applications, IT, administration and finance, 183 employees were in customer service, application engineering, solution services and customer support and 326 were in product development, custom solutions, mentoring and hosting.

As of January 31, 2006, 545 employees were located in the United States and 434 in our international locations. None of our employees are subject to a collective bargaining agreement and we have not experienced any work stoppages. We believe that our employee relations are good.

Our future success will depend in large part on the continued service of our key management, sales, product development and operational personnel and on our ability to attract, motivate and retain highly qualified employees. We also depend on writers, programmers and graphic artists. We expect to continue to hire additional product development, sales and marketing, information services, accounting staff and other resources as we deem appropriate to meet our business objectives.

### **Item 1A. Risk Factors**

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

## **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 SUBJECT 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**

**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, \$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, 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

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 e-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 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 in 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.**

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 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. In particular, the negative consequences (including litigation) of having to restate SmartForce's historical financial statements, uncertainties surrounding the Merger, and our recent adverse operating results and stock price performance could create uncertainties that materially and adversely affect our ability to attract and retain 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 STOCK 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 stock options granted to employees as an expense commencing in our first quarter of fiscal 2007. This change will require companies to record a compensation expense equal to the value of each stock option granted. This expense will be spread over the vesting period of the stock option. Due to the fact that we will be required to expense stock option grants, it could reduce the attractiveness of granting stock options because the additional expense associated with these grants would reduce our profitability. However, stock 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 stock option program. Accordingly, either our profitability, or our ability to use stock 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 multinational 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 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 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

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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 1B. *Unresolved Staff Comments***

Not applicable.

**Item 2. *Properties***

Our United States headquarters are located in Nashua, New Hampshire where we lease an aggregate of 62,816 square feet. We have one lease for 37,416 square feet of space and a second for 25,400 square feet of space. The leases for both locations expire in June 2009. In addition to our U.S. headquarters our primary facilities are located in Dublin, Ireland; Norwood, Massachusetts; and Fredericton, New Brunswick, Canada.

In Ireland, we currently lease and occupy a 35,421 square foot facility in Dublin, which primarily houses our main content development center. In addition, we currently lease two other facilities in Dublin totaling approximately 28,814 square feet. These spaces have been vacated and the operations previously performed in these facilities have been consolidated into the 35,421 square foot facility.

In Norwood, Massachusetts, we currently lease and occupy 10,658 square feet. This facility houses the operations of our Books24x7.com subsidiary under a lease that expires in December 2010.

In Canada, we currently lease a total of 47,906 square feet in Fredericton, New Brunswick between two buildings. A portion of one building is subleased. The Fredericton facility primarily houses our mentoring operations, telesales and certain customer service and support personnel and the lease expires in August 2008.

We also lease sales offices in a number of other countries including the United Kingdom and Australia, and we lease a development office in Belfast, Northern Ireland.

We believe that our existing facilities are adequate to meet our current needs and that suitable additional or substitute space will be available on commercially reasonable terms when needed.

**Item 3. *Legal Proceedings***

**SEC Investigation**

On or about February 4, 2003, the SEC informed us that we are the subject of a formal order of private investigation relating to our November 19, 2002 announcement that we would restate the financial statements of SmartForce PLC for the period 1999 through June 2002. We understand 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 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. If we cannot 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.

**Lawsuits**

On November 18, 2004, Jody Glidden, Michael LeBlanc and Trish Glidden filed a lawsuit against us, David C. Drummond, Gregory M. Priest, Patrick E. Murphy and Jack Hayes in the United States District Court for the Northern District of California. The plaintiffs subsequently dismissed Patrick E. Murphy and Jack Hayes from the lawsuit. The court subsequently dismissed Trish Glidden's claims. The plaintiffs had previously opted out of the class action settlement that received final approval from the court on September 29, 2004. The lawsuit sets forth substantially the same claims as were alleged in the class action litigation. In particular, the lawsuit alleges that we misrepresented or omitted to state material facts in our SEC filings and press releases regarding our revenues and earnings and failed to correct such false and misleading SEC filings and press releases, which are alleged to have artificially inflated the price of our ADSs in connection with our acquisition of IC Global in early 2001. The lawsuit sought compensatory damages in excess of \$3.7 million and other unspecified damages, including punitive damages. The parties settled the lawsuit on April 7, 2006. Pursuant to the settlement, we will pay approximately \$1.8 million to the plaintiffs by April 17, 2006, which has been recorded as legal settlement in our statement of operations for the year ended January 31, 2006. Within five days of receipt of payment, counsel for the plaintiffs will submit to the Court a Stipulation and Request for Dismissal with Prejudice of the action.

We are not a party to any other material legal proceedings.

**Item 4. *Submission of Matters to a Vote of Security Holders***

Not applicable.

## PART II

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our ADSs are listed on the NASDAQ National Market under the symbol SKIL. The following table sets forth, for the periods indicated, the high and low intraday sale prices per share of our ADSs as reported on the NASDAQ National Market between February 1, 2004 and January 31, 2006.

| Quarter Ended    | High     | Low     |
|------------------|----------|---------|
| April 30, 2004   | \$ 13.31 | \$ 8.50 |
| July 31, 2004    | 13.59    | 5.98    |
| October 31, 2004 | 7.45     | 5.28    |
| January 31, 2005 | 7.77     | 4.68    |
| April 30, 2005   | 5.33     | 2.95    |
| July 31, 2005    | 4.10     | 3.30    |
| October 31, 2005 | 4.93     | 3.77    |
| January 31, 2006 | 5.97     | 3.87    |

As of March 31, 2006, there were 11 holders of ordinary shares of record.

We have not paid any cash dividends on our ordinary shares and do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain future earnings, if any, to fund the growth of our business. Dividends may only be declared and paid out of profits available for distribution determined in accordance with accounting principles generally accepted in Ireland and applicable Irish Company Law. There are no additional material restrictions on the distribution of income or retained earnings by our consolidated group companies. Any dividends, if and when declared, will be declared and paid in United States dollars. We did not sell unregistered securities during fiscal 2006.

The following table provides information about purchases by the Company and our affiliated purchasers during the quarter ended January 31, 2006 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

**Issuer Purchases of Equity Securities**

| Period | (a)<br>Total<br>Number<br>of<br>Shares<br>(or Units)<br>Purchased(1) | (b)<br>Average<br>Price Paid<br>per Share<br>(or<br>Unit)(\$) | (c)<br>Total<br>Number<br>of<br>Shares<br>(or Units)<br>Purchased<br>as<br>Part of<br>Publicly<br>Announced<br>Plans | (d)<br>Maximum<br>Number<br>(or Approximate<br>Dollar Value) of<br>Shares (or Units)<br>that may yet be<br>Purchased Under<br>the Plans or<br>Programs |
|--------|--|---|--|--|
|--------|--|---|--|--|

**or**  
**Programs(2)**

|                   |         |
|-------------------|---------|
| 11/01/05-11/30/05 | 466,116 |
| 12/01/05-12/31/05 | 466,116 |
| 01/01/06-01/31/06 | 466,116 |
| Total:            | 466,116 |

- (1) We have repurchased an aggregate of 6,533,884 ADSs pursuant to the repurchase program that was approved by our shareholders on September 24, 2004 (the Program ).
- (2) Our Board of Directors and shareholders approved the repurchase by us of up to an aggregate of 7,000,000 ADSs at a per share purchase price which complies with the requirements of Rule 10b-18 pursuant to the Program. The Program expired on March 24, 2006 and our shareholders approved the renewal and extension of the Program on March 23, 2006 to repurchase up to an aggregate of 3,500,000 ADSs. Unless terminated earlier by resolution of our Board of Directors, the Program will expire on the

earlier of September 22, 2007 or when we have repurchased all shares authorized for repurchase thereunder.

### **Irish Stamp Duty**

Stamp duty, which is a tax on certain documents, is payable on all transfers of ordinary shares in companies registered in Ireland wherever the instrument of transfer may be executed. In the case of a transfer on sale, stamp duty will be charged at the rate of 1 for every 100 (or part thereof) of the amount or value of the purchase price. Where the consideration for the sale is expressed in a currency other than Euro, the duty will be charged on the Euro equivalent calculated at the rate of exchange prevailing on the date of the transfer. In the case of a transfer by way of gift, subject to certain exceptions, or for considerations less than the market value of the shares transferred, stamp duty will be charged at the above rate on such market value.

A transfer or issue of ordinary shares for deposit under the deposit agreements among us, The Bank of New York, as Depositary, and the registered holders and the owners of a beneficial interest in book-entry American Depositary Receipts, or ADRs, in return for ADRs will be similarly chargeable with stamp duty as will a transfer of ordinary shares from the Depositary or the custodian under the deposit agreements upon surrender of an ADR for the purpose of the withdrawal of the underlying ordinary shares in accordance with the terms of the Deposit Agreement.

We received a ruling from the Irish Revenue Commissioners that transfers of ADRs issued in respect of our shares will not be chargeable with Irish stamp duty for so long as the ADRs are dealt in and quoted on the NASDAQ National Market. It has been confirmed in Section 207, Finance Act 1992 that transfers of ADRs will be exempt from stamp duty where the ADRs are dealt with in a recognized stock exchange. The NASDAQ National Market is regarded by the Irish authorities as a recognized stock exchange for these purposes.

The person accountable for payment of stamp duty is the transferee or, in the case of a transfer by way of gift or for a consideration less than the market value, both parties to the transfer. Stamp duty is normally payable within 30 days after the date of execution of the transfer. Late payment of stamp duty will result in liability to interest, penalties and fines.

### **Item 6. Selected Financial Data**

Incorporated by reference from *Appendix A* attached hereto.

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Any statement in this Annual Report on Form 10-K 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 in Item 1A, Risk Factors.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and notes appearing in Appendix B of this Annual Report on Form 10-K.

#### **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 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. Please refer to Critical Accounting Policies - Revenue Recognition below for a product licensing and discounting discussion.

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, 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 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 \$0.5 million was amortized in fiscal 2006. Selling and marketing expenses consist primarily of salaries and benefits, commissions, advertising and promotion expenses, travel expenses and certain infrastructure and occupancy expenses. General and administrative expenses consist primarily of salaries and benefits, consulting and service expenses, legal expenses, audit and tax preparation costs, regulatory compliance costs and certain infrastructure and occupancy expenses.

Legal settlements/ (insurance recoveries) includes amounts incurred in connection with the settlement of various legal matters, such as the 2002 securities class action lawsuit, the NETg infringement lawsuit and other matters. Any insurance recoveries related to these legal settlements are recorded and, if appropriate, netted in legal settlements/ (insurance recoveries). Legal fees incurred in connection with the settlement of lawsuits are recorded as legal expenses within general and administrative expenses in our statement of operations, as incurred.

Deferred compensation consists of the value of unvested options assumed in the Books acquisition and the Merger and is amortized over the vesting period of the underlying share option or shares.

Amortization of intangibles represents the amortization of intangible assets, such as customer value and content, from the Books acquisition, the GoTrain acquisition and the Merger, as well as 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.

SEC investigation and other professional fees primarily consist of direct, incremental charges associated with, and as a result of, the restatement of SmartForce's financial statements for 1999, 2000, 2001 and the first two quarters of 2002, the re-filing of statutory tax returns as a result of the restatement and charges related to the ongoing SEC investigation.

### **Business Outlook**

In the fiscal year ended January 31, 2006, we generated revenue of \$215.6 million, an increase of \$3.3 million compared to the revenue in the fiscal year ended January 31, 2005 of \$212.3 million, and we reported net income. While we continue to find ourselves in a challenging business environment due to the overall market adoption rate for e-learning solutions remaining relatively slow, budgetary constraints on IT spending by our current and potential customers and price competition in the e-learning market, 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 informal learning, such as our Books24x7 Referenceware product line. As a result, we have increased our sales and marketing investment in those areas to help capitalize on the recent growth and potential continued growth for informal learning. 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 addition, during 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 have 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 of approximately \$6.4 million in fiscal 2006, 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 multi-modal learning (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 have maintained a reseller arrangement with the acquiring organization, and we also have maintained the existing customer contracts and will service those contracts until the contractual obligation is 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 IT retail certification business have been eliminated.

In fiscal 2007, we plan to focus on revenue and earnings growth primarily through new customer acquisitions, continuing to execute on our new product and telesales distribution initiatives to provide new revenue streams, and a higher priority approach to produce a long-term contribution from possible merger and acquisition opportunities.

#### **Critical Accounting Policies**

Our significant accounting policies are more fully described in Note 2 of the Notes to the Consolidated Financial Statements. However, we believe the accounting policies described below 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.

#### ***Revenue Recognition***

We generate revenue from the license of products and services and from providing hosting/ASP services.

We follow 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 our products and 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). 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 our product 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. Our product

licenses provide customers access to a full range of learning products including courseware, Referenceware, simulations, mentoring and prescriptive assessment.

A Referenceware license gives users access to a full Referenceware library within one or more Referenceware collections (examples of which include: ITPro, BusinessPro, FinancePro, EngineeringPro, GovEssentials and OfficeEssentials) from Books. The pricing for our 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.

We offer discounts from our ordinary pricing, and purchasers of licenses for larger numbers of courses, for larger user bases or for longer periods 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. We also derive revenue from hosting fees for clients that use our solutions on an ASP basis, online mentoring services and professional services. In selected circumstances, we derive 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.

We recognize 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 we do 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 our contractual arrangements result in the recognition of revenue ratably over the license period.

We also derive revenue from extranet hosting/ ASP services and online mentoring services. We recognize revenue related to extranet hosting/ ASP services and online mentoring services on a straight-line basis over the period the services are provided.

We generally bill 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, we bill customers on a quarterly basis. In some circumstances, we offer payment terms of up to six months from the initial shipment date or anniversary date for multi-year license agreements to our customers. To the extent that a customer is given extended payment terms (defined by us as greater than six months), revenue begins to be recognized as cash becomes due, assuming all of the other elements of revenue recognition have been satisfied.

We typically recognize 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, we recognize revenue related to the portion of the minimum commitment that exceeds the end user sales at the expiration of the commitment period provided we have 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.

We also provide professional services including instructor led training, customized content, websites, and implementation services. We recognize professional services revenue as the services are performed.

We record reimbursable out-of-pocket expenses in both maintenance and services revenues and as a direct cost of maintenances and services in accordance with EITF Issue No. 01-14, *Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred* ( EITF 01-14 ). EITF 01-14 requires reimbursable out-of-pocket expenses incurred to be characterized as revenue in the income statement.

We record 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 we have 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.

Our contracts often include an uptime guarantee for solutions hosted on our server whereby customers would be entitled to credits in the event of nonperformance. We also retain the right to remedy any nonperformance event prior to issuing a credit. Historically, we have not incurred substantial costs relating to this guarantee and we currently accrue for such costs as they are incurred. We review these costs on a regular basis as actual experience and other information becomes available; and should they become more substantial, we would accrue an estimated exposure and consider the potential related effects of the timing of recording revenue on our license arrangements. We have not accrued any costs related to these warranties in the accompanying consolidated financial statements.

#### ***Amortization of Intangible Assets and Impairment of Goodwill***

*We record intangible assets as historical cost.* We amortize our intangible assets, which include customer contracts and internally developed software. We review these intangible assets at least annually to determine if any adverse conditions exist or a change in circumstances has occurred that would indicate impairment or a change in their remaining useful life. We also review our indefinite-lived intangible assets at least annually for impairment which includes trademarks and trade names.

We test goodwill during the fourth quarter of each year for impairment, or more frequently if certain indicators are present or changes in circumstances suggest that impairment may exist. In performing the test, we calculate the fair value of the reporting units as the present value of estimated future cash flows using a risk-adjusted discount rate. The selection and use of an appropriate discount rate requires significant management judgment with respect to revenue and expense growth rates.

#### ***Share Based Compensation***

We account for our share-based employee compensation plans on the intrinsic value method under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25) and related Interpretations under APB No. 25. We provide pro forma disclosures only of the compensation expense determined under the fair value provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123).

See Recent Accounting Pronouncements for a description of FASB Statement No. 123 (revised 2004), Share-Based Payment.

#### ***Deferral of Commissions***

We employ an accounting policy consistent with guidance provided by FASB Technical Bulletin 90-1 *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts* and SEC Staff Accounting Bulletin 104 *Revenue Recognition*, related to the concept of a direct and incremental relationship between revenue and expense. As such, we defer the recognition of commission expense until such time as the revenue related to the contract for which the commission was paid is recognized.

#### ***Restructuring Charges***

We account for our restructuring activities under guidance provided by SFAS No. 141 (SFAS 141), *Business Combinations* EITF 95-3 and SFAS No. 146 (SFAS 146), *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS 141 states that after the end of the allocation period (generally one year from date of merger) an adjustment that results from a pre-acquisition contingency other than an income tax loss carryforward should be included in the determination of net income/(loss) in the period in which the adjustment is determined. As such, adjustments to pre-acquisition contingencies established at the time of the SmartForce SkillSoft merger are recorded as restructuring charges in our statement of operations. SFAS 146 states that a liability related to an exit or disposal activity should be recognized at fair value in the

period in which it is incurred. As such, when we identify restructuring charges that fulfill the requirements identified in SFAS 146 as incurred, we record the charges in our statement of income.

The most significant element for each of our restructuring charges incurred relates to lease abandonments. In determining the fair value of liabilities associated with lease abandonments, we assess our contractual ability to sub-lease the spaces currently under lease and obtain local independent professional assessments of current commercial real estate market conditions in those areas so that we can reasonably determine estimable sub-lease income benefits.

Furthermore, judgment is used in determining how to estimate long-term restructuring costs. Generally the Company uses a present value technique to estimate the fair value of a liability and discounts the expected cash flow associated with the restructuring activity using a credit-adjusted, risk free rate.

### ***Legal Contingencies***

In connection with any material legal proceedings that we may become involved in, management periodically reviews estimates of potential costs to be incurred by us in connection with the adjudication or settlement, if any, of these proceedings. These estimates are developed in consultation with our outside counsel and are based on an analysis of potential litigation outcomes and settlement strategies. In accordance with SFAS No. 5, *Accounting for Contingencies*, loss contingencies are accrued if, in the opinion of management, an adverse outcome is probable and such outcome can be reasonably estimated. In accordance with SFAS No. 5, gain contingencies are recorded at the time of realization. Legal costs are expensed as incurred.

### ***Income Taxes***

We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the period in which related temporary differences become deductible. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date of such change.

## Results of Operations

Fiscal Year Ended January 31,

|   | Dollar                           | Percent                                    | Percentage of Revenue |      |       |
|---|----------------------------------|--|-----------------------|------|-------|
|   | Increase/(Decrease)<br>2005/2006 | Change<br>Increase/(Decrease)<br>2005/2006 | 2006                  | 2005 | 2004  |
| (In thousands)                                  |                                  |  |                       |      |       |
| Revenue   | \$ 3,267                         | 2%   | 100%                  | 100% | 100%  |
| Cost of revenue                                 | 3,583                            | 16%  | 12%                   | 10%  | 10%   |
| Gross profit                                    | (316)                            |  | 88%                   | 90%  | 90%   |
| Research and development                        | (6,590)                          | (14)%                                      | 18%                   | 21%  | 28%   |
| Selling and marketing                           | (5,722)                          | (6)%                                       | 41%                   | 44%  | 45%   |
| General and administrative                      | 583                              | 2%   | 12%                   | 12%  | 14%   |
| Legal settlements/(insurance recoveries)        | (17,710)                         | *  | (8)%                  |      | 48%   |
| Amortization of share-based compensation        | (299)                            | (25)%                                      |                       | 1%   | 1%    |
| Amortization of intangible assets               | (462)                            | (5)%                                       | 4%                    | 5%   | 5%    |
| Impairment charge                               | (19,268)                         | *  |                       | 9%   |       |
| Restructuring                                   | (12,720)                         | (95)%                                      |                       | 6%   | 1%    |
| Restatement:                                    |                                  |  |                       |      |       |
| SEC investigation                               | (194)                            | (9)%                                       | 1%                    | 1%   | 1%    |
| Other professional fees                         | (320)                            | *  |                       |      | 7%    |
| Total operating expenses                        | (62,702)                         | (30)%                                      | 68%                   | 99%  | 151%  |
| Operating income/(loss)                         | 62,386                           | *  | 20%                   | (9)% | (61)% |
| Other income/(expense), net                     | 1,433                            | *  |                       |      |       |
| (Loss)/gain on sale assets, net                 | (586)                            | *  |                       |      | 2%    |
| Interest income                                 | 688                              | 63%  | 1%                    |      |       |
| Interest expense                                | (94)                             | 28%  |                       |      |       |
| Income/(loss) before provision for income taxes | 63,827                           | *  | 21%                   | (9)% | (58)% |
| Provision for income taxes                      | 8,499                            | 1,347%                                     | 4%                    |      |       |
| Net income/(loss)                               | \$ 55,328                        | *  | 16%                   | (9)% | (59)% |

\* Not meaningful  
Does not add due to rounding.



**Comparison of the Fiscal Years Ended January 31, 2006 and 2005****Revenue**

The increase in revenue during the fiscal year ended January 31, 2006 as compared to the fiscal year ended January 31, 2005 was primarily due to revenue generated from new business primarily derived from our product lines focused on informal learning, better than anticipated reseller revenues and a greater share of business having closed earlier in each of the respective quarterly periods for the fiscal year ended January 31, 2006.

|                 | <b>Fiscal Year Ended January 31,</b> |                   |                 |
|-----------------|--------------------------------------|-------------------|-----------------|
|                 | <b>2006</b>                          | <b>2005</b>       | <b>Change</b>   |
|                 | <b>(In thousands)</b>                |                   |                 |
| <b>Revenue:</b> |                                      |                   |                 |
| United States   | \$ 168,525                           | \$ 165,871        | \$ 2,654        |
| International   | 47,042                               | 46,429            | 613             |
| <b>Total</b>    | <b>\$ 215,567</b>                    | <b>\$ 212,300</b> | <b>\$ 3,267</b> |

Revenue increased by 2% and 1% in the United States and internationally, respectively, in the fiscal year ended January 31, 2006 as compared to the fiscal year ended January 31, 2005.

|                      | <b>Fiscal Year Ended January 31,</b> |                   |                 |
|----------------------|--------------------------------------|-------------------|-----------------|
|                      | <b>2006</b>                          | <b>2005</b>       | <b>Change</b>   |
|                      | <b>(In thousands)</b>                |                   |                 |
| <b>Revenue:</b>      |                                      |                   |                 |
| Multi-Modal Learning | \$ 201,236                           | \$ 192,135        | \$ 9,101        |
| Retail Certification | 14,331                               | 20,165            | (5,834)         |
| <b>Total</b>         | <b>\$ 215,567</b>                    | <b>\$ 212,300</b> | <b>\$ 3,267</b> |

In the first quarter of fiscal 2006, we sold certain assets related to SmartCertify, our Retail Certification business. The sale resulted in a reduction in revenue of \$5.8 million in our Retail Certification business for the fiscal year ended January 31, 2006 as compared to the fiscal year ended January 31, 2005. The increase in our MML revenue is primarily due to revenue generated from new business primarily derived from our product lines focused on informal learning and better than anticipated reseller revenues. We expect a reduction of approximately \$9.0 million in revenue in our Retail Certification business in fiscal 2007 when compared to fiscal 2006. We expect this decrease in revenue to be offset in fiscal 2007 by increased MML revenue generated from new business.

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 when compared to January 31, 2005 and SmartCertify will not contribute new or continuing 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 fiscal year ended January 31, 2006 versus the fiscal year ended January 31, 2005 was primarily due to a higher mix of royalty-bearing content due to the growth of our Books24x7 Referenceware product line.

The decrease in research and development expenses in the fiscal year ended January 31, 2006 versus the fiscal year ended January 31, 2005 was primarily due to the inclusion of \$3.8 million of purchased technology in fiscal 2005 and savings of \$6.4 million realized in fiscal 2006 as the result of the reorganization of our content development organization completed in the quarter ended January 31, 2005. This decrease was partially offset by the increased costs associated with outsourcing activity of \$4.0 million. We anticipate that research and development expenses will be between 18% and 19% of revenue in fiscal 2007.

The decrease in selling and marketing expenses in the fiscal year ended January 31, 2006 versus the fiscal year ended January 31, 2005 was primarily due to the expense reduction of \$10.5 million resulting from the sale of certain assets related to SmartCertify, our Retail Certification business, at the end of our fiscal 2006 first quarter. This was partially offset by incremental expenses incurred to support the new Dialogue product line of \$1.3 million, new telesales distribution operation focusing on small and mid-sized businesses of \$1.2 million and the additional investment in our Books sales force of \$1.7 million. We anticipate that selling and marketing expenses will be between 40% and 41% of revenue in fiscal 2007.

The increase in general and administrative expenses in the fiscal year ended January 31, 2006 versus the fiscal year ended January 31, 2005 was primarily due to an increase in compensation expense of \$1.7 million, which included a \$0.5 million payment to Howard Edelstein, a director of the Company, in recognition of Mr. Edelstein's contributions to the Company in connection with the settlements of our litigation with NETg and our the securities class action litigation, which was partially offset by the expense reduction of \$1.5 million resulting from the sale of certain assets of SmartCertify at the end of our fiscal 2006 first quarter. We anticipate that general and administrative expense will be between 12% and 13% of revenue in fiscal 2007.

Within legal settlements/(insurance recoveries), we received an insurance settlement of \$19.5 million in the fiscal year ended January 31, 2006, 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 settlement with our insurance carriers was partially offset by the settlement of a lawsuit with Jody Glidden, Trish Glidden and Michael LeBlanc, who had previously opted out of the 2002 securities class action settlement, for approximately \$1.8 million on April 7, 2006.

In the fourth quarter of fiscal 2005 we evaluated the fair value of goodwill. In November of 2004 we hired an investment banker to actively market the Retail Certification segment to third party buyers. However by January 31, 2005 the investment banker reported the efforts to sell the business were unsuccessful. In the first quarter of fiscal 2006, we sold certain assets and liabilities of the business in exchange for nominal consideration and the execution of a reseller agreement with the buyer. In fiscal 2005, we concluded that the Retail Certification segment had no goodwill and we recorded an impairment charge of approximately \$19.3 million in the fiscal year ended January 31, 2005. In the first quarter of fiscal 2006, we completed a restructuring of our Retail Certification business which resulted in a charge of approximately \$0.5 million.

In the fourth quarter of fiscal 2006 we evaluated the fair value of goodwill of the MML segment and concluded there was no impairment of goodwill.

The key assumptions utilized in the preparation of forecasted statements of operations for the MML segment, which reflect certain new initiatives, were as follows:

| <b>Multi-Modal Learning</b> |                                |
|-----------------------------|--------------------------------|
| Revenue                     | Compound annual growth of 7.0% |
| Gross profit                | 88.0%                          |
| Research and development    | 15.0%                          |
| Selling and marketing       | 35.0%                          |
| General and administrative  | 9.0%                           |
| Other income/(expense)      | \$2.4 million for all years    |
| Working capital             | 14.00% of gross revenue        |

On January 13, 2006, we accelerated the vesting of all currently outstanding unvested stock options awarded to employees. This vesting acceleration does not extend to any options held by executive officers and directors. As a result of this action, we expect to avoid recognition of approximately \$9.1 million of stock-based compensation expense in future periods beginning February 1, 2006, including approximately \$4.7 million of stock-based compensation expense in the fiscal year ending January 31, 2007. We recorded a charge of approximately \$89,000 in the fourth quarter of fiscal 2006 related to expected forfeitures due to the acceleration of vesting of in-the-money options.

The decrease in restructuring expenses in the fiscal year ended January 31, 2006 versus the fiscal year ended January 31, 2005 was primarily due to the restructuring of our content development organization in the fourth quarter of fiscal 2005 and the closing of our German facility. We did not incur any significant additional charges in fiscal 2006 as a result of this restructuring. We do not anticipate any significant additional charges in fiscal 2007 as a result of these restructurings.

SEC investigation charges decreased in the fiscal year ended January 31, 2006 versus the fiscal year ended January 31, 2005 due to a decrease in activity related to the ongoing SEC investigation in which costs are expensed as incurred.

Other professional fees in the fiscal year ended January 31, 2005 consisted primarily of the re-filing of certain international tax returns and statutory financial statements as a result of the restatement. We incurred no such charges in the fiscal year ended January 31, 2006.

*Other (Expense)/Income, net*

The change in other (expense)/income, net in the fiscal year ended January 31, 2006 versus the fiscal year ended January 31, 2005 was primarily due to foreign currency fluctuations. Due to our multinational operations, our business is subject to fluctuations based upon changes in the exchange rates between the currencies used in our business.

*Gain/(Loss) on Sale of Assets, net*

We recorded a loss of \$586,000 in the fiscal year ended January 31, 2006. This loss is primarily the result of investment banking and professional fees associated with the sale of certain assets of the Retail Certification business in the first quarter of fiscal 2006.

*Interest Income*

The increase in interest income in the fiscal year ended January 31, 2006 versus the fiscal year ended January 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*

The increase in the provision for income taxes in the fiscal year ended January 31, 2006 versus the fiscal year ended January 31, 2005 was primarily due to of the generation of higher taxable income in fiscal 2006 versus fiscal 2005. Our effective tax rate of 20.6% is significantly less than the combined federal and state tax rates primarily due to the fact that the \$19.5 million insurance recovery related to the settlement of the 2002 securities class action lawsuit recorded in fiscal 2006 was not taxable and to a lesser extent due to the utilization of net operating loss carryforwards and income being earned in lower or no tax jurisdictions.

*Comparison of the Fiscal Years Ended January 31, 2005 and 2004*

|  | <b>Fiscal Year Ended January 31,</b> |                            |                      |              |  |
|--|--------------------------------------|----------------------------|----------------------|--------------|--|
|  | <b>Dollar</b>                        | <b>Percent Change</b>      | <b>Percentage of</b> |              |  |
|  | <b>Increase/(Decrease)</b>           | <b>Increase/(Decrease)</b> | <b>Revenue</b>       |              |  |
|  | <b>2004/2005</b>                     | <b>2004/2005</b>           | <b>2005</b>          | <b>2004</b>  |  |
| <b>(In thousands)</b>                                  |                                      |                            |                      |              |  |
| Revenue  | \$ 18,825                            | 10%                        | 100%                 | 100%         |  |
| Cost of revenue  | 3,327                                | 18%                        | 10%                  | 10%          |  |
| <b>Gross profit</b>                                    | <b>15,498</b>                        | <b>9%</b>                  | <b>90%</b>           | <b>90%</b>   |  |
| Research and development                               | (8,052)                              | (15)%                      | 21%                  | 28%          |  |
| Selling and marketing                                  | 5,954                                | 7%                         | 44%                  | 45%          |  |
| General and administrative                             | (2,721)                              | (10)%                      | 12%                  | 14%          |  |
| Legal settlements                                      | (93,750)                             | (100)%                     |                      | 48%          |  |
| Amortization of share-based compensation               | (795)                                | (40)%                      | 1%                   | 1%           |  |
| Amortization of intangible assets                      | (497)                                | (5)%                       | 5%                   | 5%           |  |
| Impairment charge                                      | 19,268                               | 100%                       | 9%                   |              |  |
| Restructuring  | 11,504                               | 619%                       | 6%                   | 1%           |  |
| Restatement:   |                                      |                            |                      |              |  |
| SEC investigation                                      | 284                                  | 15%                        | 1%                   | 1%           |  |
| Other professional fees                                | (14,153)                             | (98)%                      |                      | 7%           |  |
| <b>Total operating expenses</b>                        | <b>(82,958)</b>                      | <b>(28)%</b>               | <b>99%</b>           | <b>151%</b>  |  |
| <b>Operating loss</b>                                  | <b>98,456</b>                        | <b>83%</b>                 | <b>(9)</b>           | <b>(61)%</b> |  |
| Other (expense)/income, net                            | (1,478)                              | (188)%                     |                      |              |  |
| Gain/(loss) on sale of assets, net                     | (3,682)                              | (100)%                     |                      | 2%           |  |
| Interest income  | 137                                  | 14%                        |                      |              |  |
| Interest expense                                       | (170)                                | 102%                       |                      |              |  |
| <b>Income/(loss) before provision for income taxes</b> | <b>93,263</b>                        | <b>83%</b>                 | <b>(9)</b>           | <b>(58)%</b> |  |
| Provision for income taxes                             | 102                                  | (19)%                      |                      |              |  |
| <b>Net income/(loss)</b>                               | <b>\$ 93,161</b>                     | <b>82%</b>                 | <b>(9)</b>           | <b>(59)%</b> |  |

*Revenue*

Revenue increased \$18.8 million, or 10%, to \$212.3 million in the fiscal year ended January 31, 2005 from \$193.5 million in the fiscal year ended January 31, 2004. This increase was primarily due to revenue generated from new business primarily derived from our product lines focused on informal learning and an increase in revenue from our Retail Certification segment due to sales to new customers as well as the full recognition of the segment's subscription based revenue recognition model. The segment defers revenue at the time of sale over 18 to 24 months. We exited the fiscal year ended January 31, 2005 with noncancellable backlog of

approximately \$168 million as compared to \$170 million at January 31, 2004. 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 over the next twelve months. The amount scheduled to amortize into revenue over the next twelve months is disclosed as backlog. Amounts to be added to deferred revenue throughout the next twelve months include subsequent billings for ongoing contract periods as well as billings for new or continuing contracts.

|                 | <b>Fiscal Year Ended January 31,</b> |                   |                  |
|-----------------|--------------------------------------|-------------------|------------------|
|                 | <b>2005</b>                          | <b>2004</b>       | <b>Change</b>    |
| <b>Revenue:</b> |                                      |                   |                  |
| United States   | \$ 165,871                           | \$ 156,121        | \$ 9,750         |
| International   | 46,429                               | 37,354            | 9,075            |
| <b>Total</b>    | <b>\$ 212,300</b>                    | <b>\$ 193,475</b> | <b>\$ 18,825</b> |

Revenue increased by 6% and 24% in the United States and internationally, respectively, in the fiscal year ended January 31, 2005 as compared to the fiscal year ended January 31, 2004. The international revenue increase was due, in addition to the factors discussed above, to increased reseller revenue due to the timing of receipt of sell-through reporting and cash from resellers. The United States represented 78% and 81% of revenue for the fiscal year ended January 31, 2005 and 2004, respectively.

|                      | <b>Fiscal Year Ended January 31,</b> |                   |                  |
|----------------------|--------------------------------------|-------------------|------------------|
|                      | <b>2005</b>                          | <b>2004</b>       | <b>Change</b>    |
| <b>Revenue:</b>      |                                      |                   |                  |
| Multi-Modal Learning | \$ 192,135                           | \$ 180,098        | \$ 12,037        |
| Retail Certification | 20,165                               | 13,377            | 6,788            |
| <b>Total</b>         | <b>\$ 212,300</b>                    | <b>\$ 193,475</b> | <b>\$ 18,825</b> |

Revenue increased by 7% and 51% in the MML and Retail Certification segments, respectively, in the fiscal year ended January 31, 2005 as compared to the fiscal year ended January 31, 2004. The revenue increase for MML was primarily due to revenue generated from new business primarily derived from our product lines focused on informal learning. The revenue increase for Retail Certification was primarily due to sales to new customers as well as the full recognition of the segment's subscription based revenue recognition model. The segment defers revenue at the time of sale over 18 to 24 months. The MML segment represented 91% and 93% of revenues for the fiscal years ended January 31, 2005 and 2004, respectively.

#### *Costs and Expenses*

Cost of revenue increased \$3.3 million, or 18%, to \$21.7 million in the fiscal year ended January 31, 2005 from \$18.4 million in the fiscal year ended January 31, 2004. This increase was primarily due to higher sales volumes as well as increased use of contract services and infrastructure charges incurred in connection with our efforts to consolidate hosting sites. Cost of revenue as a percentage of total revenue was 10% in both the fiscal year ended January 31, 2005 and the fiscal year ended January 31, 2004.

Research and development expenses decreased \$8.0 million, or 15%, to \$45.6 million in the fiscal year ended January 31, 2005 from \$53.6 million in the fiscal year ended January 31, 2004. Research and development expenses as a percentage of total revenue decreased to 21% in the fiscal year ended January 31, 2005 from 28% in the fiscal year ended January 31, 2004. Research and development for the fiscal year ended January 31, 2005 included expenses of \$3.8 million to modify and enhance the technology we purchased that will underlie our virtual classroom product offering, SkillSoft Dialogue. The decrease in expenses compared to fiscal 2004 was primarily due to our completion of the initiative for content and platform improvements in the quarter ended January 31, 2004.

Selling and marketing expenses increased \$6.0 million, or 7%, to \$93.5 million in the fiscal year ended January 31, 2005 from \$87.5 million in the fiscal year ended January 31, 2004. The increase was primarily due to increased compensation and benefit costs of approximately \$7.0 million as a result of increased commissions derived from increased bookings in fiscal 2005 as compared to fiscal 2004. We also incurred additional expenses associated with building the SkillSoft Dialogue direct sales channel. This increase was partially offset by a decline in certain infrastructure and occupancy charges of \$0.8 million. Selling and marketing expenses as a percentage of total revenue decreased to 44% in the fiscal year ended January 31, 2005 from 45% in the fiscal year ended January 31, 2004, due to the increase in revenue between fiscal years.

General and administrative expenses decreased \$2.7 million, or 10%, to \$25.2 million in the fiscal year ended January 31, 2005 from \$27.9 million in the fiscal year ended January 31, 2004. General and administrative expenses as a percentage of total revenue decreased to 12% in the fiscal year ended January 31, 2005 from 14% in the fiscal year ended January 31, 2004.

These decreases were primarily due to a reduction of litigation costs of \$3.0 million in the fiscal year ended January 31, 2005 compared to the fiscal year ended January 31, 2004.

We had no litigation settlement expenses in the fiscal year ended January 31, 2005. We recorded \$93.8 million in the fiscal year ended January 31, 2004. This related primarily to the settlements of the 1998 securities class action litigation (\$16.0 million), the NETg litigation (\$44.0 million), the 2002 class action litigation (\$31.5 million) and the IPLearn litigation (\$2.0 million).

Stock-based compensation expense decreased \$795,000, or 40% to \$1.2 million in the fiscal year ended January 31, 2005 from \$2.0 million in the fiscal year ended January 31, 2004. The expense relates to amortization of deferred compensation resulting from granting of stock options to employees at exercise prices below the fair market value of the stock and the sales of restricted common stock with sales prices below the fair market value of the stock. The stock options granted and restricted stock sold at prices below fair market value of the stock were granted by SkillSoft Corporation prior to its initial public offering and by Books prior to its acquisition by SkillSoft Corporation in December 2001. In addition, we recorded a one time compensation charge of \$274,000 in the fiscal year ended January 31, 2004 due to the extension of certain option agreements.

Amortization of intangible assets decreased \$497,000, or 5%, to \$9.6 million in the fiscal year ended January 31, 2005 from \$10.1 million in the fiscal year ended January 31, 2004. See Note 5 of the Notes to the Consolidated Financial Statements.

In the fourth quarter of fiscal 2005 we evaluated the fair value of goodwill. We prepared a cash flow analysis for the MML segment comparing the discounted cash flows to the net book values of the direct assets, goodwill and intangible assets. The discounted cash flows supported the direct assets, goodwill and intangible assets of the MML segment. At January 31, 2005, we concluded there was no impairment of goodwill for the MML segment.

The key assumptions utilized in the preparation of forecasted statements of operations for the MML segment, which reflect certain new initiatives were as follows:

|                            | <b>2005 Multi-Modal Learning</b> |
|----------------------------|----------------------------------|
| Revenue                    | Compound annual growth of 7.0%   |
| Gross profit               | 89.0%                            |
| Research and development   | 15.0%                            |
| Selling and marketing      | 36.0%                            |
| General and administrative | 9.0%                             |
| Other income/(expense)     | \$2.4 million for all years      |
| Working capital            | 15.00% of gross revenue          |

Restructuring charges increased \$11.5 million, or 619%, to \$13.4 million in the fiscal year ended January 31, 2005 from \$1.9 million in the fiscal year ended January 31, 2004. This increase was due to the





fiscal 2005 fourth quarter restructuring related to content development which included charges related to payments to terminated employees, facilities consolidation, the repayment of grants previously awarded by Irish agencies as a result of the headcount reduction and the closing of our German facility.

SEC investigation charges increased \$0.3 million, or 15%, to \$2.2 million in the fiscal year ended January 31, 2005 from \$1.9 million in the fiscal year ended January 31, 2004.

Other professional fees decreased \$14.2 million, or 98%, to \$0.3 million in the fiscal year ended January 31, 2005 from \$14.5 million in the fiscal year ended January 31, 2004. The decrease is due to the completion of the restatement of the SmartForce historical financial statements in the fiscal year ended January 31, 2004. Charges for the fiscal year ended January 31, 2005 consist primarily of the re-filing of certain international tax returns and statutory financial statements as a result of the restatement.

*Interest Income*

Interest income decreased to \$1,091,000 in the year ended January 31, 2005 from \$954,000 in the year ended January 31, 2004. This decrease was primarily due to fewer funds available for investment and lower interest rates on our cash and cash equivalents and investments.

*Other (Expense)/Income, net*

Other income/(expense), net decreased to (\$692,000) in the year ended January 31, 2005 from \$786,000 in the year ended January 31, 2004. This decrease was primarily due to foreign currency fluctuations. Due to our multinational operations, our business is subject to fluctuations based upon changes in the exchange rates between the currencies used in our business.

*Gain on Sale of Investments, net*

We recorded no net gain on sale of investments in the fiscal year ended January 31, 2005. We recorded a one-time gain of \$3.6 million from the sale of an equity investment in fiscal 2004.

*Provision for Income Taxes*

The provision for income taxes was \$631,000 and \$529,000 in the fiscal years ended January 31, 2005 and 2004, respectively. The provision consists of income taxes payable in certain foreign locations, which cannot be offset by net operating loss carryforwards.

**Quarterly Operating Results for Fiscal Years Ended January 31, 2006 and 2005 (unaudited)**

The following table sets forth, for the periods indicated, certain financial data of SkillSoft PLC

|  | Q1 2006   | Q2 2006   | Q3 2006   | Q4 2006   |
|--|-----------|-----------|-----------|-----------|
| <b>(In thousands, except per share data)</b> |           |           |           |           |
| Revenues                                     | \$ 53,327 | \$ 53,604 | \$ 53,901 | \$ 54,735 |
| Cost of revenues                             | 5,834     | 6,318     | 6,509     | 6,646     |
| Gross profit                                 | 47,493    | 47,286    | 47,392    | 48,089    |
| Operating expenses:                          |           |           |           |           |
| Research and development                     | 9,869     | 10,190    | 9,122     | 9,804     |
| Selling and marketing                        | 24,030    | 20,718    | 20,382    | 22,634    |
| General and administrative                   | 6,276     | 6,735     | 5,496     | 7,238     |
| (Insurance recoveries)/ legal settlements    |           | (19,500)  |           | 1,790     |
| Amortization of share-based compensation     | 237       | 220       | 219       | 216       |
| Amortization of intangible assets            | 2,246     | 2,307     | 2,285     | 2,275     |
| Restructuring                                | 703       | (116)     | 226       | (172)     |
| Restatement:                                 |           |           |           |           |
| SEC investigation                            | 250       | 834       | 507       | 397       |
| Other professional fees                      |           |           |           |           |
| Total operating expenses                     | 43,611    | 21,388    | 38,237    | 44,182    |
| Operating income                             | 3,882     | 25,898    | 9,155     | 3,907     |
| Other (expense)/income, net                  | (110)     | 495       | 341       | 15        |
| (Loss)/gain on sale of assets, net           | (681)     |           | 73        | 22        |
| Interest income                              | 356       | 348       | 511       | 564       |
| Interest expense                             | (61)      | (38)      | (243)     | (89)      |
| Income before provision for income taxes     | 3,386     | 26,703    | 9,837     | 4,419     |
| Provision for income taxes                   | 919       | 3,759     | 4,154     | 298       |
| Net income                                   | \$ 2,467  | \$ 22,944 | \$ 5,683  | \$ 4,121  |
| Basic and dilutive income per share          | \$ 0.02   | \$ 0.22   | \$ 0.06   | \$ 0.04   |
| Basic weighted average shares outstanding    | 105,662   | 103,796   | 100,664   | 100,707   |
| Diluted weighted average shares outstanding  | 105,877   | 104,223   | 101,541   | 102,439   |

|   | Q1 2005                               | Q2 2005   | Q3 2005   | Q4 2005     |
|---|---------------------------------------|-----------|-----------|-------------|
|   | (In thousands, except per share data) |           |           |             |
| Revenues  | \$ 52,817                             | \$ 50,625 | \$ 52,507 | \$ 56,351   |
| Cost of revenues                                | 5,078                                 | 5,257     | 5,597     | 5,792       |
| Gross profit                                    | 47,739                                | 45,368    | 46,910    | 50,559      |
| Operating expenses:                             |                                       |           |           |             |
| Research and development                        | 9,444                                 | 12,639    | 10,505    | 12,987      |
| Selling and marketing                           | 24,362                                | 22,664    | 22,441    | 24,019      |
| General and administrative                      | 6,054                                 | 6,182     | 6,388     | 6,538       |
| Amortization of stock-based compensation        | 348                                   | 300       | 296       | 247         |
| Amortization of intangible assets               | 2,422                                 | 2,390     | 2,390     | 2,373       |
| Impairment charge                               |                                       |           |           | 19,268      |
| Restructuring                                   | 147                                   | 175       | (7)       | 13,046      |
| Restatement:                                    |                                       |           |           |             |
| SEC investigation                               | 324                                   | 779       | 716       | 363         |
| Other professional fees                         | 114                                   | 136       | 87        | (17)        |
| Total operating expenses                        | 43,215                                | 45,265    | 42,816    | 78,824      |
| Operating income/(loss)                         | 4,524                                 | 103       | 4,094     | (28,265)    |
| Other (expense)/income, net                     | (179)                                 | (32)      | 75        | (556)       |
| Interest income                                 | 150                                   | 286       | 294       | 361         |
| Interest expense                                | (27)                                  | (45)      | (206)     | (59)        |
| Income/(loss) before provision for income taxes | 4,468                                 | 312       | 4,257     | (28,519)    |
| Provision for income taxes                      | 1,265                                 | (1,045)   | 142       | 269         |
| Net income/(loss)                               | \$ 3,203                              | \$ 1,357  | \$ 4,115  | \$ (28,788) |
| Basic and dilutive income/(loss) per share      | \$ 0.03                               | \$ 0.01   | \$ 0.04   | \$ (0.27)   |
| Basic weighted average shares outstanding       | 103,163                               | 105,422   | 105,936   | 105,973     |
| Diluted weighted average shares outstanding     | 110,393                               | 110,555   | 108,941   | 105,973     |

### Liquidity and Capital Resources

As of January 31, 2006, our principal source of liquidity was our cash and cash equivalents and short-term investments, which totaled \$73.3 million. This compares to \$54.9 million at January 31, 2005.

Net cash provided by operating activities was \$42.2 million for the fiscal year ended January 31, 2006, which includes net income of \$35.2 million (inclusive of the net insurance recovery and legal settlement of \$17.7 million), depreciation and amortization of \$14.3 million and a non-cash income tax provision of \$7.9 million. These amounts were partially offset by a decrease in deferred revenue of \$2.7 million, which was primarily due to the sale of certain assets of SmartCertify, our Retail Certification business, which was partially offset by increased billings in our MML business, as well as decreases in accrued expenses of \$12.9 million. The decrease in accrued expenses is primarily a result of the payment of short-term restructuring and merger accruals.

Net cash used in investing activities was \$4.9 million for the fiscal year ended January 31, 2006. Purchases of capital assets, primarily related to additional investments in our hosting infrastructure, and capitalized software development costs related to our SkillSoft Dialogue product totaled approximately \$6.4 million and \$1.7 million, respectively. Additionally, approximately \$4.0 million of cash was designated as restricted cash pursuant to an arrangement with the named insureds as part of the legal settlement payment received in fiscal 2006 in connection with the 2002 securities class action, related litigation and the SEC investigation. These amounts were partially offset by the maturity of investments, net of purchases (short and long-term), which generated a net cash inflow of approximately \$7.2 million in fiscal 2006.

Net cash used in financing activities was \$18.9 million for the fiscal year ended January 31, 2006. Cash was used to purchase approximately 6.1 million shares having a value of approximately \$22.0 million on the open market under our shareholder approved share repurchase program. This was partially offset by proceeds from the exercise of share options and share purchases under our 2004 Employee Share Purchase Plan totaling \$3.1 million.

Our working capital deficit was approximately \$8.2 million and \$46.8 million as of January 31, 2006 and 2005, respectively. The reduction in our working capital deficit was primarily due to our net income of \$35.2 million, depreciation and amortization of \$14.3 million, a non-cash provision for income tax of \$7.9 million, \$3.1 million of proceeds from the exercise of share options and share purchases under our 2004 Employee Share Purchase Plan and the maturity of long-term investments of \$7.2 million, which was partially offset by the repurchase of shares with a value of approximately \$22.0 million and the purchase of property and equipment of \$6.4 million.

We entered into a \$25 million two year, line of credit with a bank on July 23, 2004, which was amended in April 2005. 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 revolving line of credit. We paid approximately \$12,000 in unused commitment fees for the fiscal year ended January 31, 2006. 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 January 31, 2006, there were no borrowings on 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% as well as administrative costs. We paid approximately \$79,000 in letters of credit fees in the fiscal year ended January 31, 2006.

As of January 31, 2006, we had U.S. federal net operating loss carryforwards (NOLs) of approximately \$314.0 million. These NOLs, 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. We also had U.S. federal tax credit carryforwards of approximately \$5.6 million at January 31, 2006. Additionally, we had approximately \$99.7 million of net operating loss carryforwards in jurisdictions outside of the U.S. If not utilized, these carryforwards expire at various dates through the year ending January 31, 2025. Included in the \$314.0 million are approximately \$200.1 million of U.S. net operating loss carryforwards and \$365,000 of U.S. tax credit carryforwards that were acquired in the Merger and the purchase of Books. In addition, included in the \$99.7 million is approximately \$61.1 million of net operating loss carryforwards in jurisdictions outside the U.S. acquired in the Merger and the purchase of Books. We will realize the benefits of these acquired net operating losses through reductions to goodwill and non-goodwill intangibles during the period that the losses are utilized to reduce tax payments. Also included in the \$314.0 million at January 31, 2006, we have approximately \$28.0 million of net operating loss carryforwards in the United States resulting from disqualifying dispositions. We will realize the benefit of these losses through increases to stockholder's equity in the periods in which the losses are utilized to reduce tax payments.

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):

| Contractual Obligations     | Total     | Payments Due by Period |           |           |                   |
|-----------------------------|-----------|------------------------|-----------|-----------|-------------------|
|                             |           | Less Than 1 Year       | 1-3 Years | 3-5 Years | More Than 5 Years |
| Operating Lease Obligations | \$ 30,927 | \$ 5,197               | \$ 8,900  | \$ 3,729  | \$ 13,101         |

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.

We have a payout to be made by April 17, 2006 of \$1.8 million to the plaintiffs relating to the settlement on April 7, 2006 described in Note 8(d) of the Notes to the Consolidated Financial Statements.

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 program. 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 recently approved shareholder plan. Under the program, 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 (which totaled approximately \$73.3 million as of January 31, 2006), 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.

#### **Recent Accounting Pronouncements**

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

Statement 123(R) is effective for the first quarter of the first fiscal year that begins after June 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. We adopted Statement 123(R) on February 1, 2006.

Statement 123(R) permits public companies to adopt its requirements using one of two methods:

1. A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date; or

2. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.





We have determined to utilize the modified prospective method to use in adopting SFAS 123(R).

As a result of the adoption of SFAS 123(R), we expect share-based compensation expense to be approximately \$3.0 million to \$4.0 million for the fiscal year ending January 31, 2007. However, our assessment of the estimated compensation charges is affected by our share price as well as assumptions regarding a number of complex and subjective variables and the related tax impact. These variables include, but are not limited to, the volatility of our share price and employee share option exercise behaviors. In addition, compensation expense could increase to the extent additional share options are granted in the future. The adoption of SFAS 123(R) will have no material impact on our net cash flows.

On January 13, 2006 we accelerated the vesting of all currently outstanding unvested stock options awarded to employees. This vesting acceleration does not extend to any options held by executive officers and directors. As a result of this action we expect to avoid recognition of approximately \$9.1 million of stock-based compensation expense in future periods beginning February 1, 2006, including approximately \$4.7 million of stock-based compensation expense in the fiscal year ending January 31, 2007. We recorded a charge of approximately \$89,000 in the fourth quarter of fiscal 2006 related to expected forfeitures due to the acceleration of vesting of in-the-money options.

The FASB recently issued Statement No. 154, *Accounting Changes and Error Corrections*, (SFAS 154), which is a replacement of APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. (SFAS 3). SFAS 154 applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impracticable. APB 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is effected by a change in accounting principle. APB 20 previously required that such a change be reported as a change in accounting principle. SFAS 154 carries forward many provisions of APB 20 without change, including the provisions related to the reporting of a change in accounting estimate, a change in the reporting entity, and the correction of an error. SFAS 154 also carries forward the provisions of SFAS 3 that govern reporting accounting changes in interim financial statements. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Earlier application is permitted for accounting changes and corrections of errors made occurring in fiscal years beginning after June 1, 2005. SFAS 154 does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of SFAS 154. We currently believe that the adoption of SFAS 154 will have no impact on our results of 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 stock-based compensation, amortization of purchased intangible assets, impairment of goodwill and purchased intangible assets, management can evaluate our operations excluding these non-cash charges and can compare its results on a more consistent basis to the results of other companies in our industry. By excluding charges such as restructuring charges (benefits), our management can compare our ongoing operations to prior quarters where such items may be materially different and to ongoing operations of other companies in our industry who may have materially different one-time charges. Our management 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.

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

As of January 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 multinational 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 fiscal 2004, 2005 and 2006, we incurred foreign currency exchange gains/ (losses) of \$581,000, \$(803,000) and \$410,000, respectively.

**Item 8. *Financial Statements and Supplementary Data***

Incorporated by reference from Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Quarterly Operating Results and Appendix B attached hereto.

**Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

**Item 9A. *Controls and Procedures***

***Evaluation of Disclosure Controls & 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 January 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 January 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.

### ***Changes in Internal Control***

No change in our internal control over financial reporting occurred during the fiscal quarter ended January 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### ***Management's Report on Internal Control over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known risks of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Our management assessed the effectiveness of our internal control over financial reporting as of January 31, 2006. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on this assessment, our management believes that, as of January 31, 2006 our internal control over financial reporting is effective based on those criteria.

Our management's assessment of the effectiveness of our internal control over financial reporting as of January 31, 2006 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report appearing on the following page of this Form 10-K.



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and  
Shareholders of SkillSoft Public Limited Company

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that SkillSoft Public Limited Company maintained effective internal control over financial reporting as of January 31, 2006 based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). SkillSoft Public Limited Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that SkillSoft Public Limited Company maintained effective internal control over financial reporting as of January 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, SkillSoft Public Limited Company maintained, in all material respects, effective internal control over financial reporting as of January 31, 2006, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of SkillSoft Public Limited Company as of January 31, 2005 and 2006 and the related consolidated statements of operations, stockholders' equity and comprehensive income/(loss) and cash flows for each of the three years in the period ended January 31, 2006 of SkillSoft Public Limited Company and our report dated April 10, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts  
April 10, 2006

**Item 9B. Other Information**

On April 7, 2006, we agreed to settle a lawsuit filed by Jody Glidden, Trish Glidden and Michael LeBlanc against us and certain of our former and current officers and directors in late 2004 related to our 2002 securities class action lawsuit. Under the terms of the settlement, we will pay a total of \$1.79 million to the plaintiffs prior to April 17, 2006. A description of the lawsuit and settlement is included in Item 3 of this Annual Report on Form 10-K.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant**

**Directors**

The following is a list of our directors and certain information about their background.

Gregory M. Priest, age 42, was appointed Chairman of the Board of Directors in November 2000, and has held the position of Strategic Advisor with the Company since April 2005. Mr. Priest served as our Chief Strategy Officer from September 2002 to April 2005. Mr. Priest served as the Company's President and Chief Executive Officer from December 1998 to September 2002. Mr. Priest has been a director since June 1996.

Charles E. Moran, age 51, has served as our President and Chief Executive Officer and as a director since our merger with SkillSoft Corporation in September 2002. Mr. Moran is a founder of SkillSoft Corporation and served as its Chairman of the Board, President and Chief Executive Officer from January 1998 until September 2002.

P. Howard Edelstein, age 51, has served as our director since our merger with SkillSoft Corporation in September 2002. Mr. Edelstein is currently an Executive in Residence with Radianz, Inc., an Internet Protocol (IP)-based networking company for the global financial services industry, and an Entrepreneur in Residence with Warburg Pincus LLC. Mr. Edelstein served as President and Chief Executive Officer of Radianz from July 2003 to January 2006. Mr. Edelstein served as an Entrepreneur in Residence with Warburg Pincus LLC from January 2002 to July 2003. Mr. Edelstein previously served as President and Chief Executive Officer of Thomson Financial ESG (now known as Omgeo), a provider of electronic commerce, transaction processing and information services to the international securities/trading community, from 1993 to 2001. Mr. Edelstein is also a director of PalmSource, a software developer for mobile information devices, and Alacra, a privately held financial information company.

Stewart K.P. Gross, age 46, has served as our director since our merger with SkillSoft Corporation in September 2002. Mr. Gross is Managing Director with Lightyear Capital LLC, a private equity firm concentrating on investments in the financial services industry. Mr. Gross served as a director of SkillSoft Corporation from January 1998 to September 2002. Mr. Gross was Managing Director of Warburg Pincus LLC, from July 1987 to December 2004. Mr. Gross is a director of BEA Systems, Inc., and Aldabra Acquisition Corporation. Mr. Gross is also a director to several privately held companies.

James S. Krzywicki, age 54, has served as our director since October 1998. Mr. Krzywicki has served as President and Chief Executive officer of Docutron Systems, Inc., a provider of web-based document management software solutions that work in small business environments and connect with enterprise objectives, since April 2004. Mr. Krzywicki was Vice President, Channel Services of Parametric Technology Corporation (PTC), a provider of software solutions for manufacturers for product development and improvement, from April 2003 to April 2004. Prior to joining PTC, Mr. Krzywicki served as President of North American Services of RoweCom, Inc. a provider of knowledge resource management and acquisition services, from October 1999 to February 2001, and as Chief Operating Officer from February 2001 to November 2001. In November 2001, RoweCom, Inc. was acquired by divine, inc., a premier integrated solution provider focused on the extended enterprise, and Mr. Krzywicki became Senior Vice President and General Manager, divine information services, and held this position until January 2003. Subsequently,



RoweCom, Inc. filed for protection under Chapter 11 of the United States Bankruptcy Code in the United States District Court for the District of Massachusetts in January 2003.

William F. Meagher, Jr., age 67, has served as our director since March 2004. Mr. Meagher was the Managing Partner of the Boston Office of Arthur Andersen LLP ( Andersen ) from 1982 until 1995, and spent a total of 38 years with Andersen. Mr. Meagher was a member of the American Institute of Certified Public Accountants and the Massachusetts Society of Certified Public Accountants. Mr. Meagher is a trustee of Living Care Villages of Massachusetts, Inc. d/b/a North Hill and the Dana Farber Cancer Institute and the Greater Boston YMCA. Mr. Meagher also sits on the Board of Directors of Dover Saddlery, a direct marketer and a leading specialty retailer of equestrian products.

Ferdinand von Prondzynski, age 52, has served as our director since November 2001. Dr. von Prondzynski has been the President of Dublin City University, one of Ireland's leading higher education institutions, since July 2000. From January 1991 to July 2000, Dr. von Prondzynski served as Professor of Law and Dean of the Faculty of Social Services, the University of Hull, UK.

There are no family relationships among any of the directors of the Company.

### Executive Officers

Our executive officers are as follows:

| Name                | Age | Position  |
|---------------------|-----|---|
| Charles E. Moran    | 51  | President and Chief Executive Officer                 |
| Thomas J. McDonald  |     | Chief Financial Officer, Executive Vice President and |
|                     | 56  | Assistant Secretary                                   |
| Jerald A. Nine, Jr. | 48  | Chief Operating Officer                               |
| Mark A. Townsend    | 53  | Executive Vice President, Technology                  |
| Colm M. Darcy       | 42  | Executive Vice President, Content Development         |

*Charles E. Moran* has served as our President and Chief Executive Officer since our merger with SkillSoft Corporation in September 2002. Mr. Moran is a founder of SkillSoft Corporation and served as its Chairman of the Board, President and Chief Executive Officer from January 1998 until September 2002.

*Thomas J. McDonald* has served as our Chief Financial Officer and Executive Vice President and Assistant Secretary since our merger with SkillSoft Corporation in September 2002. Mr. McDonald is a founder of SkillSoft Corporation and served as its Chief Financial Officer, Vice President, Operations, Treasurer and Secretary since February 1998.

*Jerald A. Nine, Jr.* has served as our Chief Operating Officer since February 2004. Mr. Nine served as our Executive Vice President, Global Sales & Marketing and General Manager, Content Solutions Division from our merger with SkillSoft Corporation in September 2002 to February 2004. Mr. Nine is a founder of SkillSoft Corporation and served as its Executive Vice President, Sales and Marketing and General Manager, Books Division from December 2001 to February 2004. From April 1998 to December 2001, Mr. Nine served as Vice President, Worldwide Sales and Marketing.

*Mark A. Townsend* has served as our Executive Vice President, Technology since our merger with SkillSoft Corporation in September 2002. Mr. Townsend is a founder of SkillSoft Corporation and served as its Vice President, Product Development since January 1998.

*Colm M. Darcy* has served as our Executive Vice President, Content Development since our merger with SkillSoft Corporation in September 2002. From April 2002 to September 2002, Mr. Darcy served as our Executive Vice President, Research and Development. From January 2002 to April 7, 2002, Mr. Darcy served as Vice President of Solutions Management. From January 2001 to December 2001, Mr. Darcy served as Vice President, Strategic Alliances. From January 1999 to December 2000, he served as our Vice President, Content Solutions and from January 1997 to December 1998, he served as Director, Curriculum Develop-



ment. Prior to joining us, Mr. Darcy held positions in Finance, Human Resources, Training and Information Technology in the Irish Government's Department of Health and Child Welfare.

There are no family relationships among any of the executive officers.

#### **Audit Committee**

The Board of Directors has determined that Mr. Meagher is an audit committee financial expert as defined in Item 401(h) of Regulation S-K. The current members of the Audit Committee are Messrs. Gross, Meagher (Chair) and Dr. von Prondzynski. The Board of Directors has determined that all of the members of the Audit Committee are independent as defined under applicable NASDAQ rules and Rule 10A-3 under the Exchange Act.

#### **Director Nomination Process**

The process followed by the Nominating and Corporate Governance Committee to identify and evaluate director candidates includes requests to Board members and others for recommendations, meetings from time to time to evaluate biographical information and background material relating to potential candidates and interviews of selected candidates by members of the Nominating and Corporate Governance Committee and the Board of Directors.

In considering whether to recommend any particular candidate for inclusion in the Board of Director's slate of recommended director nominees, the Nominating and Corporate Governance Committee applies the criteria set forth in our Corporate Governance Guidelines. These criteria include the candidate's integrity, business acumen, knowledge of our business and industry, age, experience, diligence, conflicts of interest and the ability to act in the interests of all shareholders. The Nominating and Corporate Governance Committee does not assign specific weights to particular criteria and no particular criterion is a prerequisite for recommendation. We believe that the backgrounds and qualifications of its directors, considered as a group, should provide a composite mix of experience, knowledge and abilities that will allow the Board of Directors to fulfill its responsibilities.

Shareholders may recommend individuals to the Nominating and Corporate Governance Committee for consideration as potential director candidates by submitting their names, together with appropriate biographical information and background materials and a statement as to whether the shareholder or group of shareholders making the recommendation has beneficially owned more than 5% of our ADSs for at least a year as of the date such recommendation is made, to the Nominating and Corporate Governance Committee, c/o Investor Relations, SkillSoft Public Limited Company, 107 Northeastern Boulevard, Nashua, New Hampshire 03062. Assuming that appropriate biographical and background material has been provided on a timely basis, the Nominating and Corporate Governance Committee will evaluate shareholder-recommended candidates by following substantially the same process, and applying substantially the same criteria, as it follows and applies for candidates submitted by others.

#### **Code of Business Conducts and Ethics**

We have adopted a written Code of Business Conduct and Ethics (the Code) that applies to our directors, officers and employees, including our principal executive officer, principal financial officer, and principal accounting officer or controller, or persons performing similar functions. We have posted the Code on our Web site, which is located at [www.SkillSoft.com](http://www.SkillSoft.com). In addition, we intend to disclose on our Web site any amendments to, or waivers from, any provision of the Code that applies to our principal executive officer, principal financial officer, and principal accounting officer or controller, or persons performing similar functions.

#### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Exchange Act requires our directors, executive officers and holders of more than 10% of a registered class of our equity securities to file with the SEC initial reports of ownership of our equity

securities on a Form 3 and reports of changes in such ownership on a Form 4 or Form 5. Officers, directors and 10% shareholders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

Based solely on its review of copies of such filings by our directors and executive officers and 10% shareholders or written representations from certain of those persons, we believe that all filings required to be made by those persons during the fiscal year ended January 31, 2006 were timely made.

### Item 11. *Executive Compensation*

**Summary Compensation Table.** The following table sets forth the total compensation for the fiscal years ended January 31, 2004, 2005 and 2006 for our chief executive officer and the four most highly compensated other executive officers who were serving as executive officers on January 31, 2006 (the Named Executive Officers), as required under applicable rules of the SEC.

| Name and Principal Position   | Fiscal Year(1) | Annual Compensation |            | All Other Compensation(2) |
|---|----------------|---------------------|------------|---------------------------|
|   |                | Salary              | Bonus      |                           |
| Charles E. Moran<br>President and Chief Executive Officer                     | 2006           | \$ 250,000          | \$ 395,314 | \$ 5,012                  |
|   | 2005           | 250,000             | 42,969     | 9,610                     |
|   | 2004           | 237,500             | 299,333    | 9,610                     |
| Jerald A. Nine Jr.<br>Chief Operating Officer                                 | 2006           | 225,000             | 274,920    | 4,531                     |
|   | 2005           | 225,000             | 29,883     | 6,919                     |
|   | 2004           | 212,500             | 213,400    | 4,973                     |
| Colm M. Darcy<br>Executive Vice President,<br>Content Development             | 2006           | 200,000             | 225,000    | 3,281                     |
|   | 2005           | 200,000             | 23,438     | 6,150                     |
|   | 2004           | 200,000             | 166,000    | 5,092                     |
| Mark A. Townsend<br>Executive Vice President, Technology                      | 2006           | 200,000             | 225,000    | 4,050                     |
|   | 2005           | 200,000             | 23,438     | 7,688                     |
|   | 2004           | 180,000             | 166,000    | 7,688                     |
| Thomas J. McDonald<br>Executive Vice President<br>and Chief Financial Officer | 2006           | 200,000             | 225,000    | 4,050                     |
|   | 2005           | 200,000             | 23,438     | 7,688                     |
|   | 2004           | 175,000             | 166,000    | 7,368                     |

(1) The fiscal years in this column refer to the fiscal year ended January 31 of that year.

(2) Includes amounts paid as accrued vacation time per Company policy to each of Moran, Nine, Darcy, Townsend and McDonald in the amounts of \$4,812, \$4,331, \$3,080, \$3,850 and \$3,850, respectively. For the fiscal year ending January 31, 2006, includes \$200 for each of Moran, Nine, Darcy, Townsend and McDonald that was paid pursuant to the Company's 401(k) matching program.

**Share Option Grants Table.** We granted no share options or share appreciation rights during the fiscal year ended January 31, 2006 to the Named Executive Officers.

**Fiscal Year-End Option Value Table.** The following table provides information with respect to share options exercised by the Named Executive Officers during the fiscal year ended January 31, 2006, and the number and value of unexercised share options held by each of the Named Executive Officers as of January 31, 2006.

| Name               | Number of Shares Acquired on Exercise | Value Realized(1) | Number of Ordinary Shares Underlying Unexercised Options at January 31, 2006 |               | Value of Unexercised In-the-money Options at January 31, 2006(2) |               |
|--------------------|---------------------------------------|-------------------|--|---------------|--|---------------|
|                    |                                       |                   | Exercisable  | Unexercisable | Exercisable  | Unexercisable |
| Charles E. Moran   |                                       |                   | 1,462,984  | 241,673       | \$ 1,196,896   | \$ 384,260    |
| Colm M. Darcy      |                                       |                   | 309,449  | 52,085        | 370,513  | 114,482       |
| Jerald A. Nine Jr. |                                       |                   | 860,562  | 155,360       | 998,048  | 247,022       |
| Mark A. Townsend   |                                       |                   | 832,791  | 138,099       | 1,198,666  | 219,577       |
| Thomas J. McDonald |                                       |                   | 1,045,599  | 138,099       | 1,286,087  | 219,577       |

- (1) The value realized upon exercise is the excess of the fair market value (determined on the basis of the closing price per share of our ADSs on the NASDAQ National Market) of the underlying ordinary shares on the date of exercise over the exercise price of the option multiplied by the number of ordinary shares acquired upon exercise.
- (2) The value of the in-the-money options is the excess of the fair market value (determined on the basis of the closing price per share of our ADSs on the NASDAQ National Market) of the underlying ordinary shares on January 31, 2006 (\$5.65 per share) over the exercise price of the option multiplied by the number of ordinary shares underlying the option.

### Employment Agreements

*Charles E. Moran's Employment Agreement.* In connection with our merger with SkillSoft Corporation, we entered into an employment agreement, effective on September 6, 2002, the date of completion of the merger, with Charles E. Moran, to employ Mr. Moran as our President and Chief Executive Officer. Mr. Moran's employment agreement provides for a cash compensation plan that reflects the level established by the SkillSoft Corporation board of directors for the then current fiscal year. Specifically, Mr. Moran's employment agreement provides that he will be paid a base salary of \$225,000 per year to be reviewed for increases at least annually by our Board of Directors. Mr. Moran's current base salary is \$250,000. In addition, Mr. Moran will be entitled to receive an annual performance bonus based on performance metrics established by the Board of Directors. Mr. Moran's employment is at-will, but if Mr. Moran's employment is terminated without cause or if he resigns with good reason, each as defined in his employment agreement, he will be entitled to receive a payment equal to the sum of his base salary and target bonus for a period of one year after the date of termination. In addition, if Mr. Moran is terminated without cause or if he resigns with good reason, he may elect to continue vesting of the options granted to him for a period of one year after the date of termination, if he agrees to be bound by the non-solicitation and non-compete provisions contained in his employment agreement. The employment agreement also includes a covenant not to solicit employees and a covenant not to compete for a period extending until one year after the termination of his employment, if Mr. Moran's termination is voluntary (other than for good reason) or we terminate him for cause.

*Colm M. Darcy's Employment Agreement.* In connection with our merger with SkillSoft Corporation, we entered into an employment agreement, effective on September 6, 2002, the date of completion of the merger, with Colm M. Darcy, to employ Mr. Darcy as our Executive Vice President, Content Development. Mr. Darcy's employment

agreement provides that he will be paid a base salary of \$200,000 per year to be reviewed for increases at least annually by the Board of Directors. Mr. Darcy's current base salary is \$200,000. Pursuant to the employment agreement, on September 6, 2002, we granted Mr. Darcy an option to purchase an aggregate of 50,000 shares at an exercise price of \$4.25 per share. The option grant vested as to 25% of the shares on September 6, 2003 and vests thereafter in 48 equal monthly installments on each monthly anniversary of the date of the grant. Mr. Darcy will also be reimbursed for certain supplemental travel

expenses for him and his wife. In addition, Mr. Darcy will be entitled to receive relocation expense reimbursement in the event Mr. Darcy either relocates to Ireland at our request or returns there within three months after his employment is terminated without cause or if he resigns with good reason, each as defined in his employment agreement.

Mr. Darcy's employment is at-will, but if his employment is terminated without cause or if he resigns with good reason, he will be entitled to receive a payment equal to the sum of \$75,000 plus his base salary for a period of six months after the date of termination. In addition, if Mr. Darcy is terminated without cause or if he resigns with good reason, he may elect to continue vesting of the options granted to him for a period of six months after the date of termination, if he agrees to be bound by the nonsolicitation and noncompete provisions contained in his employment agreement. The employment agreement also includes a covenant not to solicit employees and a covenant not to compete for a period extending until the later of six months after the termination of his employment and September 6, 2006, if Mr. Darcy's termination is voluntary (other than for good reason) or we terminate him for cause.

*Jerald A. Nine's Employment Agreement.* In connection with our merger with SkillSoft Corporation, we entered into an employment agreement, effective on September 6, 2002, the date of completion of the merger, with Jerald A. Nine, to employ Mr. Nine as our Executive Vice-President, Content Solutions and General Manager Books Division. Mr. Nine's employment agreement provides for a cash compensation plan that reflects the level established by the SkillSoft Corporation Board of Directors for the then current fiscal year. Mr. Nine's employment agreement provides that he will be paid a base salary of \$200,000 per year to be reviewed for increases at least annually by the Board of Directors. Mr. Nine's current base salary is \$225,000. In addition, Mr. Nine will be entitled to receive an annual performance bonus based on performance metrics established by the Board of Directors. Mr. Nine's employment is at-will, but if Mr. Nine's employment is terminated without cause or if he resigns with good reason, as defined in his employment agreement, he will be entitled to receive a payment equal to the sum of his base salary plus the then maximum performance bonus for a period of one year. In addition, if Mr. Nine is terminated without cause or if he resigns with good reason, he may elect to continue vesting of the options granted to him for a period of one year. The employment agreement also includes a covenant not to solicit employees and a covenant not to compete for a period extending until one year after the termination of his employment if Mr. Nine's termination is voluntary (other than for good reason) or we terminate him for cause.

*Mark A. Townsend's Employment Agreement.* SkillSoft Corporation is a party to an employment agreement with Mark A. Townsend, dated January 12, 1998. Under the terms of the employment agreement, Mr. Townsend is entitled to receive a base salary of \$145,000, which may be increased in accordance with SkillSoft Corporation's regular salary review practices. Mr. Townsend's current base salary is \$200,000. Mr. Townsend is also entitled to participate in any bonus plans that SkillSoft Corporation may establish for its senior executives. Either SkillSoft Corporation or Mr. Townsend may terminate the employment agreement at will for any reason upon three months' prior notice in the case of termination by SkillSoft Corporation, or upon two months' prior notice in the case of termination by Mr. Townsend. In addition, in the event of such a termination, Mr. Townsend's stock options will continue to vest and be exercisable if he performs consulting services for SkillSoft Corporation of up to ten hours per week during the six months following termination.

*Thomas J. McDonald's Employment Agreement.* SkillSoft Corporation is a party to an employment agreement with Thomas J. McDonald, dated February 2, 1998. Under the terms of the employment agreement, Mr. McDonald is entitled to receive a base salary of \$135,000, which may be increased in accordance with SkillSoft Corporation's regular salary review practices. Mr. McDonald's current base salary is \$200,000. Mr. McDonald is also entitled to participate in any bonus plans that SkillSoft Corporation may establish for its senior executives. Either SkillSoft Corporation or Mr. McDonald may terminate the employment agreement at will for any reason upon three months' prior notice in the case of termination by SkillSoft Corporation, or upon two months' prior notice in the case of termination by Mr. McDonald. In addition, in the event of such a termination, Mr. McDonald's stock options will continue to vest and be exercisable if he performs consulting services for SkillSoft Corporation of up to ten hours per week during the six months following termination.

### **Compensation Committee Interlocks and Insider Participation**

During the fiscal year ended January 31, 2006, the members of the Compensation Committee of the Company's Board of Directors were Messrs. Krzywicki, Edelstein and Gross (Chair). In December 2005, Mr. Edelstein resigned from the Compensation Committee. No executive officer of the Company has served as a director or member of the compensation committee of any other entity whose executive officers served as a director or member of the Company's Compensation Committee.

### **Directors' Compensation**

At an Extraordinary General Meeting of our shareholders held on March 23, 2006, our shareholders approved an ordinary resolution pursuant to our Articles of Association that fixed the annual fees to be paid to each director who is not an employee of SkillSoft (each, an Outside Director) for their ordinary services as directors in each fiscal year of SkillSoft. Pursuant to such ordinary resolution, no such annual ordinary remuneration shall be paid to directors who are also employees of SkillSoft for their services as directors. Beginning with the fiscal year ending January 31, 2007, each Outside Director will be paid cash compensation as follows:

each Outside Director will receive an annual retainer of \$30,000;

the chairman of each of the Audit Committee and the Compensation Committee will receive an additional annual retainer of \$7,500; and

each Outside Director who is a member of any standing committee (a Committee) of the Board will receive a payment of \$2,000 per Board or Committee meeting attended up to a maximum of six meetings per year (including by conference telephone) beyond regularly scheduled meetings (i.e. a maximum additional payment of \$12,000), provided that only one meeting payment would be made in the event such additional meetings of the Board and one or more Committee were held on the same day.

Any director who is in office only for a portion of a fiscal year shall only be entitled to be paid a pro-rated portion of such remuneration reflecting such portion of the year during which he held office.

Except as described below, we have not previously paid cash compensation to any director for services as a member of the Board or Committee, other than reimbursements for expenses in attending meetings of the Board and Committees. We will continue to reimburse directors for expenses in attending meetings of the Board and Committees. On December 22, 2005, we made a one-time payment in the amount of \$500,000 to Howard Edelstein, a director of SkillSoft, in recognition of Mr. Edelstein's contributions in connection with the settlement of our litigation with NETg and our securities class action litigation. As a result of the payment to Mr. Edelstein, the Board determined that Mr. Edelstein is no longer an independent director as defined under Rule 4200(a)(15) of the NASDAQ Stock Market, Inc. Marketplace Rules and the Board accepted Mr. Edelstein's resignation from each of the Compensation Committee and the Nominating and Corporate Governance Committee.

We currently have five Outside Directors, each of whom is eligible for cash remuneration as described above: P. Howard Edelstein, Stewart K.P. Gross, James S. Krzywicki, William F. Meagher, Jr. and Dr. Ferdinand von Prondzynski. Mr. Meagher is the chair of the Audit Committee and Mr. Gross is the chair of the Compensation Committee. As such, Messrs. Meagher and Gross will each be eligible to receive the additional \$7,500 retainer described above.

We continue to grant Outside Directors compensation in the form of share options for their services as members of the Board of Directors. On initial election to the Board of Directors, each new non-employee director receives an option to purchase 25,000 ordinary shares (the Initial Grant) under our 2001 Outside Director Option Plan (the Director Plan). Each non-employee director who has been a director for at least six months receives an option to purchase 10,000 ordinary shares on January 1st of each year (the Annual Grant). All options granted under the Director Plan have a term of ten years and an exercise price equal to the fair market value of the ordinary shares on the date of grant. The Initial Grant becomes exercisable as to



one-third of the shares subject to the option on each of the first three anniversaries of the date of grant, provided the non-employee director remains a director on such dates. The Annual Grant becomes fully exercisable on the first anniversary of the date of grant, provided the non-employee director remains a director on such date. Upon exercise of an option, the non-employee director may elect to receive his ordinary shares in the form of ADSs. After termination as a non-employee director, an optionee may exercise an option during the period set forth in his option agreement. If termination is due to death or disability, the option will remain exercisable for 12 months. In all other cases, the option will remain exercisable for a period of three months. However, an option may never be exercised later than the expiration of its ten-year term. A non-employee director may not transfer options granted under the Director Plan other than by will or the laws of descent and distribution. Only the non-employee director may exercise the option during his lifetime. In the event of our merger with or into another corporation or a sale of substantially all of our assets, the successor corporation may assume, or substitute a new option in place of, each option. If such assumption or substitution occurs, the options will continue to be exercisable according to the same terms as before the merger or sale of assets. Following such assumption or substitution, if a non-employee director is terminated other than by voluntary resignation, the option will become fully exercisable and generally will remain exercisable for a period of three months. If the outstanding options are not assumed or substituted for, the Board of Directors will notify each non-employee director that he has the right to exercise the option as to all shares subject to the option for a period of 30 days following the date of the notice. The option will terminate upon the expiration of the 30-day period. Unless terminated sooner, the Director Plan will automatically terminate in 2011. The Board of Directors has the authority to amend, alter, suspend, or discontinue the Director Plan, but no such action may adversely affect any grant previously made under the Director Plan.

On January 1, 2006, Messrs. Meagher, Edelstein, Gross and Krzywicki and Dr. von Prondzynski were each granted an option to purchase 10,000 ordinary shares at an exercise price of \$5.50 per share. Each option granted to a non-employee director was in accordance with the terms of the Director Plan described above.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The following table sets forth certain information as of March 31, 2006 with respect to the beneficial ownership of our ADSs by:

each person known to SkillSoft to own beneficially more than 5% of our outstanding securities;

each director;

our chief executive officer and the four most highly compensated executive officers who were serving as executive officers on January 31, 2006 (the "Named Executive Officers"); and

the current directors and executive officers of SkillSoft as a group.

The number of ADSs beneficially owned by each 5% shareholder, director or executive officer is determined under rules of the SEC. Under such rules, beneficial ownership includes any shares as to which the individual or entity has sole or shared voting power or investment power and includes any ADSs representing the ordinary shares which the individual has the right to acquire on or before May 30, 2006 through the exercise of share options, and any reference in the footnotes to this table to shares subject to share options refers only to share options that are so exercisable. For purposes of computing the percentage of outstanding ADSs held by each person or entity, any shares which that person or entity has the right to acquire on or before May 30, 2006, are deemed to be outstanding but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person. Unless otherwise indicated, each person or entity has sole investment and voting power (or shares such power with his or her spouse) with respect to the shares set forth in the following table. The inclusion herein of any shares deemed beneficially owned does not constitute an admission of beneficial ownership of those shares.

As of March 31, 2006, we had approximately 107,493,534 ordinary shares outstanding. Our shareholders may elect to hold their respective shares of our outstanding securities in the form of ordinary shares or ADSs. In addition, holders of options to purchase ordinary shares of SkillSoft may, upon exercise of their options,



elect to receive such ordinary shares in the form of ADSs. The 5% shareholders, directors and executive officers identified in the following table hold their respective shares of SkillSoft outstanding securities in the form of ADSs.

| Name and Address of Beneficial Owner                                 | Amount and Nature of Beneficial Ownership |                  |
|--|---|------------------|
|  | ADSs                                      | Percentage Owned |
| <i>5% Shareholders</i>   |   |                  |
| Columbia Wanger Asset Management, L.P.(1)                            | 22,445,000                                | 20.3%            |
| Warburg, Pincus Ventures, L.P.(2)                                    | 13,279,987                                | 12.4             |
| Cramer Rosenthal McGlynn, LLC(3)                                     | 8,524,225                                 | 7.9              |
| Westfield Capital Management(4)                                      | 7,743,119                                 | 7.2              |
| Prentice Capital Management, LP(5)                                   | 6,426,015                                 | 6.0              |
| Transamerica Investment Management, LLC(6)                           | 4,812,950                                 | 4.5              |
| <i>Directors</i>   |   |                  |
| Charles E. Moran(7)  | 3,040,745                                 | 2.8              |
| Gregory M. Priest(8)   | 2,537,499                                 | 2.3              |
| James S. Krzywicki(9)  | 153,000                                   | *                |
| Ferdinand von Prondzynski(10)  | 40,010                                    | *                |
| P. Howard Edelstein(11)  | 26,250                                    | *                |
| Stewart K.P. Gross(12)   | 26,250                                    | *                |
| William F. Meagher, Jr.(13)  | 16,000                                    | *                |
| <i>Named Executive Officers</i>                                      |   |                  |
| Mark A. Townsend(14)   | 1,419,655                                 | 1.3              |
| Jerald A. Nine(15)   | 1,331,903                                 | 1.2              |
| Thomas J. McDonald(16)   | 1,195,785                                 | 1.1              |
| Colm M. Darcy (17)   | 342,783                                   | *                |
| All current directors and executive officers as a group (11 persons) | 10,129,880                                | 8.8              |

\* Less than 1%

- (1) On February 14, 2006, Columbia Wanger Asset Management, L.P. ( WAM ), WAM Acquisition GP, Inc. ( WAM GP ) filed Amendment No. 5 to Schedule 13G with the SEC reporting beneficial ownership and shared voting and dispositive power with respect to 22,445,000 ADSs for WAM and WAM GP, consisting of shares beneficially owned by WAM and WAM GP; the following information is reported in reliance on such filing. WAM is an Investment Adviser registered under section 203 of the Investment Advisors Act of 1940 and reports ADSs acquired on behalf of discretionary clients. The shares reported include the shares held by Columbia Acorn Trust ( Acorn ), a Massachusetts business trust that is a discretionary client of WAM. Acorn holds 17.8% of the Company's shares. WAM GP is the general partner of WAM. WAM, WAM GP and Acorn file jointly pursuant to a Joint Filing Agreement dated February 13, 2006 among WAM, WAM GP and Acorn. The address of WAM, WAM GP and Acorn is 227 West Monroe Street, Suite 3000, Chicago, Illinois 60606.
- (2) On September 16, 2002, Warburg Pincus Ventures, L.P. ( WPV ), Warburg Pincus & Co. ( WP ) and Warburg Pincus LLC ( WP LLC ) filed a Schedule 13D with the SEC reporting beneficial ownership and shared voting and dispositive power with respect to 13,279,987 ADSs, consisting of shares beneficially owned by WPV, WP and WP LLC; the following information is reported in reliance on such filing. WP is the sole general partner of

WPV. WPV is managed by WP LLC. The address for WPV is 466 Lexington Avenue, 10th Floor, New York, New York 10017-3147.

- (3) On February 14, 2006, Cramer Rosenthal McGlynn, LLC ( Cramer ) filed Amendment No. 3 to Schedule 13G with the SEC reporting beneficial ownership with respect to 8,524,225 ADSs, consisting

of 3,844,650 ADSs for which Cramer has sole voting power, 4,077,450 ADSs for which Cramer has sole dispositive power, 4,338,775 ADSs for which Cramer has shared voting power and 4,446,775 ADSs for which Cramer has shared dispositive power; the following information is reported in reliance on such filing. Cramer is an Investment Adviser registered under section 203 of the Investment Advisors Act of 1940. The address of Cramer is 520 Madison Avenue, New York, New York 10022.

- (4) On February 10, 2006, Westfield Capital Management, Co., LLC ( Westfield ) filed Amendment No. 2 to Schedule 13G with the SEC reporting beneficial ownership with respect to 7,743,119 ADSs, consisting of 4,990,419 ADSs for which Westfield has sole voting power and 7,743,119 ADSs for which Westfield has sole dispositive power; the following information is reported in reliance on such filing. Westfield is an Investment Adviser registered in accordance with (S)240.13d-1(b) (1) (ii) (E). The address of Westfield is One Financial Center, Boston, Massachusetts 02111.
- (5) On February 14, 2006, Prentice Capital Management, LP ( PCM ) and Michael Zimmerman filed Amendment No. 1 Schedule 13G with the SEC reporting beneficial ownership and shared voting and dispositive power with respect to 6,426,015 ADSs, consisting of shares beneficially owned by PCM and Michael Zimmerman; the following information is reported in reliance on such filing. PCM serves as an investment manager to a number of investment funds (including Prentice Capital Partners, LP, Prentice Capital Partners QP, LP and Prentice Capital Offshore, Ltd.) and manages investments for certain entities in managed accounts with respect to which it has voting and dispositive authority over the shares reported in the Schedule 13G. Michael Zimmerman is the Managing Member of (a) Prentice Management GP, LLC, the general partner of PCM and (b) Prentice Capital GP, LLC, the general partner of certain investment funds. As such, he may be deemed to control PCM and certain of the investment funds and therefore may be deemed to be the beneficial owner of the securities reported in the Schedule 13G. Each of Michael Zimmerman and PCM disclaims beneficial ownership of all of the shares reported in this Schedule 13G. The address of the principal business office of PCM and Michael Zimmerman is 623 Fifth Avenue, 32nd Floor, New York, New York 10022.
- (6) On September 12, 2005, Transamerica Investment Management, LLC ( TIM ) filed Amendment No. 2 to Schedule 13G with the SEC reporting beneficial ownership and sole voting and sole dispositive power with respect to 4,812,950 ADSs; the following information is reported in reliance on such filing. TIM is deemed to be the beneficial owner pursuant to separate arrangements whereby TIM acts as investment adviser to certain individuals and entities. The address of TIM is 1150 S. Olive Street, Los Angeles, California 90015.
- (7) Represents 1,601,082 ADSs issuable upon exercise of share options held by Mr. Moran, 11 ADSs held by Mr. Moran s wife, 2,367 ADSs held in a family trust of which Mr. Moran is a trustee, and 1,437,285 ADSs beneficially owned by Mr. Moran s wife, as trustee of various trusts for the benefit of Mr. Moran s children.
- (8) Includes 2,526,340 ADSs issuable upon exercise of share options held by Mr. Priest.
- (9) Includes 150,000 ADSs issuable upon exercise of share options held by Mr. Krzywicki.
- (10) Includes 40,000 ADSs issuable upon exercise of share options held by Dr. von Prondzynski.
- (11) Represents 26,250 ADSs issuable upon exercise of share options held by Mr. Edelstein.
- (12) Represents 26,250 ADSs issuable upon exercise of share options held by Mr. Gross.
- (13) Includes 15,000 ADSs issuable upon exercise of share options held by Mr. Meagher.
- (14)

Includes 911,704 ADSs issuable upon exercise of share options held by Mr. Townsend and 59,185 ADSs beneficially owned by Mr. Townsend's wife as trustee of the MCM Trust. Mr. Townsend disclaims beneficial ownership of the shares held in trust.

(15) Includes 949,338 ADSs issuable upon exercise of share options held by Mr. Nine and 332,244 ADSs held by Mr. Nine's wife as trustee of the Kimberly M. Nine Revocable Trust. Mr. Nine disclaims beneficial ownership of the shares held in trust.

(16) Includes 1,124,512 ADSs issuable upon exercise of share options held by Mr. McDonald, 1,953 ADSs beneficially owned by Mr. McDonald's wife, as trustee for the benefit of Mr. McDonald's family and

3,906 owned by Mr. McDonald's daughters. Mr. McDonald disclaims beneficial ownership of the shares held in trust and by his daughters.

(17) Represents 342,783 ADSs issuable upon exercise of share options held by Mr. Darcy.

### Equity Compensation Plan Information

The following table provides information about the ordinary shares authorized for issuance under our equity compensation plans as of January 31, 2006.

| Plan Category(1)   | (a)<br>Number of<br>Shares to<br>be Issued upon<br>Exercise of<br>Outstanding<br>Options,<br>Warrants and<br>Rights | (b)<br>Weighted-average<br>Exercise Price<br>of<br>Outstanding<br>Options,<br>Warrants and<br>Rights | (c)<br>Number of Shares<br>Remaining Available for<br>Future Issuance under<br>Equity Compensation<br>Plans<br>(Excluding Securities<br>Reflected in Column (a)) |
|--|---|--|--|
| Equity compensation plans approved by security holders     | 4,531,314(2)  | \$ 7.90(2)   | 2,747,763(3)   |
| Equity compensation plans not approved by security holders | 3,879,075(4)  | 11.96  | 7,321,928(5)   |
| <b>Total</b>   | <b>8,410,389</b>  | <b>9.77</b>  | <b>10,069,691</b>  |

- (1) This table excludes an aggregate of 8,020,024 ordinary shares issuable upon exercise of options that we assumed in connection with our merger with SkillSoft Corporation. The weighted average exercise price of the excluded options is \$5.53 per share. We assumed the SkillSoft Corporation 1998 Stock Incentive Plan, 1999 Non-Employee Director Stock Option Plan, 2001 Stock Incentive Plan and Books24x7.com, Inc. 1994 Stock Option Plan only insofar as they related to options outstanding under the plans at the time of the merger, and we may not grant any future options under any of those plans.
- (2) Excludes ordinary shares issuable under the Company's 2004 Employee Stock Purchase Plan in connection with the current offering period; such ordinary shares are included in column (c).
- (3) Consists of 564,513 ordinary shares reserved for issuance under the 2002 Share Option Plan (the 2002 Plan), 1,734,500 ordinary shares reserved for issuance under the 2004 Employee Share Purchase Plan and 448,750 ordinary shares reserved for issuance under the 2001 Outside Director Plan.
- (4) Consists of 3,878,987 ordinary shares subject to outstanding options under our 1996 Supplemental Stock Plan (the 1996 Plan) and 88 ordinary shares subject to outstanding options under the Knowledge Well Group Limited 1998 Share Option Plan (the Knowledge Well Group 1998 Plan).
- (5) Consists of 6,120,372 ordinary shares available for issuance under the 1996 Plan, 2 ordinary shares available for issuance under the ForeFront Group, Inc. 1996 Non-Employee Director's Stock Option Plan (the ForeFront 1996 Director Plan), 342,823 ordinary shares available for issuance under the ForeFront Group, Inc. Amended

and Restated 1996 Stock Option Plan (the ForeFront 1996 Plan ), 624,462 ordinary shares available for issuance under the Knowledge Well Group 1998 Plan and 234,269 ordinary shares available for issuance under the Knowledge Well Limited 1998 Share Option Plan (the Knowledge Well 1998 Plan ).

A description of the material terms of the 1996 Plan, the ForeFront 1996 Director Plan, the ForeFront 1996 Plan, the Knowledge Well 1998 Plan and the Knowledge Well Group 1998 Plan is included in Note 9 to the Company s consolidated financial statements filed as part of this Annual Report on Form 10-K for the fiscal year ended January 31, 2006 and is incorporated herein by reference.

On March 23, 2006 at the Extraordinary General Meeting of Shareholders, our shareholders approved an amendment to the 2002 Plan increasing the number of shares reserved for issuance thereunder by 5,100,000 ordinary shares. This amendment did not increase the total number of shares that we have reserved for future grants under its equity plans. As indicated in the table above, as of January 31, 2006 under existing non-shareholder approved employee share plans, we had in excess of 5,100,000 shares currently available for future issuance. For ease of administration, and to avoid the loss of available shares under certain of the existing non-



shareholder approved plans, some of which will expire by their terms in the near future, we decided to amend such plans to reduce the number of shares available for future issuance under those plans by an aggregate of 5,100,000 shares.

**Item 13. *Certain Relationships and Related Transactions***

Not applicable.

**Item 14. *Principal Accountant Fees and Services***

**Auditors Fees**

The following table summarizes the fees of Ernst & Young, our registered public accounting firm, billed to us for each of the last two fiscal years.

| Fee Category          | Fiscal Year Ended<br>January 31, 2006 | Fiscal Year Ended<br>January 31, 2005 |
|-----------------------|---------------------------------------|---------------------------------------|
| Audit Fees(1)         | \$ 1,492,900                          | \$ 1,775,600                          |
| Audit-Related Fees(2) | 15,000                                | 27,000                                |
| Tax Fees(3)           | 646,900                               | 782,500                               |
| All Other Fees(4)     | 0                                     | 0                                     |
| <b>Total Fees</b>     | <b>\$ 2,154,800</b>                   | <b>\$ 2,585,100</b>                   |

- (1) Audit fees consist of fees for the audit of our financial statements, the audit of our internal control over financial reporting as set forth in Section 404 of the Sarbanes-Oxley Act, the review of the interim financial statements in our quarterly reports on Form 10-Q, other professional services provided or accrued for in connection with statutory and regulatory filings or engagements for the fiscal years ended January 31, 2006 and January 31, 2005.
- (2) Audit-related fees consist of fees for assurance and related services that are reasonably related to the performance of the audit and the review of our financial statements and which are not reported under Audit Fees. These services relate to accounting consultations and employee benefit plan audits.
- (3) Tax fees consist of fees for tax compliance, tax advice and tax planning services. Tax compliance services, which relate to preparation of original and amended tax returns and claims for refunds, accounted for \$458,200 of the total tax fees billed in the fiscal year ended January 31, 2006 and \$292,500 of the total tax fees billed in the fiscal year ended January 31, 2005. Tax advice and tax planning services relate to a transfer pricing analysis, tax advice, assistance with tax audits and appeals, tax advice related to mergers and acquisitions, employee benefit plans and requests for rulings or technical advice for taxing authorities.

**Pre-approval Policies and Procedures**

The Audit Committee has adopted policies and procedures relating to the approval of all audit and non-audit services that are to be performed by our registered public accounting firm. This policy generally provides that we will not engage our independent registered public accounting firm to render audit or non-audit services unless the service is specifically approved in advance by the Audit Committee or the engagement is entered into pursuant to one of the pre-approval procedures described below.

From time to time, the Audit Committee may pre-approve specified types of services that are expected to be provided to us by our registered independent public accounting firm during the next 12 months. Any such pre-approval is detailed as to the particular service or type of services to be provided and is also generally subject to a maximum dollar amount.

The Audit Committee has also delegated to the Chair of the Audit Committee the authority to approve any audit or non-audit services to be provided to us by our registered public accounting firm. Any approval of

services by the Chair of the Audit Committee pursuant to this delegated authority is reported on at the next meeting of the Audit Committee.

#### **PART IV**

##### **Item 15. Exhibits and Financial Statement Schedules**

(a) Documents Filed as a Part of this Report:

1. *Financial Statements*. The following documents are filed as *Appendix B* hereto and are included as part of this Annual Report on Form 10K:

Financial Statements:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statements of Stockholders' Equity and Comprehensive Loss

Consolidated Statements of Cash Flows

Notes to the Consolidated Financial Statements

2. *Financial Statement Schedules*. All Financial Statement Schedules have been omitted since they are either not required, not applicable, or the information is otherwise included in this report.

3. *Exhibits*. The Exhibits listed in the Exhibit Index immediately preceding such Exhibits are filed as part of and incorporated by reference in this Form 10-K.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SKILLSOFT PUBLIC LIMITED COMPANY  
 (Registrant)  
 By: /s/ CHARLES E. MORAN

Charles E. Moran  
*President and Chief Executive Officer*

Date: April 13, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been duly signed below by the following persons on behalf of SkillSoft and in the capacities and on the date set forth below.

| Signature  | Title  | Date              |
|--|--|-------------------|
| /s/ CHARLES E. MORAN<br><hr/> Charles E. Moran                   | President and Chief Executive Officer<br>and Director<br>(Principal Executive Officer) | April 13,<br>2006 |
| /s/ THOMAS J. MCDONALD<br><hr/> Thomas J. McDonald               | Chief Financial Officer<br>(Principal Financial and Accounting<br>Officer)             | April 13,<br>2006 |
| /s/ GREGORY M. PRIEST<br><hr/> Gregory M. Priest                 | Director   | April 13,<br>2006 |
| /s/ P. HOWARD EDELSTEIN<br><hr/> P. Howard Edelstein             | Director   | April 13,<br>2006 |
| /s/ STEWART K. P. GROSS<br><hr/> Stewart K. P. Gross             | Director   | April 13,<br>2006 |
| /s/ JAMES S. KRZYWICKI<br><hr/> James S. Krzywicki               | Director   | April 13,<br>2006 |
| /s/ FERDINAND VON PRONDZYNSKI<br><hr/> Ferdinand von Prondzynski | Director   | April 13,<br>2006 |

/s/ WILLIAM F. MEAGHER, JR

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Director

April 13,  
2006

William F. Meagher, Jr.

## APPENDIX A

## SELECTED FINANCIAL DATA

The selected consolidated financial data set forth below should be read in conjunction with our consolidated financial statements and notes and Management's Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this Form 10-K. This selected consolidated financial data are derived from our audited consolidated financial statements.

|  | Year<br>Ended<br>January 31,<br>2002 | Year<br>Ended<br>January 31,<br>2003(1) | Year<br>Ended<br>January 31,<br>2004 | Year<br>Ended<br>January 31,<br>2005 | Year<br>Ended<br>January 31,<br>2006 |
|--|--------------------------------------|---|--------------------------------------|--------------------------------------|--------------------------------------|
| (In thousands, except per share data)            |                                      |   |                                      |                                      |                                      |
| <b>Statement of Operations Data:</b>             |                                      |   |                                      |                                      |                                      |
| Revenue  | \$ 44,271                            | \$ 101,470                              | \$ 193,475                           | \$ 212,300                           | \$ 215,567                           |
| Cost of revenue                                  | 2,552                                | 11,548                                  | 18,397                               | 21,724                               | 25,307                               |
| Gross profit                                     | 41,719                               | 89,922                                  | 175,078                              | 190,576                              | 190,260                              |
| Operating expenses:                              |                                      |   |                                      |                                      |                                      |
| Research and development                         | 17,698                               | 29,104                                  | 53,627                               | 45,575                               | 38,985                               |
| Selling and marketing                            | 27,602                               | 52,691                                  | 87,532                               | 93,486                               | 87,764                               |
| General and administrative                       | 7,199                                | 17,914                                  | 27,883                               | 25,162                               | 25,745                               |
| Legal settlements/ (insurance recoveries)        |                                      |   | 93,750                               |                                      | (17,710)                             |
| Amortization of share-based compensation         | 793                                  | 1,634                                   | 1,986                                | 1,191                                | 892                                  |
| Amortization of intangible assets                | 27                                   | 4,683                                   | 10,072                               | 9,575                                | 9,113                                |
| Impairment charge                                |                                      | 250,107                                 |                                      | 19,268                               |                                      |
| Restructuring                                    |                                      | 14,179                                  | 1,857                                | 13,361                               | 641                                  |
| Restatement:                                     |                                      |   |                                      |                                      |                                      |
| SEC Investigation                                |                                      |   | 1,898                                | 2,182                                | 1,988                                |
| Other professional fees                          |                                      | 5,107                                   | 14,473                               | 320                                  |                                      |
| Total operating expenses                         | 53,319                               | 375,419                                 | 293,078                              | 210,120                              | 147,418                              |
| Operating (loss)/ income                         | (11,600)                             | (285,497)                               | (118,000)                            | (19,544)                             | 42,842                               |
| Other income/ (expense), net                     | 150                                  | (282)                                   | 786                                  | (692)                                | 741                                  |
| Gain/ (loss) on sale of investments, net         |                                      |   | 3,682                                |                                      | (586)                                |
| Interest income                                  | 1,811                                | 2,288                                   | 954                                  | 1,091                                | 1,779                                |
| Interest expense                                 | (1)                                  | (123)                                   | (167)                                | (337)                                | (431)                                |
| (Loss)/ income before provision for income taxes | (9,640)                              | (283,614)                               | (112,745)                            | (19,482)                             | 44,345                               |
| Provision for income taxes                       |                                      | 383                                     | 529                                  | 631                                  | 9,130                                |
| Net (loss)/ income                               | \$ (9,640)                           | \$ (283,997)                            | \$ (113,274)                         | \$ (20,113)                          | \$ 35,215                            |

Net income/ (loss) per share(2):

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|   |           |           |           |           |         |
|---|-----------|-----------|-----------|-----------|---------|
| Basic and dilutive (loss)/ income per share | \$ (0.27) | \$ (4.40) | \$ (1.13) | \$ (0.19) | \$ 0.34 |
| Basic weighted average shares outstanding   | 35,324    | 64,472    | 100,115   | 105,134   | 102,473 |
| Diluted weighted average shares outstanding | 35,324    | 64,472    | 100,115   | 105,134   | 103,352 |

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|  | As of<br>January 31,<br>2002 | As of<br>January 31,<br>2003 | As of<br>January 31,<br>2004 | As of<br>January 31,<br>2005 | As of<br>January 31,<br>2006 |
|--|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
|--|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|

(In thousands)

**Balance Sheet Data:**

|   |           |            |           |           |           |
|---|-----------|------------|-----------|-----------|-----------|
| Cash, cash equivalents and short-term investments | \$ 68,946 | \$ 125,031 | \$ 61,340 | \$ 54,927 | \$ 73,339 |
| Working capital (deficit)                         | 48,650    | 31,822     | (49,115)  | (46,754)  | (8,248)   |
| Long-term investments & other assets              | 13,814    | 1,132      | 390       | 9,003     | 966       |
| Total assets                                      | 153,458   | 378,137    | 342,378   | 303,497   | 299,902   |
| Stockholders equity                               | 113,750   | 191,087    | 85,758    | 84,919    | 102,272   |

- (1) The statement of operations data for the year ended January 31, 2003 includes the operating results of SkillSoft PLC for the post-September 6, 2002 period.
- (2) See Note 2(e) of the Notes to the Consolidated Financial Statements for the determination of shares used in computing basic and diluted net loss per common share.

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**FINANCIAL STATEMENTS  
INDEX**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and  
Shareholders of SkillSoft Public Limited Company:

We have audited the accompanying consolidated balance sheets of SkillSoft Public Limited Company as of January 31, 2005 and 2006, and the related consolidated statements of operations, stockholders' equity and comprehensive income/ (loss), and cash flows for each of the three years in the period ended January 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of SkillSoft Public Limited Company at January 31, 2005 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of SkillSoft Public Limited Company's internal control over financial reporting as of January 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 10, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG, LLP

Boston, Massachusetts  
April 10, 2006

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

|  | January 31,   |                |
|--|---|----------------|
|  | 2005  | 2006           |
|  | (In thousands<br>except share data<br>and per share data) |                |
| <b>ASSETS</b>  |   |                |
| Current assets:  |   |                |
| Cash and cash equivalents  | \$ 34,906   | \$ 51,937      |
| Short-term investments   | 20,021  | 21,402         |
| Accounts receivable, less reserves of approximately \$1,383 and \$787 as of<br>January 31, 2005 and 2006, respectively | 87,030  | 85,681         |
| Prepaid expenses and other current assets  | 22,659  | 22,006         |
| Restricted cash  | 994   | 5,039          |
| <br>Total current assets   | <br>165,610   | <br>186,065    |
| Property and equipment, at cost:   |   |                |
| Computer equipment   | 23,900  | 29,341         |
| Furniture and fixtures   | 2,142   | 2,128          |
| Leasehold improvements   | 1,559   | 1,615          |
|  | 27,601  | 33,084         |
| Less accumulated depreciation and amortization   | 18,464  | 22,853         |
|  | 9,137   | 10,231         |
| Intangible assets:   |   |                |
| Acquired intangible assets, net  | 16,171  | 8,711          |
| Goodwill   | 103,576   | 93,929         |
|  | 119,747   | 102,640        |
| Long-term investments  | 8,943   | 230            |
| Other assets   | 60  | 736            |
| <br>Total assets   | <br>\$ 303,497  | <br>\$ 299,902 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |   |                |
| Current liabilities:   |   |                |
| Accounts payable   | \$ 5,361  | \$ 3,819       |
| Accrued expenses   | 66,995  | 53,795         |
| Deferred revenue   | 140,008   | 136,699        |
| <br>Total current liabilities  | <br>212,364   | <br>194,313    |
| Long term liabilities  | 6,214   | 3,317          |
| Commitments and Contingencies (Note 8)   |   |                |

## Stockholders equity:

|  |            |            |
|--|------------|------------|
| Ordinary Shares, 0.11 par value Authorized 250,000,000 shares 106,207,818 and 107,344,243 issued at January 31, 2005 and January 31, 2006, respectively and 105,764,061 and 100,810,359 outstanding at January 31, 2005 and January 31, 2006, respectively | 11,617     | 11,773     |
| Additional paid-in capital   | 559,052    | 562,052    |
| Treasury stock, at cost, 443,757 and 6,533,884 ordinary shares at January 31, 2005 and January 31, 2006, respectively  | (2,523)    | (24,524)   |
| Accumulated deficit  | (481,029)  | (445,814)  |
| Deferred compensation  | (1,358)    | (465)      |
| Accumulated other comprehensive loss   | (840)      | (750)      |
| Total stockholders equity  | 84,919     | 102,272    |
| Total liabilities and stockholders equity  | \$ 303,497 | \$ 299,902 |

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

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

Years Ended January 31,

|   | 2004         | 2005        | 2006       |
|---|--------------|-------------|------------|
| <b>(In thousands, except per share data)</b>    |              |             |            |
| Revenue   | \$ 193,475   | \$ 212,300  | \$ 215,567 |
| Cost of revenue(1)                              | 18,397       | 21,724      | 25,307     |
| Gross profit                                    | 175,078      | 190,576     | 190,260    |
| Operating expenses:                             |              |             |            |
| Research and development(1)                     | 53,627       | 45,575      | 38,985     |
| Selling and marketing(1)                        | 87,532       | 93,486      | 87,764     |
| General and administrative(1)                   | 27,883       | 25,162      | 25,745     |
| Legal settlements/ (insurance recoveries)       | 93,750       |             | (17,710)   |
| Amortization of share-based compensation(1)     | 1,986        | 1,191       | 892        |
| Amortization of intangible assets               | 10,072       | 9,575       | 9,113      |
| Impairment charge                               |              | 19,268      |            |
| Restructuring                                   | 1,857        | 13,361      | 641        |
| Restatement:                                    |              |             |            |
| SEC investigation                               | 1,898        | 2,182       | 1,988      |
| Other professional fees                         | 14,473       | 320         |            |
| Total operating expenses                        | 293,078      | 210,120     | 147,418    |
| Operating (loss)/income                         | (118,000)    | (19,544)    | 42,842     |
| Other income/(expense), net                     | 786          | (692)       | 741        |
| Gain/(loss) on sale of assets, net              | 3,682        |             | (586)      |
| Interest income                                 | 954          | 1,091       | 1,779      |
| Interest expense                                | (167)        | (337)       | (431)      |
| (Loss)/income before provision for income taxes | (112,745)    | (19,482)    | 44,345     |
| Provision for income taxes                      | 529          | 631         | 9,130      |
| Net (loss)/income                               | \$ (113,274) | \$ (20,113) | \$ 35,215  |
| Net (loss)/income per share:                    |              |             |            |
| Basic and diluted (loss)/income per share       | \$ (1.13)    | \$ (0.19)   | \$ 0.34    |
| Basic weighted average shares outstanding       | 100,115      | 105,134     | 102,473    |
| Diluted weighted average shares outstanding     | 100,115      | 105,134     | 103,352    |

(1)

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The following summarizes the departmental allocation of the amortization of stock-based compensation (in thousands):

|                            | 2004     | 2005     | 2006   |
|----------------------------|----------|----------|--------|
| Cost of revenue            | \$ 4     | \$       | \$     |
| Research and development   | 772      | 266      | 187    |
| Selling and marketing      | 446      | 879      | 674    |
| General and administrative | 764      | 46       | 31     |
|                            | \$ 1,986 | \$ 1,191 | \$ 892 |

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

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**  
**(LOSS)**

(In thousands except share and per share data)

|   | Ordinary<br>Shares<br>Number of<br>Shares | Additional<br>0.11 Par<br>Paid-In<br>Value | Capital<br>Accumulated | Deferred from<br>Stockholders'<br>Equity | Notes      |             | Other<br>Comprehensive<br>Income | Total<br>Stockholders'<br>Equity | Total<br>Comprehensive<br>Loss |
|---|---|--|------------------------|--|------------|-------------|----------------------------------|----------------------------------|--------------------------------|
|   |   |  |                        |  | Receivable | Accumulated |                                  |                                  |                                |
| <b>BALANCE,<br/>JANUARY 31,<br/>2003</b>  | 99,598,146                                | \$ 10,737                                  | \$ 530,929             | \$ (347,642)                             | \$ (4,345) | \$ (58)     | \$ 1,466                         | \$ 191,087                       | \$                             |
| Exercise of<br>stock options  | 1,530,657                                 | 201  | 4,936                  |  |            |             |                                  | 5,137                            |                                |
| Issuance of<br>common stock<br>settlement of IP<br>Learn litigation   | 100,000                                   | 13   | 487                    |  |            |             |                                  | 500                              |                                |
| Issuance of<br>common stock<br>under employee<br>stock purchase<br>plan                                       | 628,911                                   | 80   | 2,096                  |  |            |             |                                  | 2,176                            |                                |
| Deferred<br>compensation<br>reversal of<br>unearned<br>compensation<br>related to<br>employee<br>terminations |   |  | (229)                  |  | 229        |             |                                  |                                  |                                |
| Amortization of<br>deferred<br>compensation   |   |  |                        |  | 1,986      |             |                                  | 1,986                            |                                |
| Deferred<br>compensation<br>amended stock<br>option grants  |   |  | 274                    |  | (274)      |             |                                  |                                  |                                |
| Repayment of<br>note receivable   |   |  |                        |  |            | 58          |                                  | 58                               |                                |
| Unrealized<br>(losses) on<br>marketable<br>securities   |   |  |                        |  |            |             | (1,713)                          | (1,713)                          | \$ (1,713)                     |
| Translation<br>adjustment   |   |  |                        |  |            |             | (199)                            | (199)                            | (199)                          |
| Net loss  |   |  |                        | (113,274)                                |            |             |                                  | (113,274)                        | (113,274)                      |

Comprehensive  
net loss for the  
year ended  
January 31,  
2004

\$ (115,186)

**BALANCE,  
JANUARY 31,  
2004**

101,857,714 \$ 11,031 \$ 538,493 \$ (460,916) \$ (2,404) \$ (446) \$ 85,758

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

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE**  
**INCOME/(LOSS)**

(In thousands except share and per share data)

|   | Ordinary Shares | Additional |            | Treasury Stock | Accumulated |              |               | Total    | Total         |             |
|---|-----------------|------------|------------|----------------|-------------|--------------|---------------|----------|---------------|-------------|
|   | Number of       | 0.11 Par   | Paid-In    | Number         | Cost        | Accumulated  | Deferred from | Other    | Stockholders' |             |
|   | Shares          | Value      | Capital    | of             | Cost        | Deficit      | Compensation  | Income   | Equity        |             |
|   |                 |            |            | Shares         |             |              | Stockholders' | (Loss)   | Equity        |             |
|   |                 |            |            |                |             |              | Equity        |          | Loss          |             |
| <b>BALANCE, JANUARY 31, 2004</b>                            | 101,857,714     | \$ 11,031  | \$ 538,493 |                | \$          | \$ (460,916) | \$ (2,404)    | \$ (446) | \$ 85,758     | \$          |
| Exercise of stock options                                   | 3,816,626       | 514        | 17,436     |                |             |              |               |          | 17,950        |             |
| Issuance of common stock under employee stock purchase plan | 533,478         | 72         | 2,978      |                |             |              |               |          | 3,050         |             |
| Purchase of treasury stock                                  |                 |            |            | 443,757        | (2,523)     |              |               |          | (2,523)       |             |
| Amortization of deferred compensation                       |                 |            | 145        |                |             |              | 1,046         |          | 1,191         |             |
| Unrealized (losses)/gains on marketable securities          |                 |            |            |                |             |              |               | (133)    | (133)         | \$ (133)    |
| Translation adjustment                                      |                 |            |            |                |             |              |               | (261)    | (261)         | (261)       |
| Net loss  |                 |            |            |                |             | (20,113)     |               |          | (20,113)      | (20,113)    |
| Comprehensive net loss for the year ended January 31, 2005  |                 |            |            |                |             |              |               |          |               | \$ (20,507) |
| <b>BALANCE, JANUARY 31, 2005</b>                            | 106,207,818     | \$ 11,617  | \$ 559,052 | 443,757        | (2,523)     | \$ (481,029) | \$ (1,358)    | \$ (840) | \$ 84,919     |             |

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



**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE**  
**INCOME/(LOSS) (Continued)**

(In thousands except share and per share data)

|  | Ordinary<br>Shares | Additional<br>0.11 Par<br>Value | Paid-In<br>Capital | Treasury Stock<br>Number of<br>shares | Cost       | Accumulated<br>Deficit | Compen-<br>sation | Accumulated<br>Deferred<br>Income<br>(Loss) | Other<br>Comprehen-<br>sive | Total<br>Stockhold-<br>ers' Equity | Total<br>Comprehen-<br>sive<br>Loss |
|--|--------------------|---------------------------------|--------------------|---------------------------------------|------------|------------------------|-------------------|---|-----------------------------|------------------------------------|-------------------------------------|
| <b>BALANCE,<br/>JANUARY 31,<br/>2005</b>                     | 106,207,818        | \$ 11,617                       | \$ 559,052         | 443,757                               | \$ (2,523) | \$ (481,029)           | \$ (1,358)        | \$ (840)                                    | \$ 84,919                   | \$                                 |                                     |
| Exercise of stock options                                    | 370,930            | 51                              | 797                |                                       |            |                        |                   |   |                             | 848                                |                                     |
| Issuance of common stock under employee stock purchase plan  | 765,495            | 105                             | 2,105              |                                       |            |                        |                   |   |                             | 2,210                              |                                     |
| Stock option modification                                    |                    |                                 | 89                 |                                       |            |                        |                   |   |                             | 89                                 |                                     |
| Tax Benefit Non-qualified stock options                      |                    |                                 | 9                  |                                       |            |                        |                   |   |                             | 9                                  |                                     |
| Purchase of treasury stock                                   |                    |                                 |                    | 6,090,127                             | (22,001)   |                        |                   |   |                             | (22,001)                           |                                     |
| Amortization of deferred compensation                        |                    |                                 |                    |                                       |            |                        | 893               |   |                             | 893                                |                                     |
| Unrealized gains on marketable securities                    |                    |                                 |                    |                                       |            |                        |                   | 44  |                             | 44                                 | \$ 44                               |
| Translation adjustment                                       |                    |                                 |                    |                                       |            |                        |                   | 46  |                             | 46                                 | 46                                  |
| Net income   |                    |                                 |                    |                                       |            | 35,215                 |                   |   |                             | 35,215                             | 35,215                              |
| Comprehensive net income for the year ended January 31, 2006 |                    |                                 |                    |                                       |            |                        |                   |   |                             |                                    | \$ 35,305                           |
|  | 107,344,243        | \$ 11,773                       | \$ 562,052         | 6,533,884                             | (24,524)   | \$ (445,814)           | \$ (465)          | \$ (750)                                    |                             | \$ 102,272                         |                                     |

**BALANCE,  
JANUARY 31,  
2006**

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

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years Ended January 31,

2004                      2005                      2006

(In thousands)

|   |              |             |           |
|---|--------------|-------------|-----------|
| Cash flows from operating activities:   |              |             |           |
| Net (loss)/ income  | \$ (113,274) | \$ (20,113) | \$ 35,215 |
| Adjustments to reconcile net (loss)/ income to net cash (used in)/ provided by operating activities |              |             |           |
| Stock-based compensation  | 2,486        | 1,191       | 981       |
| Depreciation and amortization   | 9,329        | 4,779       | 5,224     |
| Impairment charge   |              | 19,268      |           |
| Amortization of intangible assets   | 10,072       | 9,575       | 9,113     |
| Provision/ (recovery) for bad debts   | 459          | 335         | (593)     |
| Provision for income tax non-cash   |              | 326         | 7,922     |
| Realized (loss)/ gain on sale of assets, net  | (3,682)      |             | 586       |
| Changes in current assets and liabilities, net of acquisitions                                      |              |             |           |
| Accounts receivable   | (5,149)      | (14,062)    | 784       |
| Prepaid expenses and other current assets   | (6,632)      | 2,406       | 407       |
| Accounts payable  | (4,181)      | (1,220)     | (1,935)   |
| Accrued expenses (includes long-term)   | 45,887       | (40,858)    | (12,859)  |
| Deferred revenue  | 23,522       | 4,743       | (2,693)   |
| Net cash (used in)/ provided by operating activities  | (41,163)     | (33,630)    | 42,152    |
| Cash flows from investing activities:   |              |             |           |
| Purchases of property and equipment   | (3,643)      | (7,594)     | (6,423)   |
| Capitalized software development costs  |              |             | (1,652)   |
| Purchase of investments   | (92,614)     | (52,456)    | (20,048)  |
| Maturity of investments   | 137,786      | 42,063      | 27,219    |
| Sales of short-term investments   | 6,119        |             |           |
| (Designation)/ release of restricted cash, net  | (25,981)     | 24,943      | (4,045)   |
| Net cash used for a business combination  | (5,187)      |             |           |
| Decrease in other assets  | 409          |             |           |
| Net cash provided by/ (used in) investing activities  | 16,889       | 6,956       | (4,949)   |
| Cash flows from financing activities:   |              |             |           |
| Exercise of stock options   | 5,137        | 17,950      | 848       |
| Proceeds from employee stock purchase plan  | 2,176        | 3,050       | 2,210     |
| Repayment of note receivable  | 58           |             |           |
| Purchase treasury stock   |              | (2,523)     | (22,001)  |
| Net cash provided by/ (used in) financing activities  | 7,371        | 18,477      | (18,943)  |
| Effect of exchange rate changes on cash and cash equivalents  | 5,551        | 1,174       | (1,229)   |
| Net (decrease)/ increase in cash and cash equivalents   | (11,352)     | (7,023)     | 17,031    |
| Cash and cash equivalents, beginning of year  | 53,281       | 41,929      | 34,906    |

|   |           |           |           |
|---|-----------|-----------|-----------|
| Cash and cash equivalents, end of year                                      | \$ 41,929 | \$ 34,906 | \$ 51,937 |
| Supplemental disclosure of cash flow information:                           |           |           |           |
| Cash paid for interest  | \$ 167    | \$ 337    | \$ 431    |
| Cash paid for income taxes  | 781       | 200       | 1,375     |
| Supplemental disclosure of cash flows related to acquisitions (see Note 3): |           |           |           |
| Fair value of assets acquired, excluding cash                               | \$ 5,438  | \$        | \$        |
| Payments in connection with the acquisition, net of cash acquired           | (5,187)   |           |           |
| Issuance of common stock and assumption of common stock options             |           |           |           |
| Liabilities assumed   | \$ 251    | \$        | \$        |

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

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Basis of Presentation**

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. SkillSoft PLC is the result of a merger between SmartForce PLC and SkillSoft Corporation on September 6, 2002 (the Merger).

**(2) Summary of Significant Accounting Policies**

The accompanying consolidated financial statements reflect the application of certain significant accounting policies, as described in this note and elsewhere in these notes.

**(a) Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of the Company and its wholly and majority owned subsidiaries (see Note 6). All material intercompany transactions and balances have been eliminated in consolidation.

**(b) Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although the Company regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. The Company bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances. Actual results could differ from management's estimates if past experience or other assumptions do not turn out to be substantially accurate.

**(c) 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 product licenses varies based on the the content offering selected by the customer, the number of users within the customer's organization and the length of the license agreement. Our product licenses provide customers access to a full range of learning products including courseware, Referenceware, simulations, mentoring and prescriptive assessment.

A Referenceware license gives users access to a full Referenceware library within one or more Referenceware collections (examples of which include: ITPro, BusinessPro, FinancePro, EngineeringPro, GovEssential and OfficeEssentials) from Books24x7.com, Inc. (Books). The pricing for the Company's

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 larger numbers of courses, for larger user bases or for longer periods 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. 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.

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 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



**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 server whereby customers would be entitled to credits in the event of nonperformance. The Company also retains the right to remedy any nonperformance event prior to issuing a 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.

**(d) Deferred Commissions**

The Company employs an accounting policy consistent with guidance provided by FASB Technical Bulletin 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts* and SEC Staff Accounting Bulletin 104, *Revenue Recognition*, related to the concept of a direct and incremental relationship between revenue and expense. As such, the Company defers the recognition of commission expense until such time as the revenue related to the contract for which the commission was paid is recognized. Unamortized commissions expense is included in prepaid expenses and other current assets in the accompanying consolidated balance sheets.

**(e) Net Income/ (Loss) Per Share**

Basic and diluted net (loss)/ income per common share was determined by dividing net (loss)/ income by the weighted average common shares outstanding during the period. In fiscal 2004 and 2005 basic and diluted net loss per share is the same, as outstanding common stock options and warrants are anti-dilutive as the Company recorded a net loss for those periods.

The reconciliation of basic and diluted net shares is as follows (in thousands):

|   | <b>Year Ended January 31,</b> |             |             |
|---|-------------------------------|-------------|-------------|
|   | <b>2004</b>                   | <b>2005</b> | <b>2006</b> |
| Basic weighted average shares outstanding                           | 100,120                       | 105,134     | 102,473     |
| Effect of diluted shares outstanding                                |                               |             | 879         |
| Less weighted average unvested restricted common shares outstanding | (5)                           |             |             |
| Diluted weighted average common shares outstanding                  | 100,115                       | 105,134     | 103,352     |

The following share equivalents have been excluded from the computation of diluted weighted average shares outstanding as of January 31, 2004, 2005 and 2006, respectively, as they would be anti-dilutive.

|                     | <b>Year Ended January 31,</b> |             |             |
|---------------------|-------------------------------|-------------|-------------|
|                     | <b>2004</b>                   | <b>2005</b> | <b>2006</b> |
| Options outstanding | 23,036,822                    | 18,976,502  | 9,857,947   |

**(f) Foreign Currency Translation**

Assets and liabilities of the foreign subsidiaries are translated in accordance with Statement of Financial Accounting Standards (SFAS) No. 52, *Foreign Currency Translation*. The reporting currency for the  
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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Company is the U.S. dollar (dollar). The functional currency of the Company's subsidiaries in the United States, Ireland, the United Kingdom, Canada, Germany, Australia, the Netherlands, Sweden, Norway, Denmark, France, New Zealand and Singapore are the currencies of those countries. The functional currency of the Company's subsidiaries in the Commonwealth of the Bahamas and the Grand Cayman is the U.S. dollar. In accordance with SFAS No. 52, assets and liabilities are translated to the U.S. dollar from the local functional currency at current exchange rates, and income and expense items are translated to the U.S. dollar using the average rates of exchange prevailing during the year. Gains and losses arising from translation are recorded in other comprehensive income (loss) as a separate component of stockholders' equity. Currency gains or losses on transactions denominated in a currency other than an entity's functional currency are recorded in the results of the operations. (Losses)/gains arising from transactions denominated in foreign currencies were approximately \$581,000, (\$803,000) and \$410,000 for the years ended January 31, 2004, 2005 and 2006, respectively, and are included in other income (expense), net in the accompanying consolidated statements of operations.

**(g) Cash, Cash Equivalents, Restricted Cash, Short-term Investments, and Long-term 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 January 31, 2005 and January 31, 2006, cash equivalents consisted mainly of commercial paper, short-term notes and money market funds. The Company holds cash in investments 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. At January 31, 2006 the Company had approximately \$4.1 million of restricted cash, which is held voluntarily to defend named former and current 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 \$0.9 million, which is legally required to be held as part of certain facilities leases.

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 are reported at market value, and are classified as available-for-sale. At January 31, 2005 and 2006, the Company's investments were classified as available for sale and had an average maturity of approximately 180 and 64 days, respectively.

Cash and cash equivalents, available for sale short-term investments and long-term investments as of January 31, 2005 and 2006, respectively, were as follows (in thousands).

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

2005

| <b>Description</b>                | <b>Contracted Maturity</b> | <b>Cost</b> | <b>Gross Unrealized Gains</b> | <b>Gross Unrealized Losses</b> | <b>Fair Value</b> |
|-----------------------------------|----------------------------|-------------|-------------------------------|--------------------------------|-------------------|
| <b>Cash and cash equivalents:</b> |                            |             |                               |                                |                   |
| Cash                              | N/A                        | \$ 28,238   | \$                            | \$                             | \$ 28,238         |
| Commercial paper                  | 0-3 months                 | 3,592       |                               |                                | 3,592             |
| Federal agency notes              | 0-3 months                 | 1,999       |                               |                                | 1,999             |
| Money market funds                | 0-3 months                 | 1,077       |                               |                                | 1,077             |
|                                   |                            | 34,906      |                               |                                | 34,906            |
| <b>Short-term investments:</b>    |                            |             |                               |                                |                   |
| Commercial paper                  | 4-12 months                | 8,897       |                               | (4)                            | 8,893             |
| Federal agency notes              | 4-12 months                | 6,986       |                               | (14)                           | 6,972             |
| Corporate debt securities         | 4-12 months                | 4,178       |                               | (22)                           | 4,156             |
|                                   |                            | 20,061      |                               | (40)                           | 20,021            |
| <b>Long-term investments:</b>     |                            |             |                               |                                |                   |
| Federal agency notes              | 13-24 months               | 5,428       |                               | (36)                           | 5,392             |
| Corporate debt securities         | 13-24 months               | 3,341       |                               | (21)                           | 3,320             |
| Public equity securities          | N/A                        | 181         | 50                            |                                | 231               |
|                                   |                            | 8,950       | 50                            | (57)                           | 8,943             |
|                                   |                            | \$ 63,917   | \$ 50                         | \$ (97)                        | \$ 63,870         |

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

2006

| Description                | Contracted Maturity | Cost             | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value       |
|----------------------------|---------------------|------------------|------------------------|-------------------------|------------------|
| Cash and cash equivalents: |                     |                  |                        |                         |                  |
| Cash                       | N/A                 | \$ 25,692        | \$                     | \$                      | \$ 25,692        |
| Commercial paper           | 0-3 months          | 18,090           |                        | (3)                     | 18,087           |
| Federal agency notes       | 0-3 months          |                  |                        |                         |                  |
| Money market funds         | 0-3 months          | 8,158            |                        |                         | 8,158            |
|                            |                     | 51,940           |                        | (3)                     | 51,937           |
| Short-term investments:    |                     |                  |                        |                         |                  |
| Commercial paper           | 4-12 months         | 2,371            |                        | (1)                     | 2,370            |
| Federal agency notes       | 4-12 months         | 10,879           |                        | (29)                    | 10,850           |
| Corporate debt securities  | 4-12 months         | 8,201            |                        | (19)                    | 8,182            |
|                            |                     | 21,451           |                        | (49)                    | 21,402           |
| Long-term investments:     |                     |                  |                        |                         |                  |
| Public equity securities   | N/A                 | 181              | 49                     |                         | 230              |
|                            |                     | 181              | 49                     |                         | 230              |
|                            |                     | <u>\$ 73,572</u> | \$ 49                  | \$ (52)                 | <u>\$ 73,569</u> |

**(h) Depreciation and Amortization**

The Company records depreciation and amortization by charges to operations in amounts estimated to allocate the cost of property and equipment over their estimated useful lives, on a straight-line basis using the half year convention, as follows:

|                        | Estimated Useful Lives                 |
|------------------------|--|
| Computer equipment     | 2-3 years                              |
| Furniture and fixtures | 5 years                                |
| Leasehold improvements | Lesser of:<br>7 years or life of lease |

Repairs and maintenance are expensed as incurred.

**(i) Research and Development Expenses**

The Company expenses all research and development costs, which include course content development fees, to operations as incurred, except for costs of internally developed or externally purchased software that qualify for capitalization. SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed* (SFAS No. 86), requires the capitalization of certain computer software development costs incurred after technological feasibility is established given the Company's operations, once technological feasibility of a software product has been established, the additional development costs incurred to bring the product to a commercially

acceptable level has not been and is not expected to be significant. The Company capitalized software development costs related to new products SkillSoft Dialogue and SkillView in fiscal 2006.

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Capitalized software development costs, net of accumulated amortization were approximately \$4.8 million and \$10.1 million as of January 31, 2006 and January 31, 2005, respectively. The Company recognized approximately \$7.0 million, \$6.9 million and \$6.8 million of amortization expense related to capitalized software development costs in the fiscal years ended January 31, 2006, 2005 and 2004, respectively.

The Company enters into agreements with content providers for published content, the Company's policy is to expense these costs to research and development upon receipt of content.

**(j) Other Comprehensive Income**

SFAS No. 130, Reporting Comprehensive Income (SFAS No. 130) 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 from transactions, other events and circumstances from non-owner sources. The components of accumulated comprehensive income/(loss) as of January 31, 2005 and 2006 are as follows (in thousands):

|  | <b>Year Ended<br/>January 31,</b> |                 |
|--|-----------------------------------|-----------------|
|  | <b>2005</b>                       | <b>2006</b>     |
| Unrealized holding gains/ (losses)                         | \$ (59)                           | \$ (15)         |
| Foreign currency adjustment                                | (781)                             | (735)           |
| <b>Total accumulated other comprehensive income (loss)</b> | <b>\$ (840)</b>                   | <b>\$ (750)</b> |

**(k) Fair Value of Financial Instruments**

Financial instruments consist mainly of cash and cash equivalents, investments, restricted cash, accounts receivable and accounts payable. The Company determines fair value for short-term and long-term investments based on quoted market values. The carrying amounts of accounts receivable is net of an allowance for doubtful accounts, which is based on historical collections and known credit risks.

**(l) Concentrations of Credit Risk and Off-Balance-Sheet Risk**

For the years ended and as of January 31, 2004, 2005 and 2006, no customers individually comprised greater than 10% of total revenue or accounts receivable.

The Company performs continuing credit evaluations of its customers' financial condition and generally does not require collateral.

The Company has no significant off-balance-sheet or concentration of credit risks such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

The Company's cash, cash equivalents and investments are subject to the guidelines of the Company's investment policy. The primary objective of the policy with regard to the Company's portfolio is to provide with minimal risk as high a level of current income as is consistent with the preservation of capital and the maintenance of liquidity. Approved Instruments include U.S. Government and Agency securities as well as fixed income instruments rated AAA, A1/P1 or better.

**(m) 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 stockholders. SFAS No. 131 also established





**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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, in making decisions 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, Chief Financial Officer and the Chief Operating Officer. The Company views its operations and manages its business as principally two operating segments: MML and retail certification. MML content and software is an integrated solution that supports business and information technology professionals learning needs through its comprehensive learning management platform technology. The retail certification segment provides direct sales and services to individual end-users (See Note 11).

**(n) Amortization and Impairment of Goodwill and Intangible Assets**

The Company records intangible assets at historical costs. The Company amortizes its intangible assets including customer contracts and internally developed software. The Company reviews intangible assets subject to amortization at least annually to determine if any adverse conditions exist or a change in circumstances has occurred that would indicate impairment or a change in remaining useful life. Conditions that would indicate an impairment and trigger a more frequent impairment assessment include, but are not limited to, a significant adverse change in legal factors or business climate that could affect the value of an asset, or an adverse action or assessment by a regulator. In addition, the Company reviews its indefinite-lived intangible assets at least annually for impairment and reassesses their classification as indefinite-lived assets.

The Company tests goodwill during the fourth quarter of each year for impairment, or more frequently if certain indicators are present or changes in circumstances suggest that impairment may exist. When conducting its annual goodwill impairment test, the Company utilizes the two-step approach prescribed under FASB Statement No. 142, *Goodwill and Other Intangible Assets*.

**(o) Restructuring Charges**

The Company accounts for its restructuring activities under SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146). SFAS 146 states that a liability related to an exit or disposal activity should be recognized at fair value in the period in which it is incurred. Costs covered by SFAS 146 include, but are not limited to, the following: (1) one-time involuntary termination benefits provided to employees under the terms of a benefit arrangement that, in substance, is not an ongoing benefit arrangement or a deferred compensation contract, (2) certain contract termination costs, including operating lease termination costs and (3) other associated costs. As such, when the Company identifies restructuring charges that fulfill the requirements identified in SFAS 146 as incurred, it records the charges in its statement of operations.

**(p) Advertising Costs**

Costs incurred for producing and communicating advertising are expensed when incurred. Advertising expenses amounted to approximately \$971,000, \$975,000, and \$515,000 for the fiscal years ended January 31, 2004, 2005 and 2006, respectively.

**(q) Government Grants**

The Company has entered into grant agreements with government agencies to employ additional personnel. Conditions of employment are attached to these grant agreements. Government grants are recorded when there is reasonable assurance that the Company has complied with, and will continue to comply with, all conditions necessary to obtain the grants. In connection with the reduction in workforce resulting from the Merger and subsequent restructuring, the Company did not fulfill all the obligations associated with certain

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

grants, and therefore, reflected grants subject to refund as a liability in the accompanying consolidated balance sheet. As of January 31, 2005 and 2006, there was \$1.8 million and \$0 of grants subject to repayment, respectively, which are included in accrued liabilities on the consolidated balance sheet. At January 31, 2006, the Company had repaid all outstanding grants subject to refund.

**(r) Accounting for Stock-Based Compensation**

The Company accounts for its stock-based employee compensation plans using the intrinsic value method under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25) and related Interpretations under APB No. 25. The Company provides pro forma disclosures only of the compensation expense determined under the fair value provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123).

SFAS No. 123 requires the measurement of the fair value of stock options to employees to be included in the statements of operations or disclosed in the notes to financial statements. The Company elected the disclosure-only alternative under SFAS No. 123, which requires disclosure of the pro forma effects on earnings as if the fair-value-based method of accounting under SFAS No. 123 had been adopted, as well as certain other information. In accordance with SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure* (SFAS No. 148), the Company has provided the pro forma disclosures required under SFAS No. 123 for options granted using the Black-Scholes option-pricing model prescribed by SFAS No. 123. The weighted average information and assumptions used for the grants were as follows:

|  | <b>Year Ended January 31,</b> |             |             |
|--|-------------------------------|-------------|-------------|
|  | <b>2004</b>                   | <b>2005</b> | <b>2006</b> |
| Risk-free interest rates   | 2.84- 3.96%                   | 3.31-4.35%  | 3.86-4.48%  |
| Expected dividend yield  |                               |             |             |
| Volatility factor  | 96%                           | 86%         | 67%         |
| Expected lives   | 7 years                       | 7 years     | 7 years     |
| Weighted average fair value of options granted                     | \$ 3.50                       | \$ 8.78     | \$ 2.78     |
| Weighted average remaining contractual life of options outstanding | 7.6 years                     | 6.79 years  | 5.99 years  |

For shares purchased under the 2004 Employee Share Purchase Plan (ESPP), the Company uses a Black-Scholes option-pricing model, with the following assumptions. In valuing the ESPP, the Company used an assumed risk-free interest rate of 3.09% 3.79% for fiscal 2006, 1.01% 1.76% for fiscal 2005 and 1.24% for fiscal 2004. The Company also used an expected volatility factor of 49% for fiscal 2006, 50% for fiscal 2005 and 90% for fiscal 2004, and an expected life of six months, with the assumption that dividends will not be paid.

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Had compensation expense for its plans been determined consistent with SFAS No. 123, the Company's net income/(loss) and basic and diluted net income/(loss) per share would have been increased to the following pro forma amounts (in thousands, except per share data):

|  | <b>Year Ended January 31,</b> |                 |                |
|--|-------------------------------|-----------------|----------------|
|  | <b>2004</b>                   | <b>2005</b>     | <b>2006(1)</b> |
| <b>Net (loss)/ income</b>  |                               |                 |                |
| As reported  | \$ (113,274)                  | \$ (20,113)     | \$ 35,215      |
| Add: Share-based employee compensation expense recognized under APB No. 25   | 1,986                         | 1,191           | 893            |
| Less: Total share-based employee compensation expense determined under fair value based method for all awards under the employee share option plan | (20,885)                      | (24,474)        | (24,551)       |
| Less: Total share-based employee compensation expense determined under fair value based method for all awards under the ESPP                       | (1,296)                       | (1,019)         | (753)          |
| <br>Pro forma net income/ (loss)   | <br>\$ (133,469)              | <br>\$ (44,415) | <br>\$ 10,804  |
| <b>Basic and diluted net loss per share</b>  |                               |                 |                |
| As reported  | \$ (1.13)                     | \$ (0.19)       | \$ 0.34        |
| <br>Pro forma  | <br>\$ (1.33)                 | <br>\$ (0.42)   | <br>\$ 0.11    |

Because additional option grants are expected to be made in future periods, the above pro forma disclosures may not be representative of results for future periods. We currently expect to incur approximately \$3.1 million and \$0.2 million in fiscal 2007 and fiscal 2008, respectively, for the future compensation cost for unvested awards as of January 31, 2006.

- (1) Fiscal 2006 total share-based compensation expense determined under fair value based method for all awards included approximately \$9.1 million as a result of the acceleration of vesting of all previously outstanding unvested share options previously awarded to employees (excluding unvested share options held by executive officers and directors). The acceleration of vesting was effected in order to avoid a negative impact to the Company's income statement upon adoption of SFAS 123R in fiscal 2007.

**(s) Recent Accounting Pronouncements**

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123. Statement 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends FASB Statement No. 95, *Statement of Cash Flows*. Generally, the approach in Statement 123(R) is similar to the approach described in SFAS 123. However, Statement 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.

Statement 123(R) is effective for the first quarter of the first fiscal year that begins after June 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. The Company adopted Statement 123(R) on February 1, 2006.

Statement 123(R) permits public companies to adopt its requirements using one of two methods:

1. A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date; or

2. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company has determined to utilize the modified prospective method in adopting SFAS 123(R).

The Company currently anticipates recognizing between \$3.0 million and \$4.0 million in the fiscal year ending January 31, 2007 and approximately \$0.2 million in the fiscal year ending January 31, 2008 of compensation expense related to unvested share options currently held by executive officers and directors as a result of adopting SFAS 123(R). Compensation expense could be increased to the extent additional share options are granted in the future.

Had the Company adopted SFAS 123(R) in prior fiscal years, the impact of that standard would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net income/ (loss) and earnings per share in Note 2(r).

The FASB recently issued Statement No. 154, *Accounting Changes and Error Corrections*, (SFAS 154), which is a replacement of APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. (SFAS 3). SFAS 154 applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impracticable. APB 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is effected by a change in accounting principle. APB 20 previously required that such a change be reported as a change in accounting principle. SFAS 154 carries forward many provisions of APB 20 without change, including the provisions related to the reporting of a change in accounting estimate, a change in the reporting entity, and the correction of an error. SFAS 154 also carries forward the provisions of SFAS 3 that govern reporting accounting changes in interim financial statements. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Earlier application is permitted for accounting changes and corrections of errors made occurring in fiscal years beginning after June 1, 2005. SFAS 154 does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of SFAS 154.

**(t) Prior Year Financial Statement Reclassifications**

To conform with the current year presentation, \$787,000 and \$784,000 of interest income, net for the fiscal years ended January 31, 2004 and 2005, respectively, was reclassified as interest income of \$954,000 and \$1,091,000 and interest expense of \$167,000 and \$337,000 in the fiscal years ended January 31, 2004 and 2005, respectively.

**(3) Acquisitions**

**GoTrain Corp.**

In June 2003, the Company acquired the assets of GoTrain Corp. (GoTrain), an e-learning business, for approximately \$5.2 million in cash, which was paid during the quarter ended July 31, 2003. This acquisition

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

resulted in allocations of purchase price to goodwill and intangible assets of \$3.7 million and \$1.5 million, respectively. Intangible assets allocated were the internally developed software, which is comprised of content valued at \$498,000 that will be amortized over a period of 4 years and the platform valued at \$512,000 that will be amortized over a period of 2 years. Intangible assets also include customer contracts valued at \$518,000, which will be amortized over 4 years. The historical results of operations for GoTrain were not material to the results of the operations of the Company.

**(4) Special Charges**

**(a) Merger and Exit Costs**

In connection with a merger between SmartForce PLC and SkillSoft Corporation on September 6, 2002 (the Merger), the Company's management effected a restructuring to eliminate redundant facilities and headcount, reduce cost structure and better align the Company's operating expenses with existing economic conditions. Pursuant to this restructuring, the Company recorded \$30.3 million of costs in 2002 relating to exiting activities of pre-Merger SmartForce PLC such as severance and related benefits, costs to vacate leased facilities and other pre-Merger 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 and increased goodwill.

The reductions in employee headcount totaled approximately 632 employees from the administrative, sales, marketing and development functions, and amounted to a liability of approximately \$14.5 million in 2002. Approximately \$13.3 million was paid out against the exit plan accrual through January 31, 2006, and the remaining amount of \$1.2 million, net of adjustments for foreign currency translation, is expected to be paid by the end of fiscal 2007.

In connection with the exit plan, the Company abandoned or downsized certain leased facilities resulting in a facilities consolidation liability of \$12.7 million as of January 31, 2003, consisting of sublease losses, broker commissions and other facility costs. As part of the plan, 11 sites were vacated and 4 sites were downsized. To determine the sublease loss, which is the loss after the Company's estimated cost recovery efforts from subleasing vacated space, certain assumptions were made related to the (1) time period over which the property will remain vacant, (2) sublease terms and (3) sublease rates. The lease loss is an estimate under SFAS No. 5 Accounting for Contingencies (SFAS No. 5). In the year ended January 31, 2004, the Company revised certain of its estimates made in connection with the original purchase price pertaining to unoccupied facilities under lease as a result of the Merger. This adjustment to the exit plan accrual fell within the one year purchase price allocation period prescribed by SFAS No. 141 Business Combinations (SFAS No. 141). In the fiscal years ended January 31, 2005 and 2006, the Company again revised certain of its estimates made in connection with the original purchase price pertaining to unoccupied facilities under lease as a result of the Merger. This adjustment to the exit accrual fell outside the one year purchase price allocation period and was charged to restructuring and is included in the statement of operations. The net present value of the obligation under this exit plan, as adjusted, was approximately \$15.3 million, of which \$3.5 million remains.

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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<br/>Severance and<br/>Related Costs</b> | <b>Closedown<br/>of Facilities</b> | <b>Other</b> | <b>Total</b> |
|--|---|------------------------------------|--------------|--------------|
| Merger and exit accrual, January 31, 2004                                      | \$ 2,831  | \$ 9,073                           | \$ 484       | \$ 12,388    |
| Long-term obligation   | \$  | \$ 5,469                           | \$           | \$ 5,469     |
| Current obligation   | \$ 2,831  | \$ 3,604                           | \$ 484       | \$ 6,919     |
| Payments made during the year ended January 31, 2005                           | (925)   | (3,228)                            | (210)        | (4,363)      |
| Adjustments to accrual during the year ended January 31, 2005                  | 49  | 707                                | 60           | 816          |
| Merger and exit accrual, January 31, 2005                                      | \$ 1,955  | \$ 6,552                           | \$ 334       | \$ 8,841     |
| Long-term obligation   | \$  | \$ 4,022                           | \$           | \$ 4,022     |
| Current obligation   | \$ 1,955  | \$ 2,530                           | \$ 334       | \$ 4,819     |
| Payments made during the year ended January 31, 2006                           | (316)   | (3,275)                            | (110)        | (3,701)      |
| Reversal without utilization to accrual during the year ended January 31, 2006 | (453)   |                                    | (55)         | (508)        |
| Adjustments to accrual during the year ended January 31, 2006                  |   | 180                                |              | 180          |
| Merger and exit accrual, January 31, 2006                                      | \$ 1,186  | \$ 3,457                           | \$ 169       | \$ 4,812     |
| Long-term obligation   | \$  | \$ 1,602                           | \$           | \$ 1,602     |
| Current obligation   | \$ 1,186  | \$ 1,855                           | \$ 169       | \$ 3,210     |

Other merger accruals primarily include payments under operating equipment leases.

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 | \$ 3,210 |
| Year Ended January 31, 2008 | 551      |
| Year Ended January 31, 2009 | 493      |
| Year Ended January 31, 2010 | 518      |
| Thereafter                  | 40       |
| Total                       | \$ 4,812 |

**(b) Restructuring**

The Company recorded a \$14.2 million restructuring charge during the fiscal year ended January 31, 2003, which was included in the statement of operations. Approximately \$10.2 million of this charge represented the compensation cost of terminated SmartForce PLC employees for services rendered from the date of the Merger through such employees' termination dates and certain other compensation costs to terminated and continuing employees of the Company. Also included in the \$14.2 million charge are certain other one time costs incurred by SkillSoft Corporation as a result of the Merger. These costs primarily consist of employee severance and related costs and contractual obligations. Payments made under these obligations

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

during the years ended January 31, 2004, 2005 and 2006 aggregated approximately \$2.6 million, \$100,000, and \$0, respectively.

The Company recorded a \$13.4 million restructuring charge for the fiscal year ended January 31, 2005, which was included in the statement of operations. Approximately \$9.8 million of this charge represented contractual obligations (including \$350,000 related to Retail Certification), \$3.4 million represented the compensation cost of terminated employees, which included 131 employees in our research and development function and 41 employees in our sales function, for services rendered from the date of the restructuring through termination dates and one time severance payouts (including \$353,000 related to Retail Certification) and approximately \$400,000 was related to the write-down of fixed assets rendered obsolete as a result of the restructuring activities.

During the fiscal year ended January 31, 2006 the Company revised certain of its estimates made in connection to the previous restructurings related to both contractual obligations and employee severance and related costs.

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

|  | <b>Employee<br/>Severance and<br/>Related Costs</b> | <b>Contractual<br/>Obligations</b> | <b>Total</b> |
|--|---|------------------------------------|--------------|
| Total restructuring accrual as of January 31, 2004                   | \$  | \$ 84                              | \$ 84        |
| Payments and write downs made during the year ended January 31, 2005 | (2,932)   | (617)                              | (3,549)      |
| Restructuring charge for year ended January 31, 2005                 | 3,556   | 9,277                              | 12,833       |
| Total restructuring accrual as of January 31, 2005                   | 624   | 8,744                              | 9,368        |
| Payments and write downs made during the year ended January 31, 2006 | (968)   | (6,874)                            | (7,842)      |
| Restructuring charge for year ended January 31, 2006                 | 344   | 117                                | 461          |
| Total restructuring accrual as of January 31, 2006                   | \$  | \$ 1,987                           | \$ 1,987     |

The net restructuring charges for the fiscal years ended January 31, 2004, 2005 and 2006 would have been allocated as follows had the Company recorded the expense and adjustments within the functional department of the restructured activities (in thousands):

|                            | <b>Year<br/>Ended<br/>January 31,<br/>2004</b> | <b>Year<br/>Ended<br/>January 31,<br/>2005</b> | <b>Year<br/>Ended<br/>January 31,<br/>2006</b> |
|----------------------------|--|--|--|
| Research and development   | \$ 126   | \$ 11,510                                      | \$ 5   |
| Selling and marketing      | 643  | 846  | 394  |
| General and administrative | 1,088  | 477  | 62   |
| Total                      | \$ 1,857                                       | \$ 12,833                                      | \$ 461   |

(c) **SEC investigation and Other Professional Fees**

Consistent with the Company's accounting policy and historical treatment regarding annual audit fees, the Company accrued the estimated audit fees related to the restatement of the historical SmartForce PLC financial statements, the acquired business, in the year ended January 31, 2003. All other costs associated with the restatement, the resulting SEC investigation, and the 2002 shareholder class action lawsuit are expensed as the work is performed. For the fiscal years ended January 31, 2004, 2005 and 2006, the Company recorded

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

\$1.9 million, \$2.2 million and \$2.0 million, respectively, in expenses related to the ongoing SEC investigation. For the fiscal years ended January 31, 2004, 2005 and 2006, the Company recorded \$14.5 million, \$0.3 million and \$0, respectively in professional fees related to the re-filing of statutory tax returns as a result of the restatement of the historical SmartForce PLC financial statements.

**(5) Goodwill and Intangible Assets**

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

|  | January 31, 2005            |                             |                           | January 31, 2006            |                             |                           |
|--|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| Internally developed software/courseware | \$ 26,610                   | \$ 16,476                   | \$ 10,134                 | \$ 28,257                   | \$ 23,414                   | \$ 4,843                  |
| Customer contracts                       | 13,018                      | 7,881                       | 5,137                     | 13,018                      | 10,055                      | 2,963                     |
| Books trademark                          | 900                         |                             | 900                       | 905                         |                             | 905                       |
|  | 40,528                      | 24,357                      | 16,171                    | 42,180                      | 33,469                      | 8,711                     |
| Goodwill                                 | 103,576                     |                             | 103,576                   | 93,929                      |                             | 93,929                    |
| Total                                    | \$ 144,104                  | \$ 24,357                   | \$ 119,747                | \$ 136,109                  | \$ 33,469                   | \$ 102,640                |

Customer contracts are existing contracts that relate to underlying customer relationships pertaining to the services provided by the acquired company. The Company amortizes the fair value of customer contracts on an accelerated basis over their estimated useful lives ranging from 48 to 60 months with a weighted average estimated useful life of 48 months. Internally developed software/courseware relates to the Books platform, GoTrain content and platform, the SmartForce PLC content, and costs incurred subsequent to technological feasibility and prior to general release for the development of SkillSoft Dialogue and SkillView capitalized under SFAS No. 86. Course content includes courses in both the business skills and information technology skills subject areas. All courseware is deployable via the Internet or corporate intranets. The Company amortizes internally developed or purchased software/courseware, including SkillSoft Dialogue and SkillView costs capitalized under SFAS No. 86, over their estimated useful lives ranging from 24 to 48 months with a weighted average useful life of 46 months.

The change in goodwill at January 31, 2006 from the amount recorded at January 31, 2005 was due primarily to the Company's utilization of the tax benefit of net operating loss carryforwards assumed as part of the Merger. The change in goodwill at January 31, 2005 from the amount recorded at January 31, 2004 was due primarily to the impairment charge recorded for the Company's Retail Certification unit and to a lesser extent due to revisions to the purchase price accruals, collections of accounts receivable in excess of the

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

estimated realizable value at the purchase date and 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, 2004 | \$ 125,878   |
| Impairment  | (19,268)     |
| Utilization of tax benefit                          | (326)        |
| Other   | (2,708)      |
| <br>  |              |
| Gross carrying amount of goodwill, January 31, 2005 | 103,576      |
| Utilization of tax benefit                          | (7,922)      |
| Other   | (1,725)      |
| <br>  |              |
| Gross carrying amount of goodwill, January 31, 2006 | \$ 93,929    |

Amortization expense for the next three fiscal years is expected to be as follows (in thousands):

| <b>Fiscal Year</b> | <b>Amortization<br/>Expense</b> |
|--------------------|---------------------------------|
| 2007               | \$ 6,169                        |
| 2008               | 1,625                           |
| 2009               | 12                              |
| <br>               |                                 |
| Total              | \$ 7,806                        |

**Goodwill Impairment**

In the fourth quarter of fiscal 2005, the Company evaluated the fair value of goodwill. In November of 2004 the Company hired an investment banker to actively market the Retail Certification segment to third party buyers. However by January 31, 2005 the investment banker reported the efforts to sell the business were unsuccessful. On March 14, 2005, the Company entered into a non-binding letter of intent with respect to the sale of the Company's Retail Certification segment. The terms of the sale involve the transfer of certain assets and liabilities of the business in exchange for nominal consideration and the execution of a reseller agreement with the buyer. Consequently, based on the Company's attempts to sell the business and the results of a valuation done by an independent third party valuation firm, it is the Company's conclusion that the Retail Certification segment has no goodwill. The Company recorded an impairment charge of approximately \$19.3 million in the fiscal year ended January 31, 2005.

The Company prepared a cash flow analysis for the MML segment comparing the discounted cash flows to the net book values of the direct assets, goodwill and intangible assets. The discounted cash flows supported the direct assets, goodwill and intangible assets of the MML segment. At January 31, 2005 and 2006, the Company concluded there was no impairment of goodwill for the MML segment.

**(6) Related Party Transactions**  
**CBT Technology**

Approximately 9% of the outstanding share capital of CBT Technology Limited (CBT T), one of the Company's Irish subsidiaries, representing a special non-voting class, is owned by Stargazer Productions (Stargazer), an unlimited company which is wholly-owned by certain employees of SkillSoft PLC. These employees do not include any of the Company's directors or executive officers.

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

All of the voting securities of CBT T are owned by Fidalco Limited, a wholly owned subsidiary of SkillSoft PLC and, except for the securities owned by Fidalco Limited and Stargazer, there are no other outstanding securities of CBT T. CBT T has in the past and may in the future declare and pay dividends to Stargazer, and Stargazer may pay dividends to its shareholders out of such amounts. Dividend payments of approximately \$338,000, \$196,000 and \$0 were paid in the fiscal years ended January 31, 2004, 2005 and 2006, respectively. Stargazer does not have any rights to the assets of CBT T, only to receive periodic dividends as and when declared by CBT T. Except for the fact that Stargazer is wholly owned by certain key employees of SkillSoft PLC, there is no relationship between SkillSoft PLC and Stargazer.

**(7) Income Taxes**

Income/(loss) before provision/benefit for income taxes consists of the following (in thousands):

|               | January 31,  |             |           |
|---------------|--------------|-------------|-----------|
|               | 2004         | 2005        | 2006      |
| Ireland       | \$ (55,076)  | \$ (20,066) | \$ 13,178 |
| United States | (61,995)     | (5,994)     | 28,365    |
| Rest of World | 4,326        | 6,578       | 2,802     |
|               | \$ (112,745) | \$ (19,482) | \$ 44,345 |

The provision for income taxes consists of the following (in thousands):

|                  | January 31 |        |          |
|------------------|------------|--------|----------|
|                  | 2004       | 2005   | 2006     |
| <b>Current:</b>  |            |        |          |
| Ireland          | \$         | \$     | \$       |
| United States    | 50         | 56     | 7,992    |
| Rest of World    | 479        | 482    | 968      |
|                  | \$ 529     | \$ 538 | \$ 8,960 |
| <b>Deferred:</b> |            |        |          |
| Ireland          | \$         | \$     | \$       |
| United States    |            | 156    | 99       |
| Rest of World    |            | (63)   | 71       |
|                  | \$         | \$ 93  | \$ 170   |
| Tax provision    | \$ 529     | \$ 631 | \$ 9,130 |



**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Net deferred tax assets and liabilities consist of the following (in thousands):

|  | <b>January 31,</b> |             |
|--|--------------------|-------------|
|  | <b>2005</b>        | <b>2006</b> |
| <b>Current</b>                         |                    |             |
| Net operating loss carryforwards       | \$ 11,433          | \$ 10,822   |
| Nondeductible expenses and reserves    | (6,627)            | (4,770)     |
|  | 18,060             | 15,592      |
| <b>Non-current</b>                     |                    |             |
| Net operating loss carryforwards       | \$ 139,031         | \$ 127,815  |
| Tax credits                            | 3,326              | 5,612       |
| Nondeductible non-goodwill intangibles | (3,497)            | (2,008)     |
|  | 138,860            | 131,419     |
| Total current and non-current          | 156,920            | 147,011     |
| Less valuation allowance               | (157,004)          | (146,317)   |
|  | \$ (84)            | \$ 694      |

The Company has recorded a deferred tax asset as of January 31, 2006. The deferred tax asset is the result of temporary differences arising in Canada of \$949,000, partially offset by \$255,000 of U.S. deferred tax liabilities. The Company has reduced its valuation allowance due to the utilization of net operating losses and other temporary differences to reduce U.S. taxable income. The Company analyzes its deferred tax assets and liabilities and its valuation allowances on a jurisdiction by jurisdiction basis. Some jurisdictions have a history of profitability while others have a history of losses. Additionally, in some jurisdictions we anticipate future profitability while in others we do not.

The Company has considered all tax planning strategies available to it when calculating its deferred tax assets and liabilities and its valuation allowances.

A reconciliation of the Irish statutory rate to the Company's effective tax rate is as follows:

|   | <b>January 31,</b> |             |             |
|---|--------------------|-------------|-------------|
|   | <b>2004</b>        | <b>2005</b> | <b>2006</b> |
| Income tax provision at statutory rate                            | 12.0%              | 12.0%       | 12.0%       |
| Increase (decrease) in tax resulting from:                        |                    |             |             |
| State tax provision, net of federal benefit                       | (0.04)             | (6.8)       | 4.50        |
| Tax exempt legal settlements/(insurance proceeds)                 | 3.38               | 0.0         | (4.73)      |
| Foreign differential  | 15.44              | (21.4)      | 16.09       |
| Nondeductible items, primarily goodwill impairment charge in 2005 | 0.0                | (11.3)      | 1.95        |
| Change in valuation allowance                                     | (31.25)            | 24.3        | (9.22)      |



|                    |         |        |        |
|--------------------|---------|--------|--------|
| Effective tax rate | (0.47)% | (3.2)% | 20.59% |
|--------------------|---------|--------|--------|

The Company accounts for income taxes using the liability method in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS No. 109). Under the liability method specified by SFAS No. 109, a deferred tax asset or liability is determined based on the difference between the financial statement and tax bases of assets and liabilities, as measured by the enacted tax rates assumed to be in effect when these differences are expected to reverse. A deferred tax valuation allowance is required if it is more likely than not that all or a portion of the recorded deferred tax assets will not be realized.

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company has recorded a total provision for income taxes in 2004, 2005 and 2006 of \$529,000, \$631,000 and \$9.1 million, respectively, primarily related to the use of acquired tax assets, the benefit of which is realized through reductions to goodwill, income generated in foreign countries, which cannot be offset by loss carryforwards and tax exempt insurance proceeds and legal settlements.

As of January 31, 2006, the Company has U.S. federal net operating loss carryforwards of approximately \$314.0 million available to reduce future income taxes, if any. The Company also has U.S. federal tax credit carryforwards of approximately \$5.6 million at January 31, 2006. Additionally, the Company has approximately \$99.7 million of net operating loss carryforwards in jurisdictions outside of the U.S. Approximately \$93.8 of these carryforwards are not subject to expiration while the remainder of \$319.9, if not utilized, will expire at various dates through the year ending January 31, 2025.

Included in the \$314.0 million of U.S. federal net operating loss carryforwards and U.S. federal tax credit carryforwards of approximately \$5.6 million, is approximately \$200.1 million of U.S. net operating loss carryforwards and \$365,000 of U.S. tax credit carryforwards, respectively, that were acquired in the Merger and the purchase of Books. In addition, included in the \$99.7 million of net operating loss carryforwards in jurisdictions outside of the U.S., is approximately \$61.1 million of net operating loss carryforwards in jurisdictions outside the U.S. acquired in the Merger and the purchase of Books. The Company will realize the benefits of these acquired net operating losses through reductions to goodwill and non-goodwill intangibles during the period that the losses are utilized.

Also included in the \$314.0 million of U.S. federal net operating loss carryforwards at January 31, 2006, is approximately \$28.0 million of net operating loss carryforwards in the United States resulting from disqualifying dispositions. The Company will realize the benefit of these losses through increases to stockholder's equity in the periods in which the losses are utilized to reduce tax payments.

The Company completed several financings since its inception and has incurred ownership changes as defined under Section 382 of the Internal Revenue Code. The Company completed an analysis of these changes and does not believe that the changes will have a material impact on its ability to use its net operating loss and tax credit carryforwards.

The Company recorded as part of purchase accounting a deferred tax liability of \$7.4 million related to separately identified intangible assets. Additionally, through purchase accounting, the Company recognized a deferred tax asset of \$7.4 million relative to a portion of the net operating losses acquired. Due to the Company's history of operating losses, there is significant uncertainty surrounding the Company's ability to utilize its net operating loss and tax credit carryforwards. Accordingly, the Company has provided a full valuation allowance against its otherwise realizable net deferred tax assets as of January 31, 2005 and 2006.

The Company has a reserve for taxes that may become payable as a result of audits in future periods with respect to previously filed tax returns. The Company establishes the reserves based upon management's assessment of exposure associated with permanent tax differences and associated interest expense. The tax reserves are analyzed periodically (at least annually) and adjustments are made as events occur to warrant adjustment to the reserve. For example, if the statutory period for assessing tax on a given tax return or period lapses, the reserve associated with that period will be reduced. In addition, the adjustment to the reserve will reflect any additional exposure based on current calculations.

The American Jobs Creation Act of 2004 (the Act) introduced a special one-time dividend received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. The President signed the Act into law on October 22, 2004. The Company is an Irish based Company and cannot take advantage of the Act. The Company's current intention is to reinvest all of the Company's unremitted earnings permanently and therefore has not set up any deferred taxes on these earnings.

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(8) Commitments and Contingencies****(a) Leases**

The Company leases its facilities and certain equipment and furniture under operating lease agreements that expire at various dates through 2023. The lease agreements frequently include renewal clauses, escalation clauses and purchase provisions and require the Company to pay taxes, insurances and maintenance costs. Included in the accompanying statements of operations is rent expense for leased facilities and equipment of approximately \$5.0 million, \$5.6 million, and \$3.6 million for the fiscal years ended January 31, 2004, 2005 and 2006, respectively.

Future minimum lease payments under the operating lease agreements are approximately as follows (in thousands):

|                               | Facilities | Other  | Total     |
|-------------------------------|------------|--------|-----------|
| Fiscal year ended January 31: |            |        |           |
| 2007                          | \$ 4,730   | \$ 467 | \$ 5,197  |
| 2008                          | 4,612      | 202    | 4,814     |
| 2009                          | 4,069      | 17     | 4,086     |
| 2010                          | 2,061      |        | 2,061     |
| 2011                          | 1,668      |        | 1,668     |
| Thereafter                    | 13,101     |        | 13,101    |
|                               | \$ 30,241  | \$ 686 | \$ 30,927 |

**(b) Minimum Commitments**

As of January 31, 2006 the Company had not entered into any long-term agreements with third parties to provide services and/or subject matter expertise.

**(c) Litigation***SEC Investigation*

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.

*Lawsuits*

On November 18, 2004, Jody Glidden, Michael LeBlanc and Trish Glidden filed a lawsuit against the Company, David C. Drummond, Gregory M. Priest, Patrick E. Murphy and Jack Hayes in the United States

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

District Court for the Northern District of California. The plaintiffs subsequently dismissed Patrick E. Murphy and Jack Hayes from the lawsuit. The court subsequently dismissed Trish Glidden's claims. The plaintiffs had previously opted out of the class action settlement that received final approval from the court on September 29, 2004. The lawsuit sets forth substantially the same claims as were alleged in the class action litigation. In particular, the lawsuit alleges that the Company misrepresented or omitted to state material facts in its SEC filings and press releases regarding the Company's revenues and earnings and failed to correct such false and misleading SEC filings and press releases, which are alleged to have artificially inflated the price of the Company's ADSs in connection with its acquisition of IC Global in early 2001. The lawsuit sought compensatory damages in excess of \$3.7 million and other unspecified damages, including punitive damages. The parties settled the lawsuit on April 7, 2006. Pursuant to the settlement, the Company will pay approximately \$1.8 million to the plaintiffs by April 17, 2006, which has been recorded as legal settlement in our statement of operations for the year ended January 31, 2006. Within five days of receipt of payment, counsel for the plaintiffs will submit to the Court a Stipulation and Request for Dismissal with Prejudice of the action.

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 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 ongoing 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 has been recorded in the fiscal 2006 second quarter.

On December 1, 2003, the Company reached a settlement of the class action litigation filed in 1998 in the United States District Court for the Northern District of California against the Company, one of its subsidiaries and certain of its former and current officers and directors alleging violations of the federal securities laws. Under the terms of the settlement, the Company made a \$10 million cash payment in January 2004 and made an additional \$6 million payment in fiscal 2005. The Company's insurance carriers paid an additional \$16 million for total settlement payments of \$32 million. The court granted final approval of the settlement, and the litigation was dismissed with prejudice on February 27, 2004. The Company expensed the entire settlement in the fiscal year ending January 31, 2004.

On July 21, 2003, the parties entered into a settlement agreement, which resulted in a final dismissal and termination of the NETg State Court Litigation and the NETg Patent Litigation. Under the terms of the settlement agreement, the Company has agreed to pay NETg an aggregate of \$44 million in two payments of \$22 million each. The Company made the first payment on July 25, 2003 and the second payment on July 21, 2004. The Company also agreed not to make certain specific modifications to its information technology training courseware for a limited period of time. In exchange, SkillSoft Corporation and the other defendants received complete but conditional releases from any liability relating to the subject matter of the NETg State Court Litigation or the NETg Patent Litigation, or with certain exceptions, based on or arising from the alleged use of any alleged NETg intellectual property. The Company also received a perpetual, non-transferable, non-exclusive license to develop, use, sell, offer for sale, lease or offer to lease products or services

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

containing or embodying certain NETg technology or inventions disclosed or described in certain NETg patent applications. The Settlement Agreement provides that it is specifically understood that two million dollars of the payments provided for under the Settlement Agreement, shall be in respect of such license. Under the terms of the settlement agreement, if NETg was not compelled to return the first \$22 million payment on or before October 28, 2003, then the releases would become unconditional, the NETg State Court Litigation would be dismissed with prejudice and the NETg Patent Litigation would not be pursued further. On October 29, 2003, the state court entered the parties' stipulation of dismissal, and the action was dismissed with prejudice. The above-referenced releases likewise became unconditional. The Company expensed the entire settlement in the fiscal year ending January 31, 2004.

In June 2003, the Company reached an agreement with IP Learn regarding the settlement of the pending litigation pursuant to which the Company obtained a license to use certain of IP Learn's patents. Under the terms of the settlement agreement, the Company made a cash payment of \$2.0 million and issued 100,000 ordinary shares (which are represented by ADSs). On or about November 18, 2003, pursuant to the settlement agreement and a stipulation filed by the parties, the court entered an order dismissing the lawsuits with prejudice. The Company expensed the entire settlement in the fiscal year ending January 31, 2004.

On October 23, 2003, the Company entered into a settlement agreement with Lionet Limited. The Company recorded to expense the entire settlement in the fiscal year ended January 31, 2004.

We are not a party to any other material legal proceedings.

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.

**(d) Credit Facility**

The Company entered into a \$25 million two year, line of credit with a bank on July 23, 2004, which was amended in April 2005. 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 revolving line of credit. The Company paid approximately \$12,000 in unused commitment fees for the fiscal year ended January 31, 2006. 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 January 31, 2006, there were no borrowings on 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% as well as administrative costs. The Company paid approximately \$79,000 in letters of credit fees in the fiscal year ended January 31, 2006.

**(e) Delinquent Foreign Filings**

The Company operates in various foreign countries through subsidiaries organized in those countries. Due to the restatement of the historical SmartForce statutory financial statements, some of the subsidiaries have not filed their audited 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. The Company does not believe such restrictions, penalties and fines, if any, would have a material impact on the financial statements.

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(9) Stockholders Equity**

**(a) Stock Option Plans**

The Company adopted the 1998 Stock Incentive Plan (the 1998 Plan), pursuant to which up to 7,402,071 shares of common stock could have been issued. In July 2001, the Company adopted the 2001 Stock Incentive Plan (the 2001 Plan), pursuant to which up to 3,432,730 shares of common stock could have been issued, subject to increase in accordance with the terms of the 2001 Plan. Under the 1998 Plan and the 2001 Plan, the Company could have granted both incentive stock options and nonqualified stock options, as well as award or sell shares of common stock to employees, directors or outside consultants of the Company. All option grants, prices and vesting periods are determined by the Board of Directors or its designee. Incentive stock options were to be granted at a price not less than 100% of the fair market value of the common stock on the date of grant and not less than 110% of the fair market value for a stockholder holding more than 10% of the Company's voting common stock.

In connection with the acquisition of Books on December 28, 2001, the Company assumed the Books 1994 Stock Option Plan (the 1994 Plan), consisting of options to purchase 808,799 shares, insofar as it related to outstanding options. Under the 1994 Plan, options to acquire ordinary shares in Books could have been granted to all officers, other key employees, consultants and advisors. The 1994 Plan is administered by the Board of Directors. Options under the Plan generally expire not later than 90 days following termination of employment or service or 12 months following the optionee's death. There are certain exceptions for exercises following retirement or death.

In connection with the Merger on September 6, 2002, the Company assumed the SmartForce plans, consisting of options to purchase 15,941,705 ordinary shares under various plans. The following is a brief description of such plans:

Under the 1990 Share Option Scheme (the 1990 Plan), options to acquire ordinary shares in the Company could have been granted to any director or employee of the Company. The 1990 Plan has expired by its terms.

Under the 1994 Share Option Plan (the 1994 Plan), all employees and directors of the Company and any independent contractor who performed services for the Company were eligible to receive grants of non-statutory options (NSOs). Employees were also eligible to receive grants of incentive share options intended to qualify under Section 422 of the Internal Revenue Code. The 1994 Plan has expired by terms.

Under the 2001 Outside Director Plan (the Outside Director Plan), all outside directors of the Company are eligible to receive option grants upon appointment to the Board of Directors and each subsequent year thereafter.

Under the 1996 Supplemental Stock Plan (the 1996 Plan), all employees, with the exception of directors and executive officers, are eligible to receive grants of NSOs.

Under the ForeFront92 Plan, (the FF92 Plan) NSOs and ISOs were granted to any employee or director of ForeFront. The FF92 Plan has expired by terms.

Under the ForeFront96 Plan, (the FF96 Plan) NSOs were granted to employees and directors of ForeFront. The FF96 Plan has expired by terms.

Under the Forefront Directors 1996 Plan, (the FF96 Directors Plan) non-employee directors were eligible to receive grants of options to acquire common stock upon election to the Board of Directors and each subsequent year thereafter. The FF96 Directors Plan has expired by terms.

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Under the Knowledge Well Limited Plan, (the KWL Plan) and the Knowledge Well Group Limited Plan, (the KWGL Plan), employees and directors and any independent contractor who performs services for Knowledge Well Limited (KWL) and Knowledge Well Group Limited (KWGL) were eligible to receive grants of NSOs. Employees of KWL and KWGL were also eligible to receive grants of ISOs which were intended to qualify under Section 422 of the Internal Revenue Code.

The Plans are administered by the Compensation Committee of the Board of Directors (the Committee). The terms of the options granted under all plans, except for the Outside Director Plan, are generally determined by the Committee, the Board of Directors or a designee of the Board of Directors. All grants of options under the Outside Director Plan are automatic and nondiscretionary and are made strictly in accordance with the provisions of the plan. The exercise price of options granted under the 1990 Plan and ISOs granted under the 1994 Plan cannot be less than the fair market value of ordinary shares on the date of grant (as defined in the plans). In the case of ISOs granted to holders of more than 10% of the voting power of the Company the exercise price cannot be less than 110% of such fair market value. Under the 1994 Plan, the exercise price of NSOs may be set by the Committee at its discretion. The exercise price of option grants under the Outside Director Plan is the closing sales price for such shares (or the closing bid, if no sales were reported) as quoted on such exchange or system for the last market trading day prior to the time of determination. The term of an option under the 1994, Outside Director, 1996, FF92, FF96, KWL and KWGL Plans cannot exceed ten years and, generally, the terms of an option under the 1990 Plan and FF96 Directors' Plan cannot exceed ten years. The term of an ISO granted to a holder of more than 10% of the voting power of the Company cannot exceed five years. An option may not be exercised unless the option holder is at the date of exercise, or within three months of the date of exercise has been, a director, employee or contractor of the Company. There are certain exceptions for exercises following retirement or death. Options under the Plans generally expire not later than 30 to 90 days following termination of employment or service or six months following an optionee's death or disability.

The following is a summary of the share options authorized, outstanding and available to be granted under all of the Company's share option plans as of January 31, 2006:

| Plan Name  | Authorized | Outstanding | Available for Grant |
|--|------------|-------------|---------------------|
| 1990 Share Option Scheme (the 1990 Plan)                                     | 4,700,000  | 166,148     |                     |
| 1994 Share Option Plan (the 1994 Plan)                                       | 11,747,036 | 3,213,655   |                     |
| 1996 Supplemental Stock Plan (the 1996 Plan)(1)                              | 14,000,000 | 3,878,987   | 6,120,372           |
| 2001 Outside Director Option Plan (the Outside Director Plan)                | 750,000    | 295,000     | 448,750             |
| 1996 ForeFront Group Inc. Non-Qualified Stock Option Plan (the FF96 Plan)(1) | 798,924    |             | 342,823             |
| Knowledge Well Limited 1998 Share Option Plan (the KWL Plan)(1)              | 654,800    |             | 234,269             |
| Knowledge Well Group Limited 1998 Share Option Plan (the KWGL Plan)(1)       | 654,800    | 88          | 624,462             |
| Books24x7.com, Inc. 1994 Stock Option Plan                                   | 867,436    | 60,476      |                     |
| 1998 Stock Incentive Plan (the 1998 Plan)                                    | 7,402,071  | 1,026,130   |                     |
| 2001 Stock Incentive Plan (the 2001 Plan)                                    | 11,354,512 | 6,741,095   |                     |
| 2002 Stock Incentive Plan (the 2002 Plan)(1)                                 | 2,350,000  | 856,511     | 564,513             |
|  | 55,279,579 | 16,238,090  | 8,335,189           |





**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

- (1) On March 23, 2006, the Company's shareholders approved a resolution to transfer an aggregate of 5,100,000 shares from certain non-shareholder approved plans to the 2002 Plan. This includes 342,823 shares from the FF96 Plan, 624,462 shares from the KWGL Plan, 234,269 shares from the KWL Plan and 3,898,446 shares from the 1996 Plan available for grant.

All stock option activity under the Plans for the fiscal years ended January 31, 2004, 2005 and 2006 is as follows:

|                               | Shares      | Exercise Price |   |          | Weighted<br>Average<br>Exercise<br>Price |
|-------------------------------|-------------|----------------|---|----------|--|
| Outstanding, January 31, 2003 | 25,426,235  | \$ 0.11        | - | 44.25    | \$ 8.69                                  |
| Granted                       | 2,320,550   | 2.61           | - | 8.65     | 4.41                                     |
| Exercised                     | (1,530,657) | 0.11           | - | 8.19     | 3.40                                     |
| Canceled                      | (3,179,306) | 0.11           | - | 41.13    | 13.57                                    |
| Outstanding, January 31, 2004 | 23,036,822  | \$ 0.11        | - | 44.25    | \$ 7.88                                  |
| Granted                       | 1,713,800   | 2.82           | - | 12.99    | 10.78                                    |
| Exercised                     | (3,816,626) | 0.11           | - | 11.60    | 4.70                                     |
| Canceled                      | (1,957,494) | 0.25           | - | 43.12    | 12.86                                    |
| Outstanding, January 31, 2005 | 18,976,502  | \$ 0.11        | - | 44.25    | \$ 8.27                                  |
| Granted                       | 271,550     | 3.04           | - | 5.65     | 4.06                                     |
| Exercised                     | (370,925)   | 0.11           | - | 4.12     | 2.29                                     |
| Canceled                      | (2,639,037) | 0.25           | - | 42.38    | 12.02                                    |
| Outstanding, January 31, 2006 | 16,238,090  | \$ 0.11        | - | 44.25    | \$ 7.73                                  |
| Exercisable, January 31, 2006 | 15,189,336  | \$ 0.11        | - | \$ 44.25 | \$ 7.97                                  |
| Exercisable, January 31, 2005 | 12,083,373  | \$ 0.11        | - | \$ 44.25 | \$ 9.61                                  |
| Exercisable, January 31, 2004 | 12,117,780  | \$ 0.11        | - | \$ 44.25 | \$ 10.28                                 |

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes certain information relating to the outstanding and exercisable options as of January 31, 2006:

| Range of Exercise Prices | Outstanding      |   |                                 | Exercisable      |                                 |
|--------------------------|------------------|---|---------------------------------|------------------|---------------------------------|
|                          | Number of Shares | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
| \$ 0.11-\$ 3.30          | 1,797,921        | 6.30  | \$ 2.88                         | 1,569,482        | \$ 2.82                         |
| \$ 3.34-\$ 3.66          | 1,180,987        | 6.91  | 3.64                            | 1,180,987        | 3.64                            |
| \$ 3.72-\$ 4.06          | 4,360,368        | 6.60  | 4.05                            | 3,687,137        | 4.05                            |
| \$ 4.07-\$ 6.12          | 1,923,632        | 6.03  | 5.45                            | 1,815,298        | 5.45                            |
| \$ 6.18-\$ 6.84          | 1,641,137        | 5.69  | 6.37                            | 1,641,137        | 6.37                            |
| \$ 6.91-\$11.01          | 1,623,870        | 5.27  | 9.25                            | 1,585,120        | 9.24                            |
| \$11.14-\$16.44          | 2,352,658        | 5.73  | 13.65                           | 2,352,658        | 13.65                           |
| \$17.00-\$44.25          | 1,357,517        | 4.45  | 22.27                           | 1,357,517        | 22.27                           |
| \$ 0.11-\$44.25          | 16,238,090       | 5.99  | \$ 7.73                         | 15,189,336       | \$ 7.97                         |

In connection with the purchase of Books on December 28, 2001, the Company assumed the Books 1994 Stock Option Plan, consisting of options to purchase 808,799 shares, insofar as it related to outstanding options. These options were valued at \$6,376,000 using the Black-Scholes option pricing model, and were included in the determination of consideration paid. In addition, the Company recorded deferred compensation of \$1,752,000, which represents the intrinsic value of unvested options assumed in the transaction. The deferred compensation is being amortized to expense over the vesting period of the stock options. The Company recorded compensation expense of approximately \$583,000, \$236,000 and \$25,000 in the years ended January 31, 2004, 2005 and 2006, respectively, related to these options.

In connection with the Merger on September 6, 2002, the Company assumed all the SmartForce stock option plans consisting of options to purchase 15,941,705 shares. These options were valued at approximately \$38,900,000 using the Black-Scholes option pricing model, and were included in the determination of consideration paid. In addition, the Company recorded deferred compensation of \$3,416,000, which represents the intrinsic value of unvested options assumed in the transaction. The deferred compensation is being amortized to expense over the vesting period of the stock options. The Company recorded compensation expense of approximately \$890,000, \$880,000 and \$832,000 in the years ended January 31, 2004, 2005 and 2006 respectively, related to these options.

Dividends may only be declared and paid out of profits available for distribution determined in accordance with accounting principles generally accepted in Ireland and applicable Irish Company Law. There are no material restrictions on the distribution of income or retained earnings by the consolidated group of companies of the Company. Any dividends, if and when declared, will be declared and paid in dollars.

The Company recorded a compensation charge of \$274,000 in the fiscal year ended January 31, 2004 due to the extension of certain option agreements until the Registration Statement on Form S-8 covering such option agreements, which was suspended as a result of the delay in filing a Form 8-K/ A containing the historical SmartForce financial statements, was again available for use.

In the fourth quarter of fiscal 2006 the Company accelerated all previously outstanding unvested share options previously awarded to employees (excluding unvested share options held by executive officers and directors). The acceleration of vesting was effected in order to avoid a negative impact to the Company's income statement upon adoption of SFAS 123R in fiscal 2007.

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(b) Employee Share Purchase Plan**

The Company maintains an Employee Share Purchase Plan (the Purchase Plan) pursuant to which participants are generally granted options to purchase ordinary shares on the last business day of each six-month offering period ending each September 30 and March 31 at 85% of the market price of the ADSs on the first or last trading day of each offering period, whichever is less. The purchase price for such shares is paid through payroll deductions, and the current maximum allowable payroll deduction is 20% of each eligible employee's eligible compensation. As of January 31, 2006, there were 1,734,500 shares available for future issuance under the Purchase Plan.

**(10) Employee Benefit Plan**

The Company has a 401(k) plan covering all US-based employees of the Company who have met certain eligibility requirements. Under the terms of the 401(k) plan, the employees may elect to make tax-deferred contributions to the 401(k) plan. In addition, the Company may match employee contributions, as determined by the Board of Directors of SkillSoft Corporation, and may make a discretionary contribution to the 401(k) plan. Under this plan, contributions of approximately \$32,000, \$0 and \$70,000 were made for the fiscal years ended January 31, 2004, 2005 and 2006, respectively.

**(11) Disclosures About Segments of an Enterprise**

The Company follows the provisions of 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 stockholders. 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, in making decisions 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, Chief Financial Officer and the Chief Operating Officer. The Company views its operations and manages its business as principally two operating segments: 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 \$608,000 loss on disposition in fiscal 2006. The sale resulted in a reduction in Retail Certification revenue in fiscal 2006 of approximately \$5.8 million and the Company expects that trend to continue with a reduction in Retail Certification revenue of approximately \$9.0 million in fiscal 2007 when compared to fiscal 2006.

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following tables set forth the Company's statements of operations for the fiscal years ended January 31, 2004, 2005 and 2006 by segment with additional disclosures as required by SFAS No. 131:

|   | <b>Year Ended January 31, 2004</b> |                             |                 |
|---|------------------------------------|-----------------------------|-----------------|
|   | <b>Multi-Modal</b>                 | <b>Retail Certification</b> | <b>Combined</b> |
|   | <b>(In thousands)</b>              |                             |                 |
| Revenue   | \$ 180,098                         | \$ 13,377                   | \$ 193,475      |
| Cost of revenues  | 17,825                             | 572                         | 18,397          |
| Gross profit  | 162,273                            | 12,805                      | 175,078         |
| Operating expenses:   |                                    |                             |                 |
| Research and development  | 53,627                             |                             | 53,627          |
| Selling and marketing   | 74,556                             | 12,976                      | 87,532          |
| General and administrative                                      | 25,660                             | 2,223                       | 27,883          |
| Legal settlements   | 93,750                             |                             | 93,750          |
| Amortization of share-based compensation                        | 1,986                              |                             | 1,986           |
| Amortization of intangible assets                               | 10,072                             |                             | 10,072          |
| Impairment charge   |                                    |                             |                 |
| Restructuring and other non-recurring items                     | 1,857                              |                             | 1,857           |
| Restatement:  |                                    |                             |                 |
| SEC investigation   | 1,898                              |                             | 1,898           |
| Other professional fees   | 14,473                             |                             | 14,473          |
| Total operating expenses  | 277,879                            | 15,199                      | 293,078         |
| Loss from operations  | \$ (115,606)                       | \$ (2,394)                  | \$ (118,000)    |
| Supplemental segment disclosures                                |                                    |                             |                 |
| Provision for income taxes                                      | 529                                |                             | 529             |
| Depreciation, amortization and stock based compensation expense | \$ 20,908                          | \$ 479                      | \$ 21,387       |

**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following tables set forth the Company's supplemental balance sheet information by segment:

**As of January 31, 2004**

|  | <b>Multi-Modal</b> | <b>Retail Certification</b> | <b>Combined</b>   |
|--|--------------------|-----------------------------|-------------------|
| Current assets, net  | \$ 171,620         | \$ 12,298                   | \$ 183,918        |
| Property and equipment, net                                    | 6,272              | 175                         | 6,447             |
| Goodwill   | 106,602            | 19,276                      | 125,878           |
| Other assets   | 26,135             |                             | 26,135            |
| <b>Total consolidated assets</b>                               | <b>\$ 310,629</b>  | <b>\$ 31,749</b>            | <b>\$ 342,378</b> |
| Current liabilities  | \$ 215,111         | \$ 17,922                   | \$ 233,033        |
| Long-term liabilities  | 23,510             | 77                          | 23,587            |
| <b>Total liabilities</b>                                       | <b>238,621</b>     | <b>17,999</b>               | <b>256,620</b>    |
| Stockholders' equity   | 72,008             | 13,750                      | 85,758            |
| <b>Total consolidated liabilities and stockholders' equity</b> | <b>\$ 310,629</b>  | <b>\$ 31,749</b>            | <b>\$ 342,378</b> |
| <b>Supplemental segment disclosures</b>                        |                    |                             |                   |
| Capital Expenditures   | \$ 3,490           | \$ 153                      | \$ 3,643          |

**Year Ended January 31, 2005**

|  | <b>Multi-Modal</b> | <b>Retail Certification</b> | <b>Combined</b> |
|--|--------------------|-----------------------------|-----------------|
|  |                    | <b>(In thousands)</b>       |                 |
| Revenue                                  | \$ 192,135         | \$ 20,165                   | \$ 212,300      |
| Cost of revenues                         | 21,269             | 455                         | 21,724          |
| <b>Gross profit</b>                      | <b>170,866</b>     | <b>19,710</b>               | <b>190,576</b>  |
| <b>Operating expenses:</b>               |                    |                             |                 |
| Research and development                 | 45,306             | 269                         | 45,575          |
| Selling and marketing                    | 80,147             | 13,339                      | 93,486          |
| General and administrative               | 23,286             | 1,876                       | 25,162          |
| Amortization of share-based compensation | 1,191              |                             | 1,191           |
| Amortization of intangible assets        | 9,575              |                             | 9,575           |
| Impairment charge                        |                    | 19,268                      | 19,268          |
| Restructuring                            | 13,361             |                             | 13,361          |
| <b>Restatement:</b>                      |                    |                             |                 |
| SEC investigation                        | 2,182              |                             | 2,182           |
| Other professional fees                  | 320                |                             | 320             |

|   |            |    |          |             |
|---|------------|----|----------|-------------|
| Total operating expenses  | 175,368    |    | 34,752   | 210,120     |
| Operating loss  | \$ (4,502) | \$ | (15,042) | \$ (19,544) |
| <b>Supplemental segment disclosures</b>                         |            |    |          |             |
| Provision for income taxes                                      | 626        |    | 5        | 631         |
| Depreciation, amortization and stock based compensation expense | \$ 15,447  | \$ | 98       | \$ 15,545   |

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following tables set forth the Company's supplemental balance sheet information by segment:

As of January 31, 2005

|  | Multi-Modal       | Retail Certification | Combined          |
|--|-------------------|----------------------|-------------------|
| Current assets, net  | \$ 154,010        | \$ 11,600            | \$ 165,610        |
| Property and equipment, net                                    | 9,011             | 126                  | 9,137             |
| Goodwill   | 103,576           |                      | 103,576           |
| Other assets   | 25,174            |                      | 25,174            |
| <b>Total consolidated assets</b>                               | <b>\$ 291,771</b> | <b>\$ 11,726</b>     | <b>\$ 303,497</b> |
| Current liabilities  | \$ 195,582        | \$ 16,782            | \$ 212,364        |
| Long-term liabilities  | 6,174             | 40                   | 6,214             |
| <b>Total liabilities</b>                                       | <b>201,756</b>    | <b>16,822</b>        | <b>218,578</b>    |
| Stockholders' equity   | 90,015            | (5,096)              | 84,919            |
| <b>Total consolidated liabilities and stockholders' equity</b> | <b>\$ 291,771</b> | <b>\$ 11,726</b>     | <b>\$ 303,497</b> |
| <b>Supplemental segment disclosures</b>                        |                   |                      |                   |
| Capital expenditures   | \$ 7,476          | \$ 118               | \$ 7,594          |

Year Ended January 31, 2006

|  | Multi-Modal    | Retail Certification | Combined              |
|--|----------------|----------------------|-----------------------|
|  |                |                      | <b>(In thousands)</b> |
| Revenue                                  | \$ 201,236     | \$ 14,331            | \$ 215,567            |
| Cost of revenues                         | 25,103         | 204                  | 25,307                |
| <b>Gross profit</b>                      | <b>176,133</b> | <b>14,127</b>        | <b>190,260</b>        |
| <b>Operating expenses:</b>               |                |                      |                       |
| Research and development                 | 38,985         |                      | 38,985                |
| Selling and marketing                    | 84,988         | 2,776                | 87,764                |
| General and administrative               | 25,346         | 399                  | 25,745                |
| Legal settlements/(insurance recoveries) | (17,710)       |                      | (17,710)              |
| Amortization of share-based compensation | 892            |                      | 892                   |
| Amortization of intangible assets        | 9,113          |                      | 9,113                 |
| Restructuring                            | 123            | 518                  | 641                   |
| <b>Restatement:</b>                      |                |                      |                       |
| SEC investigation                        | 1,988          |                      | 1,988                 |
| Other professional fees                  |                |                      |                       |



|   |           |    |        |           |
|---|-----------|----|--------|-----------|
| Total operating expenses  | 143,725   |    | 3,693  | 147,418   |
| Operating income  | \$ 32,408 | \$ | 10,434 | \$ 42,842 |
| <b>Supplemental segment disclosures</b>                         |           |    |        |           |
| Provision for income taxes                                      | 9,130     |    |        | 9,130     |
| Depreciation, amortization and share-based compensation expense | \$ 15,212 | \$ | 17     | \$ 15,229 |

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**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following tables set forth the Company's supplemental balance sheet information by segment:

As of January 31, 2006

|  | Multi-Modal       | Retail Certification | Combined          |
|--|-------------------|----------------------|-------------------|
| Current assets, net  | \$ 186,065        | \$                   | \$ 186,065        |
| Property and equipment, net                                    | 10,231            | _____                | 10,231            |
| Goodwill   | 93,929            |                      | 93,929            |
| Other assets   | 9,677             |                      | 9,677             |
| <b>Total consolidated assets</b>                               | <b>\$ 299,902</b> | <b>\$</b>            | <b>\$ 299,902</b> |
| Current liabilities  | \$ 189,091        | \$ 5,222             | \$ 194,313        |
| Long-term liabilities  | 3,317             |                      | 3,317             |
| <b>Total liabilities</b>                                       | <b>192,408</b>    | <b>5,222</b>         | <b>197,630</b>    |
| Stockholders' equity   | 107,494           | (5,222)              | 102,272           |
| <b>Total consolidated liabilities and stockholders' equity</b> | <b>\$ 299,902</b> | <b>\$</b>            | <b>\$ 299,902</b> |
| <b>Supplemental segment disclosures</b>                        |                   |                      |                   |
| Capital expenditures   | \$ 6,423          | \$                   | \$ 6,423          |

*Geographical Reporting*

The Company attributes revenues to different geographical areas on the basis of the location of the customer. Revenues by geographic area are as follows (in thousands):

|  | Year Ended January 31, |                   |                   |
|--|------------------------|-------------------|-------------------|
|  | 2004                   | 2005              | 2006              |
| <b>Revenue:</b>  |                        |                   |                   |
| United States  | \$ 156,121             | \$ 165,871        | \$ 168,525        |
| United Kingdom   | 9,785                  | 20,219            | 22,838            |
| Canada   | 6,801                  | 8,274             | 9,147             |
| Europe, excluding UK                                   | 14,231                 | 7,244             | 4,793             |
| Australia/ New Zealand                                 | 5,086                  | 6,885             | 7,691             |
| Other (Countries less than 5% individually, by region) | 1,451                  | 3,807             | 2,573             |
| All Foreign Locations                                  | 37,354                 | 46,429            | 47,042            |
| <b>Total revenue</b>                                   | <b>\$ 193,475</b>      | <b>\$ 212,300</b> | <b>\$ 215,567</b> |

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



**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(12) Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets in the accompanying consolidated balance sheets consist of the following (in thousands):

|   | <b>Year Ended<br/>January 31,</b> |               |
|---|-----------------------------------|---------------|
|   | <b>2005</b>                       | <b>2006</b>   |
| Other receivables                                   | \$ 1,225                          | \$ 485        |
| Prepaid commissions and recoverable sales draw      | 13,613                            | 15,427        |
| Prepaid insurances                                  | 1,964                             | 1,559         |
| Prepaid facilities                                  | 617                               | 408           |
| Reclaimable taxes                                   | 1,731                             | 1,395         |
| Prepaid royalties                                   | 252                               | 157           |
| Other   | 3,257                             | 2,575         |
| <br>Total prepaid expenses and other current assets | <br>\$ 22,659                     | <br>\$ 22,006 |

**(13) Accrued Expenses Current**

Accrued expenses in the accompanying consolidated balance sheets consist of the following (in thousands):

|                                   | <b>Year Ended<br/>January 31,</b> |               |
|-----------------------------------|-----------------------------------|---------------|
|                                   | <b>2005</b>                       | <b>2006</b>   |
| Accrued compensation and benefits | \$ 20,415                         | \$ 15,984     |
| Course development fees           | 2,205                             | 1,170         |
| Professional fees                 | 2,788                             | 2,989         |
| Accrued payables                  | 1,798                             | 1,254         |
| Accrued miscellaneous taxes       | 238                               | 395           |
| Accrued merger related costs*     | 5,271                             | 2,977         |
| Sales tax payable/ VAT payable    | 3,864                             | 4,193         |
| Accrued royalties                 | 2,422                             | 3,129         |
| Accrued litigation settlements    | 15,250                            | 17,040        |
| Accrued restructuring             | 8,005                             | 810           |
| Other accrued liabilities         | 4,739                             | 3,854         |
| <br>Total accrued expenses        | <br>\$ 66,995                     | <br>\$ 53,795 |

\* Includes \$1,684 and \$1,584 of accrued income taxes in January 31, 2005 and 2006, respectively.



**SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(14) Valuation & Qualifying Accounts**

*Allowance for Doubtful Accounts (amounts in thousands)*

|                             | <b>Balance at<br/>Beginning<br/>of Period</b> | <b>Net provision<br/>added/(credited<br/>without<br/>utiliazation)</b> | <b>Write-offs</b> | <b>Balance<br/>at End<br/>of Period</b> |
|-----------------------------|---|--|-------------------|---|
| Year ended January 31, 2004 | \$ 848  | \$ 293   | \$ (70)           | \$ 1,071                                |
| Year ended January 31, 2005 | \$ 1,071                                      | \$ 335   | \$ (23)           | \$ 1,383                                |
| Year ended January 31, 2006 | \$ 1,383                                      | \$ 254   | \$ (850)          | \$ 787                                  |

**(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 and 443,757 shares at January 31, 2006 and January 31, 2005, respectively. 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 and as a result 3,500,000 are available for repurchase, subject to certain limitations, under the shareholder approved program.

**(16) Concentration of Suppliers**

The Company relies on a limited number of independent third parties to provide educational content for a majority of the courses based on learning objectives and specific instructional design templates that the Company provides to them. The failure to maintain or expand the current development alliances or enter into new development alliances could adversely affect the Company's operating results and financial condition.

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**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Title</b>  |
|--------------------|---|
| 2.1                | Agreement and Plan of Merger, dated as of June 10, 2002, by and among SmartForce Public Limited Company, SkillSoft Corporation and Slate Acquisition Corp. (Incorporated by reference to exhibit 2.1 to SkillSoft PLC's Current Report on Form 8-K dated June 14, 2002 (File No. 000-25674)).   |
| 3.1                | Memorandum of Association of SkillSoft PLC as amended on March 24, 1992, March 31, 1995, April 28, 1998, January 26, 2000, July 10, 2001, September 6, 2002 and November 19, 2002 (Incorporated by reference to exhibit 3.1 to SkillSoft PLC's Quarterly Report on Form 10-Q for the fiscal quarter ended October 31, 2002 as filed with the Securities and Exchange Commission on January 21, 2003 (File No. 000-25674)).  |
| 3.2                | Articles of Association of SkillSoft PLC as amended on July 6, 1995, and April 28, 1998, January 26, 2000, July 10, 2001, September 6, 2002 and November 19, 2002 (Incorporated by reference to exhibit 3.2 to SkillSoft PLC's Quarterly Report on Form 10-Q for the fiscal quarter ended October 31, 2002 as filed with the Securities and Exchange Commission on January 21, 2003 (File No. 000-25674)).  |
| 4.1                | Specimen certificate representing the ordinary shares of SkillSoft PLC (Incorporated by reference to exhibit 4.1 to SkillSoft PLC's Annual Report on Form 10-K for the fiscal year ended January 31, 2003 as filed with the Securities and Exchange Commission on April 29, 2003 (File No. 000-25674)).   |
| 4.2                | Amended and Restated Deposit Agreement (including the form of American Depositary Receipt), dated as of April 13, 1995 as amended and restated as of September 4, 2002, among SkillSoft PLC, The Bank of New York, as Depositary, and each Owner and Beneficial Owner from time to time of American Depositary Receipts issued thereunder (Incorporated by reference to Exhibit 4.1 to SkillSoft PLC's Current Report on Form 8-K dated September 4, 2002 (File No. 000-256740)).               |
| 4.3                | Amended and Restated Restricted Deposit Agreement (including the form of American Depositary Receipt), dated as of November 30, 1995 and amended and restated as of September 4, 2002, among SkillSoft PLC, The Bank of New York, as Depositary, and each Owner and Beneficial Owner from time to time of American Depositary Receipts issued thereunder (Incorporated by reference to exhibit 4.2 to SkillSoft PLC's Current Report on Form 8-K dated September 4, 2002 (File No. 000-25674)). |
| 4.4                | Restricted Deposit Agreement (B) dated as of June 8, 1998 and amended and restated as of September 4, 2002 among SkillSoft PLC, The Bank of New York, and the owners and beneficial owners of Restricted American Depositary Receipts (Incorporated by reference to Exhibit 4.3 to SkillSoft PLC's Current Report on Form 8-K dated September 4, 2002 (File No. 000-25674)).  |
| 10.1**             | 1990 Share Option Scheme (Incorporated by reference to exhibit 10.1 to SkillSoft PLC's Registration Statement on Form F-1 declared effective with the Securities and Exchange Commission on April 13, 1995 (File No. 333-89904)).   |
| 10.2**             | 1994 Share Option Plan (Incorporated by reference to exhibit 10.2 to SkillSoft PLC's Registration Statement on Form F-1 declared effective with the Securities and Exchange Commission on April 13, 1995 (File No. 333-89904)).   |
| 10.3**             | Form of Indemnification Agreement between CBT Systems USA, Ltd. (formerly, Thornton Holdings, Ltd.) and its directors and officers dated as of April 1995 (Incorporated by reference to exhibit 10.5 to SkillSoft PLC's Registration Statement on Form F-1 declared   |

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effective with the Securities and Exchange Commission on April 13, 1995 (File No. 333-89904)).

- 10.4\*\* Form of Indemnification Agreement between SmartForce (USA) and its directors and officers dated as of September 6, 2002 (Incorporated by reference to exhibit 10.5 to SkillSoft PLC's Annual Report on Form 10-K for the fiscal year ended January 31, 2003 as filed with the Securities and Exchange Commission on April 29, 2003 (File No. 000-25674)).
  - 10.5\*\* 1996 Supplemental Stock Plan.
  - 10.6\*\* 2002 Share Option Plan, as amended.
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| Exhibit<br>No. | Title  |
|----------------|--|
| 10.7**         | 2001 Outside Director Option Plan, as amended (Incorporated by reference to exhibit 99.1 to SkillSoft PLC's Current Report on Form 8-K as filed with the Securities and Exchange Commission on January 4, 2006 (File No. 000-25674)).  |
| 10.8**         | Amended and Restated Employment Agreement dated June 10, 2002 between SkillSoft PLC and Gregory M. Priest (Incorporated by reference to exhibit 10.30 to SkillSoft PLC's Amendment No. 1 to Registration Statement on Form S-4 as filed with the Securities and Exchange Commission on July 30, 2002 (File No. 333-90872)).                            |
| 10.9**         | Employment Agreement dated June 10, 2002 between SkillSoft PLC and Charles E. Moran (Incorporated by reference to exhibit 10.31 to SkillSoft PLC's Amendment No. 1 to Registration Statement on Form S-4 as filed with the Securities and Exchange Commission on July 30, 2002 (File No. 333-90872)).  |
| 10.10**        | Employment Agreement dated as of June 10, 2002 between SkillSoft PLC and Jerald A. Nine, Jr. (Incorporated by reference to exhibit 10.33 to SkillSoft PLC's Amendment No. 1 to Registration Statement on Form S-4 as filed with the Securities and Exchange Commission on July 30, 2002 (File No. 333-90872)).   |
| 10.11          | Registration Rights Agreement dated as of June 10, 2002 between SkillSoft PLC and Warburg Pincus Ventures, L.P. (Incorporated by reference to exhibit 10.27 to SkillSoft PLC's Amendment No. 1 to Registration Statement on Form S-4 as filed with the Securities and Exchange Commission on July 30, 2002 (File No. 333-90872)).                      |
| 10.12**        | Employment Agreement dated January 12, 1998 between SkillSoft Corporation and Mark A. Townsend (Incorporated by reference to exhibit 10.15 to SkillSoft PLC's Annual Report on Form 10-K for the fiscal year ended January 31, 2003 as filed with the Securities and Exchange Commission on April 29, 2003 (File No. 000-25674)).                      |
| 10.13**        | Employment Agreement dated January 12, 1998 between SkillSoft Corporation and Thomas J. McDonald (Incorporated by reference to exhibit 10.16 to SkillSoft PLC's Annual Report on Form 10-K for the fiscal year ended January 31, 2003 as filed with the Securities and Exchange Commission on April 29, 2003 (File No. 000-25674)).                    |
| 10.14**        | Employment Agreement dated effective September 6, 2002 between SkillSoft PLC and Colm Darcy (Incorporated by reference to exhibit 10.17 to SkillSoft PLC's Annual Report on Form 10-K for the fiscal year ended January 31, 2003 as filed with the Securities and Exchange Commission on April 29, 2003 (File No. 000-25674)).                         |
| 10.15          | Lease dated May 25, 2001, as amended between 1987 Tamposi Limited Partnership and SkillSoft Corporation.   |
| 10.16**        | Indemnification Agreement, dated November 13, 2003, by and between SkillSoft Corporation and P. Howard Edelstein (Incorporated by reference from exhibit 10.2 to SkillSoft PLC's Quarterly Report on Form 10-Q for the quarter ended October 31, 2003 as filed with the Securities and Exchange Commission on December 15, 2003 (File No. 000-25674)). |
| 10.17**        | Indemnification Agreement, dated March 4, 2004, by and between SkillSoft Corporation and William Meagher. (Incorporated by reference from exhibit 10.27 to SkillSoft PLC's Annual Report on Form 10-K for the fiscal year ended January 31, 2004 as filed with the Securities and Exchange Commission on April 15, 2004 (File No. 000-25674)).         |
| 10.18**        | Amended and Restated Summary of Director Compensation (Incorporated by reference from exhibit 99.1 to SkillSoft PLC's Current Report on Form 8-K as filed with the Securities and Exchange Commission on March 28, 2006 (File No. 000-25674)).   |

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- 10.19 Lease agreement, dated June 9, 2004, as amended, by and between Hewlett-Packard Company and SkillSoft Corporation.
- 10.20 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.
- 10.21\*\* Form of Director Option Agreement for initial grants under the 2001 Director Option Plan (Incorporated by reference to exhibit 99.2 to SkillSoft PLC's Current Report on Form 8-K as filed with the Securities and Exchange Commission on January 4, 2006 (File No. 000-25674)).
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| Exhibit<br>No. | Title  |
|----------------|--|
| 10.22**        | Form of Director Option Agreement for subsequent grants under the 2001 Director Option Plan (Incorporated by reference to exhibit 99.3 to SkillSoft PLC's Current Report on Form 8-K as filed with the Securities and Exchange Commission on January 4, 2006 (File No. 000-25674)).          |
| 10.23**        | Form of Option Agreement under 2002 Share Option Plan (Incorporated by reference to exhibit 10.5 to SkillSoft PLC's Quarterly Report on Form 10-Q for the quarter ended July 31, 2004 as filed with the Securities and Exchange Commission on September 9, 2004 (File No. 000-25674)).       |
| 10.24**        | Summary of Fiscal 2006 Executive Incentive Compensation Program. (Incorporated by reference to exhibit 10.34 to SkillSoft PLC's annual report on Form 10-K for the year ended January 31, 2005 as filed with the Securities and Exchange Commission on April 18, 2005 (File No. 000-25674)). |
| 10.25          | Release and Settlement Agreement (Incorporated by reference to exhibit 10.1 to SkillSoft PLC's Quarterly Report on Form 10-Q for the quarter ended July 31, 2005 as filed with the Securities and Exchange Commission on September 9, 2005 (File No. 000-25674)).                            |
| 21.1           | List of Significant Subsidiaries.  |
| 23.1           | Consent of Ernst & Young LLP   |
| 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.  |

Filed herewith.

\*\* Denotes management or compensatory plan or arrangement required to be filed by registrant pursuant to Item 15(c) of this report on Form 10-K.