SKILLSOFT PUBLIC LIMITED CO
Form 10-K/A
May 23, 2003

THE FOLLOWING ITEMS WERE THE SUBJECT OF A FORM 12B-25

AND ARE INCLUDED HEREIN: 6, 7, 7A, 8 AND 14

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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FORM 10-K/A
AMENDMENT NO. 1

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED JANUARY 31, 2003

[ ] 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<br>(State or other jurisdiction of incorporation or organization) | NONE<br>(I.R.S. Employer Identification No.) |
|---|---|
| 107 NORTHEASTERN BOULEVARD<br>NASHUA, NEW HAMPSHIRE<br>(Address of principal executive offices) | 03062<br>(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, E0.11

SUBSCRIPTION RIGHTS

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 [X]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [X] No [ ]

The approximate aggregate market value of voting shares held by non-affiliates of the registrant as of June 28, 2002 was $173,566,073.

On April 11, 2003 the registrant had outstanding 99,608,695 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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EXPLANATORY NOTE

This Annual Report on Form 10-K/A is being filed as Amendment No. 1 to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 29, 2003 for the purpose of including the following items, which were omitted from the Form 10-K: Items 6, 7, 7A, 8 and 14.

SKILLSOFT PUBLIC LIMITED COMPANY

FORM 10-K

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PART II

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

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 elsewhere in this Annual Report on Form 10-K.

OVERVIEW

We are the result of the merger of SmartForce PLC (SmartForce or SmartForce PLC) and SkillSoft Corporation. The new combined SkillSoft PLC is a global leader in corporate e-Learning and brings together SmartForce's leading portfolio of IT e-Learning content with SkillSoft Corporation's extensive suite of business skills e-Learning courseware, as well as its information technology (IT) and business Referenceware libraries.

The merger of SmartForce and SkillSoft Corporation (the Merger) closed on September 6, 2002. For accounting purposes, the Merger was accounted for as a reverse acquisition, with SkillSoft Corporation as the accounting acquirer. The historical financial statements of SkillSoft Corporation have become our historical financial statements, and the results of operations of SkillSoft PLC (formerly known as SmartForce PLC) are included in our results of operations only from September 6, 2002. For accounting purposes, the purchase price was approximately $371.7 million which consisted of the value of stock and options issued, and transaction and merger costs. The excess purchase price over the net tangible assets was primarily allocated to goodwill, content and customer base.

On December 28, 2001, we acquired Books24x7.com, Inc. (Books), a provider of web-based digital technical and business reference content. For accounting purposes, the purchase price was approximately $35.9 million which consisted of the value of stock and options issued, and transaction and merger costs. The excess purchase price over the net tangible assets was primarily allocated to goodwill, customer contracts, internally developed technology and the trademark. This acquisition was accounted for under the purchase method of accounting and, accordingly, our operating results include the operating results of Books from December 28, 2001.

A primary reason for the increase in our revenue and operating expenses from the fiscal year ended January 31, 2002 to the fiscal year ended January 31, 2003 is the inclusion of the operating results of SkillSoft PLC for the post-September 6, 2002 period and a full year of operating results for Books. We operate as two reporting segments: multi-modal learning and retail certification. These reporting units are not discussed separately as the impact on the comparison of financial results from period to period is not significant.

We are a leading global provider of comprehensive, multi-modal e-Learning

content and software products for business and IT professionals. Multi-modal learning (MML) solutions offer powerful tools to support and enhance the speed and effectiveness of both formal and informal learning processes. MML solutions integrate our in-depth courseware, learning management platform technology and support services to meet our customers' learning needs.

We derive revenue primarily 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). Our license agreements permit customers to exchange course titles, generally on the contract anniversary date. Additional product features, such as hosting and on-line mentoring services, are separately licensed for an additional fee.

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The pricing for our MML 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 MML license provides customers access to a full range of learning products including courseware, Referenceware, simulations, mentoring and prescriptive assessment.

A Referenceware license from Books gives users access to the full library within one or more collections (ITPro, BusinessPro, FinancePro and OfficeEssentials). 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 Application Service Provider (ASP) basis, on-line 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 generally bill the annual license fee for the first year of a multi-year agreement in advance. We recognize revenue with respect to courseware licenses either at the time of delivery of products or over the term of the contract, depending on products included in the license and specific contract terms. In the event that the customer specifies all licensed courses to be delivered at the outset and those courses are available and delivered on or before the contract start date, we recognize license revenue for the first year of the contract upon execution of the contract and delivery of the courses. We generally bill license fees for subsequent years of multi-year license arrangements on the anniversary date of the agreement, and if the customer exchanges courses and receives the exchanged courses by the renewal date, revenue is recognized in the manner described above.

In some circumstances, we offer payment terms of up to six months from the initial shipment date or anniversary date for multi-year agreements to our customers. To the extent that a customer is given extended payment terms, revenue is recognized as cash becomes due, assuming all of the other elements of revenue recognition have been satisfied.

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.

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 in which the service agreements are provided to the extent we have VSOE for those services. If we do not have VSOE for these services, revenue from the entire arrangement, including any implementation fees, is recognized on a straight-line basis over the period in which the services are provided. For multi-element agreements where we provide these services, VSOE is the basis used to allocate the total fee to the elements of the arrangement.

We recognize revenue on Referenceware and MML licenses ratably over the term of the agreement, which matches the period the future products or services are delivered.

We commence the recognition of revenue from resellers upon the final sale to the end user. With respect to reseller agreements with minimum commitments, we recognize revenue related to the portion of the minimum commitment that exceeds end user sales at the expiration of the commitment period.



We provide professional services, including instructor led training, customized content, websites and implementation services. We recognize professional service revenue as the services are performed. The cost of satisfying any post contract support (PCS), which essentially represents a warranty obligation, is accrued at the time license revenue is recognized, as PCS fees are included in the annual license fee. The estimated cost of providing PCS during the agreements is insignificant and we do not offer it separately. The accrued PCS costs are included in deferred revenue in the accompanying consolidated balance sheets.

We record deferred revenue when either cash is received or amounts have been billed in advance of products or services provided. Deferred revenue includes the unrecognized portion of revenue associated with license fees for which we have received payment or for which amounts have been billed and are currently due for payment in 180 days or less. In addition, deferred revenue includes amounts, which have been billed and not collected, for which revenue is being recognized ratably over the license period. In addition, in connection with the Merger, we acquired approximately $47 million of deferred revenue which was valued based upon the estimated cost to fulfill the remaining contractual and performance obligations plus a normal operating profit on fulfilling such obligations.

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 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. To date, development costs after establishment of technological feasibility have been immaterial, and we have expensed all software development costs as incurred. Selling and marketing expenses consist primarily of salaries, commissions and benefits, advertising and promotion, travel and certain infrastructure and occupancy expenses. General and administrative expenses consist primarily of salaries and benefits, consulting and service expenses, legal expenses, other public company costs and certain infrastructure and occupancy expenses.

Deferred compensation consists of two components: (1) the value of unvested options assumed in the Books acquisition and the Merger, and (2) the aggregate difference between the exercise or sale price of common stock options granted or restricted common stock sold during the year ended January 31, 2000 and the fair market value of the common stock as determined for accounting purposes. The deferred compensation is amortized over the vesting period of the underlying stock option or stock.

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

Restructuring and other non-recurring charges primarily consist of compensation cost of severed SmartForce employees for services rendered from the date of the Merger through January 31, 2003 and prior to such employees' termination dates and certain other non-recurring compensation costs to terminated and continuing employees. Additionally, these charges include expenses associated with the pending restatement of SmartForce's financial statements for 1999, 2000, 2001 and the first two quarters of 2002. See Note 4 of the Notes to the Consolidated Financial Statements.

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.

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REVENUE RECOGNITION

We recognize revenue in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 97-2 "Software Revenue Recognition," as amended by SOP No. 98-4 and SOP No. 98-9. Additionally, for agreements under which we are selling licenses and services, we recognize revenue under EITF 00-3 "Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another's Hardware" and Staff Accounting Bulletin No. 101 "Revenue Recognition." These statements require that four basic criteria must be satisfied before revenue can be recognized:

- Persuasive evidence of an arrangement between us and a third party exists;

- Delivery of our product has occurred;

- The sales price for the product is fixed or determinable; and

- Collection of the sales price is probable.

Our management uses its judgment concerning the satisfaction of these criteria, particularly the criteria relating to the determination of when delivery has occurred and the criteria relating to the collectibility of the receivables relating to such sales. Should changes and conditions cause management to determine that these criteria are not met for certain future transactions, revenue recognized for any period could be adversely affected. However, this is mitigated by the fact that the majority of our revenue is recognized ratably over the term of the respective license. Please see the discussion under the "Overview" section concerning how we recognize revenue.

IMPAIRMENT OF GOODWILL

We review the carrying value of goodwill periodically based upon the expected future and discounted operating cash flows of our business. Our cash flow estimates are based on historical results adjusted to reflect our best estimate of future markets and operating conditions. Actual results may differ materially from these estimates. The timing and size of impairment charges involves the application of management's judgment and could significantly affect our operating results. As a result of the Merger, one of our largest assets is goodwill. In response to several factors in the fourth quarter of fiscal 2003, we re-evaluated the fair value of the goodwill established in connection with the Merger and the Books acquisition and recorded an impairment charge of approximately $250.1 million. See Note 5 of the Notes to the Consolidated Financial Statements.

LEGAL CONTINGENCIES

We are currently involved in certain legal proceedings. In connection with these legal proceedings, which we discuss in Part I -- Item 3, and in Note 8 of the Notes to the Consolidated Financial Statements, 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. We do not currently have a basis for concluding that these proceedings will have a material adverse effect on our financial position; however, it is possible that future results for any particular quarter or annual period may be materially adversely affected by changes in our assumptions or the effectiveness of our strategies relating to these proceedings.

RESULTS OF OPERATIONS

COMPARISON OF THE FISCAL YEARS ENDED JANUARY 31, 2003 AND 2002

Revenue increased $57.2 million, or 129% to $101.5 million in the fiscal year ended January 31, 2003 from $44.3 million in the fiscal year ended January 31, 2002. This increase was due primarily to the addition of



revenue from SmartForce's historical customer base. To a lesser extent, this increase resulted from our new customers and increased revenue from our existing customers and a full year of revenues from Books.

Cost of revenue increased $8.9 million, or 342% to $11.5 million in the fiscal year ended January 31, 2003 from $2.6 million in the fiscal year ended

January 31, 2002. Cost of revenue as a percentage of total revenue was 11% in the fiscal year ended January 31, 2003 versus 6% in the fiscal year ended January 31, 2002. These increases were primarily due to increased costs of supporting the SmartForce hosting business and royalty fees associated with SmartForce's IT product line and, to a lesser extent, our Referenceware product line. We expect cost of revenues to continue to increase in amount but remain constant or decline as a percentage of revenue.

Research and development increased $11.4 million, or 64% to $29.1 million in the fiscal year ended January 31, 2003 from $17.7 million in the fiscal year ended January 31, 2002. This increase was primarily due to the addition of SmartForce's research and development organization. Research and development expenses in the fiscal year ended January 31, 2003 include charges of $1.5 million which represent expenses to modify the MySmartForce platform and content. Research and development expenses as a percentage of total revenue decreased to 29% in the fiscal year ended January 31, 2003 from 40% in the fiscal year ended January 31, 2002. This decrease was due to the lower research and development expenses as a percentage of revenues of SmartForce's research and development group compared to SkillSoft Corporation's. We expect research and development expenses to continue to increase, although we believe our outsourcing strategy for some of our courses provides us significant flexibility to control these expenditures.

Selling and marketing expenses increased $25.1 million, or 91% to $52.7 million in the fiscal year ended January 31, 2003 from $27.6 million in the fiscal year ended January 31, 2002. Selling and marketing expenses increased due to the addition of SmartForce's sales and marketing organization and related costs. Selling and marketing expenses as a percentage of total revenue decreased to 52% in the fiscal year ended January 31, 2003 from 62% in the fiscal year ended January 31, 2002. We believe that a significant investment in selling and marketing to expand our distribution channels worldwide is required to remain competitive, and we therefore expect selling and marketing expenses to increase both in amount and as a percentage of revenue.

General and administrative expenses increased $10.7 million, or 149% to $17.9 million in the fiscal year ended January 31, 2003 from $7.2 million in the fiscal year ended January 31, 2002. General and administrative expenses as a percentage of total revenue increased to 18% in the fiscal year ended January 31, 2003 from 16% in the fiscal year ended January 31, 2002. General and administrative expenses increased primarily due to the Merger and related integration costs. These expenses also increased as a result of higher litigation costs in the quarter ended January 31, 2003. We anticipate that general and administrative expenses will continue to increase both in amount and as a percentage of revenues due primarily to increases in litigation expenses and the increased costs of operating as a public company.

Stock-based compensation expense increased $800,000, or 100% to $1.6 million in the fiscal year ended January 31, 2003 from $800,000 in the fiscal year ended January 31, 2002. The increase reflects additional deferred compensation expense as a result of the Merger and the Books acquisition in December 2001. The remaining expense was primarily the result of 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 sale of restricted common stock with sales prices below the fair market value of the stock. The stock options granted at exercise prices below fair market value of the stock were granted by SkillSoft Corporation prior to its initial public offering and by Books prior to it being acquired in December 2001.

Amortization of intangible assets increased to $4.7 million in the fiscal year ended January 31, 2003 from $27,000 in the fiscal year ended January 31, 2002. The increase was due to the intangible assets acquired in the Merger and the Books acquisition in December 2001. See Note 5 of the Notes to the

Consolidated Financial Statements

Restructuring and other non-recurring charges were $19.3 million for the year ended January 31, 2003. The restructuring and non-recurring charges were recorded in connection with the Merger and the Books acquisition. The restructuring costs primarily consist of compensation costs for certain terminated SmartForce



employees. The other non-recurring charges primarily consist of costs directly related to the restatement of the SmartForce historical financial statements. See Notes 3 and 4 of the Notes to the Consolidated Financial Statements.

In response to several factors in the fourth quarter of fiscal 2003 and as part of our annual impairment test, we re-evaluated the fair value of the goodwill established in connection with the Merger and the Books acquisition. We prepared a cash flow analysis by reporting segment comparing the discounted cash flows to the net book values of the direct assets, goodwill and intangibles associated with the two reporting units: multi-modal learning and retail certification. The discounted cash flows did not support the direct assets, goodwill and intangibles of the multi-modal learning reporting unit. However, the discounted cash flows did support the value of the retail certification reporting unit.

The enterprise value of the two reporting units and the identifiable intangible assets were based on valuations prepared by a third party appraisal firm using assumptions provided by management. The enterprise value was based upon a discounted cash flow analysis prepared by our management. The discounted cash flow analysis included many factors including a reduction in expected revenues for the fiscal year ended January 31, 2004 due to the elimination of three non-core businesses -- Telcom, Prokoda Services and Custom Global Services and to a lesser extent, lower than anticipated revenues. Although market analysts continue to indicate strong growth in the e-Learning sector, we have assumed it to be a lower growth rate than originally considered at the time of the Merger. We have also valued our current customer base, including the synergies from cross-selling our products, content, technology, trademarks and net operating loss carryforwards. The cash flow analysis indicated the discounted cash flows were not sufficient to recover the assets. Accordingly, we have recorded a $250.1 million impairment to goodwill in the fourth quarter of fiscal 2003.

In connection with the Merger, we decided to exit the Telcom business and sold the business as of January 31, 2003. As more fully described in Note 3(c) of the Notes to the Consolidated Financial Statements, other income (expense) includes the results of operations for the period from September 6, 2002 through January 31, 2003 of the Telcom business.

Interest income (expense), net increased to $2.2 million, or 20% in the fiscal year ended January 31, 2003 from $1.8 million in the fiscal year ended January 31, 2002. This increase was primarily due to additional investments acquired in the Merger.

The provision for income taxes of $383,000 consists of income taxes payable in certain foreign locations, which cannot be offset through loss carryforwards.

COMPARISON OF THE FISCAL YEARS ENDED JANUARY 31, 2002 AND 2001

Revenue increased $25.0 million, or 129%, to $44.3 million in the fiscal year ended January 31, 2002 from $19.3 million in the fiscal year ended January 31, 2001. This increase is primarily due to the number of new customers signed

during the fiscal year ended January 31, 2002, which increased 55% over the prior fiscal year. In addition, we were successful in renewing expiring customer contracts and increasing revenue from existing customers, as customers renewing expiring contracts during the fiscal year ended January 31, 2002 increased their annual dollar commitments by an average of 35%.

Cost of revenue increased $1.1 million, or 70%, to $2.6 million in the fiscal year ended January 31, 2002 from $1.5 million in the fiscal year ended January 31, 2001. Cost of revenue as a percentage of total revenue decreased to 6% in the fiscal year ended January 31, 2001 from 8% in the fiscal year ended January 31, 2001. This decrease as a percentage of revenue was primarily due to the spreading of these costs of revenue, many of which are fixed, over a significantly larger revenue base.

Research and development expenses increased $3.7 million, or 26%, to $17.7 million in the fiscal year ended January 31, 2002 from $14.0 million in the fiscal year ended January 31, 2001. Research and development expenses as a percentage of total revenue decreased to 40% in the fiscal year ended January 31, 2002 from 73% in the fiscal year ended January 31, 2001. Research and development expenses increased due to increased personnel, courseware development costs and the purchase of IT content.

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Selling and marketing expenses increased $6.7 million, or 32%, to $27.6 million in the fiscal year ended January 31, 2002 from $20.9 million in the fiscal year ended January 31, 2001. Selling and marketing expenses as a percentage of total revenue decreased to 62% in the fiscal year ended January 31, 2002 from 109% in the fiscal year ended January 31, 2001. Selling and marketing expenses increased due to increased personnel, commissions, and travel costs.

General and administrative expenses increased $1.4 million, or 25%, to $7.2 million in the fiscal year ended January 31, 2002 from $5.8 million in the fiscal year ended January 31, 2001. General and administrative expenses as a percentage of total revenue decreased to 16% in the fiscal year ended January 31, 2002 from 30% in the fiscal year ended January 31, 2001. General and administrative expenses increased primarily due to increased personnel expenses and litigation.

Amortization expense related to stock-based compensation decreased $21,000, or 3%, to $793,000 in the fiscal year ended January 31, 2002 from $814,000 in the fiscal year ended January 31, 2001. Amortization expense decreased due to the completion of amortization for some awards during the year.

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

QUARTERLY OPERATING RESULTS FOR FISCAL YEARS 2003 AND 2002

| | Q1 2003 | Q2 2003 | Q3 2003(1) | Q4 2003 |
|---|---|---|---|---|
| | (IN THOUSANDS, EXCEPT PER SHARE DATA) | | | |
| Revenues | $13,805 | $15,415 | $ 29,336 | $ 42,914 |
| Cost of revenues | 837 | 984 | 4,739 | 4,988 |

| | | | | |
|---|---|---|---|---|
| Gross margin | 12,968 | 14,431 | 24,597 | 37,926 |
| Operating expenses: | | | | |
| Research and development | 3,439 | 3,745 | 7,702 | 14,218 |
| Selling and marketing | 7,404 | 7,860 | 16,320 | 21,107 |
| General and administrative | 1,825 | 1,776 | 7,578 | 6,735 |
| Amortization of stock-based compensation | 351 | 349 | 438 | 496 |
| Amortization of intangible assets | 81 | 81 | 1,825 | 2,696 |
| Impairment charge | -- | -- | -- | 250,107 |
| Restructuring and other non-recurring items | -- | -- | 6,607 | 12,679 |
| Total operating expenses | 13,100 | 13,811 | 40,470 | 308,038 |
| Operating income (loss) | (132) | 620 | (15,873) | (270,112 |
| Other income (expense), net | (95) | (32) | (1) | (154 |
| Interest income, net | 509 | 449 | 504 | 703 |
| Income (loss) before provision for income taxes | 282 | 1,037 | (15,370) | (269,563 |
| Provision for income taxes | | | | (383 |
| Net income (loss) | $ 282 | $ 1,037 | $(15,370) | $(269,946 |
| Net loss per share | | | | |
| Basic income/(loss) per share | $ 0.01 | $ 0.03 | $ (0.20) | $ (2.71 |
| Basic weighted average shares outstanding | 41,114 | 41,529 | 76,193 | 99,590 |
| Diluted income/(loss) per share | $ 0.01 | $ 0.03 | $ (0.20) | $ (2.71 |
| Diluted weighted average shares outstanding | 43,211 | 42,335 | 76,193 | 99,590 |

| | Q1 2002 | Q2 2002 | Q3 2002 | Q4 2002 |
|---|---|---|---|---|
| Revenues | $ 8,510 | $ 9,382 | $11,156 | $15,223 |
| Cost of revenues | 529 | 537 | 579 | 907 |
| Gross margin | 7,981 | 8,845 | 10,577 | 14,316 |
| Operating expenses: | | | | |
| Research and development | 3,640 | 3,719 | 6,126 | 4,213 |
| Selling and marketing | 6,522 | 6,622 | 6,970 | 7,488 |
| General and administrative | 1,612 | 1,677 | 1,886 | 2,024 |
| Amortization of stock-based compensation and intangible assets | 184 | 184 | 184 | 268 |
| Total operating expenses | 11,958 | 12,202 | 15,166 | 13,993 |
| Interest income, net | 368 | 235 | 754 | 603 |
| Net income (loss) | $(3,609) | $(3,122) | $(3,835) | $ 926 |
| Net loss per share | | | | |
| Basic income/(loss) per share(2) | $ (0.12) | $ (0.10) | $ (0.10) | $ 0.02 |
| Basic weighted average shares outstanding(2) | 31,257 | 32,071 | 38,445 | 39,412 |
| Diluted income/(loss) per share(2) | $ (0.12) | $ (0.10) | $ (0.10) | $ 0.02 |

| | | | | |
|---|---|---|---|---|
| Diluted weighted average shares outstanding(2)......... | 31,257 | 32,071 | 38,445 | 41,581 |
| | ======= | ======= | ======= | ======= |

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(1) Includes reclassification of Telcom results to other income (expense). (See Note 3(c) of the Notes to the Consolidated Financial Statements.)

(2) Adjusted to reflect the Merger. (See Note 2(d) of the Notes to the Consolidated Financial Statements.)



LIQUIDITY AND CAPITAL RESOURCES

As of January 31, 2003, our principal source of liquidity was our cash and cash equivalents and short-term investments, which totaled $125 million.

Net cash used in operating activities was $38.8 million and $6.6 million for the fiscal years ended January 31, 2003 and 2002, respectively. Our net cash used in the fiscal year ended January 31, 2003 reflects primarily our net loss totaling $283.9 million as well as increased operating activities resulting from the Merger. The net loss includes a non-cash charge of $250.1 million relating to the impairment of goodwill.

Cash provided by investing activities was approximately $54.7 million in the fiscal year ended January 31, 2003. Cash used in investing activities was approximately $54.4 million in the fiscal year ended January 31, 2002. Our primary investing activity during the fiscal year ended January 31, 2003 was the acquisition of cash of approximately $49.1 million as a result of the Merger. Maturation of investments, net of purchases (short and long-term), generated a net cash inflow of $17.5 million in the fiscal year ended January 31, 2003 compared to a net cash outflow of approximately $46.2 million in the fiscal year ended January 31, 2002. In addition, the property and equipment purchases for the fiscal year ended January 31, 2003 and 2002 were approximately $8.9 million and $1.9 million, respectively.

Cash provided by financing activities was approximately $1.9 million and $73.6 million for the fiscal years ended January 31, 2003 and 2002, respectively. For the fiscal year ended January 31, 2003, this consisted primarily of approximately $1.7 million relating to cash from the exercise of stock options and purchases under the employee stock purchase plan. For the fiscal year ended January 31, 2002, this consisted primarily of the net proceeds from the sale of SkillSoft Corporation common stock in the secondary offering of approximately $72.0 million.

Working capital was approximately $31.8 million and $48.7 million as of January 31, 2003 and January 31, 2002, respectively. Total assets were approximately $378.1 million and $153.5 million as of January 31, 2003 and January 31, 2002, respectively. Primarily as a result of the Merger and the acquisition of Books, we have approximately $119.4 million and $34.3 million of goodwill and separately identifiable net intangible assets, respectively.

On April 28, 2003, we signed a term sheet to obtain a $25 million one-year, secured line of credit from a bank. We expect to execute the definitive loan documents by May 31, 2003. Under the terms of the line of credit, the facility is to be initially secured by cash held in a certificate of deposit in the amount of the line, plus a first security interest in all domestic business assets. The cash held in the certificate of deposit is to be released on a quarterly basis beginning the quarter following the achievement of two

consecutive minimum levels of operating income. All borrowings under the line of credit bear interest at the lesser of the bank's prime rate or the 30 or 60-day Libor rate plus 2.75%.

As of January 31, 2003, we had worldwide net operating loss carryforwards of approximately $359 million for income tax purposes available to reduce future income taxes, if any. See Note 7 of the Notes to the Consolidated Financial Statements.

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 follow (in thousands):

| FISCAL YEAR ENDING JANUARY 31: | FACILITIES | OTHER | TOTAL |
|---|---|---|---|
| 2004 | $ 6,051 | $1,695 | $ 7,746 |
| 2005 | 5,291 | 814 | 6,105 |
| 2006 | 4,098 | 77 | 4,175 |
| 2007 | 3,344 | 12 | 3,356 |
| 2008 | 3,199 | 2 | 3,201 |
| Thereafter | 11,366 | -- | 11,366 |

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We have entered into long-term agreements with third parties to provide content and subject matter expertise. In connection with these agreements, our minimum obligations are approximately $5,787,000 and $2,286,000 for the fiscal years ending January 31, 2004 and 2005, respectively.

We expect to continue to experience growth in capital expenditures and operating expenses, particularly sales and marketing and product development expenses, for the foreseeable future in order to execute our business plan. To the extent that our execution of the business plan results in increased sales, we expect to experience corresponding increases in deferred revenue and prepaid expenses. We expect that the principal sources of funding for our operating expenses, capital expenditures and other liquidity needs will be a combination of our available cash and cash equivalents and short-term investments (which totaled approximately $125 million as of January 31, 2003) and funds generated from operations. Approximately $22.8 million was paid out against the exit and restructuring plan accruals during the year ended January 31, 2003. Approximately $17.2 million is expected to be paid by January 2004, and the remaining value of approximately $6.3 million is expected to be disbursed between January 2004 and December 2005. 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 a number of factors that may negatively impact our available sources of funds including any unfavorable outcomes or settlements of pending litigation. The amount of cash generated from operations will be dependent upon the successful execution of our business plan and worldwide economic conditions. In addition, our cash needs may increase due to factors such as unanticipated developments in our business or significant acquisitions.

RECENT ACCOUNTING PRONOUNCEMENTS

In April 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 145, "Rescission of Statements No. 4, 44, and 64, Amendment of FASB

Statement No. 13, and Technical Corrections." Under SFAS No. 145, gains and losses on extinguishments of debt are to be classified as income or loss from continuing operations rather than extraordinary items. We are required to adopt SFAS No. 145 in the first quarter of fiscal 2004 and do not expect the adoption of this statement to have a material impact on our financial condition or results of operations.

In July 2002, the FASB issued Statement of Financial Accounting Standards SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The statement requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to exit or disposal plan. Costs covered by SFAS No. 146 include lease termination costs and certain employee severance costs that are associated with a restructuring, branch closing, or other exit disposal activity. This statement is effective for exit or disposal activities initiated after December 31, 2002. SFAS No. 146 may affect the timing of our recognition of future exit or disposal costs, if any.

In November 2002, the FASB issued Interpretation No. 45 (FIN No. 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 requires a guarantor to record certain guarantees at fair value and to make significant new disclosures, even when the likelihood of making any payments under the guarantee is remote. The interpretation and its disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The interpretation's initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The guarantor's previous accounting for guarantees issued prior to December 31, 2002 should not be revised or restated due to the adoption of this interpretation. The adoption of FIN No. 45 did not have a material impact on our financial condition or results of operations.

In January 2003, the FASB issued Interpretation No. 46 (FIN No. 46), "Consolidation of Variable Interest Entities," which requires the consolidation of a variable interest entity, as defined, by its primary beneficiary. Primary beneficiaries are those companies that are subject to a majority of the risk of loss or entitled to receive a majority of the entity's residual returns, or both. In determining whether it is the primary beneficiary of a variable interest entity, an entity with a variable interest shall treat variable interests in that same entity held by its related parties as its own interests. We are currently evaluating the existence of variable



interest entities, if any, and the impact of adopting the interpretation on the consolidated financial statements. Refer to Note 3 and Note 8 of the Notes to the Consolidated Financial Statements for additional disclosures regarding related parties, and commitments and contingencies, respectively.

In January 2003, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," an amendment of SFAS No. 123, which provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in annual financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We have elected to continue to account for stock-based compensation under APB No. 25, and related Interpretations under FIN 44 and elect the disclosure-only alternative under SFAS No. 123 and the enhanced disclosures as required by SFAS No. 148. See Note 2(p) of the Notes to the Consolidated Financial Statements.

FUTURE OPERATING RESULTS

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, certain accounting matters were identified relating to the historical financial statements of SmartForce (which, following the Merger, are no longer our historical financial statements -- see Note 1 of the Notes to the Consolidated 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. Following this announcement, six lawsuits claiming to be class actions were commenced against us and certain of our current and former directors and officers, by or on behalf of persons claiming to be our shareholders and persons claiming to have purchased or otherwise acquired our securities at specified periods beginning as early as October 19, 1999 and continuing after September 6, 2002. These lawsuits have been consolidated. Additional lawsuits may be filed against us. Regardless of the outcome of the consolidated action, it is likely that we will incur substantial defense costs and that such actions will cause a diversion of our management's time and attention. If we do not prevail in the case we could be required to pay substantial damages or settlement costs, which could have a material adverse effect on our financial condition or results of operation. We are unable at this time to assess the validity of the claims or estimate the possible range of damages that might be incurred as a result of the consolidated lawsuit. We have not yet established any financial reserves relating to this lawsuit. We believe that we have meritorious defenses to these actions and intend to defend ourselves vigorously.

We are the subject of a formal order of private investigation entered by the SEC. We are cooperating with the SEC in connection with this investigation. We will likely 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, which could adversely affect our business.

WE HAVE MISSED THE DEADLINE FOR THREE RECENT SEC FILINGS, WHICH HAS SEVERAL ADVERSE CONSEQUENCES FOR US.

Neither our Quarterly Report on Form 10-Q for the quarter ended October 31, 2002 nor this Annual Report on Form 10-K were filed with the SEC by the due dates. In addition, we were required to file an amendment to our Current Report on Form 8-K relating to the SmartForce-SkillSoft Corporation merger by November 22, 2002, and that amendment has not yet been filed. Until we file our Form 8-K amendment, we will not be able to have a registration statement under the Securities Act of 1933, covering a public offering of securities, declared effective by the SEC, and we will not be able to make offerings pursuant to existing registration statements (including registration statements on Form S-8 covering employee stock plans), or pursuant to certain "private placement" rules of the SEC under Regulation D, to any purchasers not qualifying as "accredited investors". In addition, our affiliates will not be able to sell our securities pursuant to

Rule 144 under the Securities Act until the Form 8-K amendment is filed. Finally, we will not be eligible to use a "short form" registration statement on Form S-3 for a period of 12 months after the time our Form 8-K amendment is filed. These restrictions may impair our ability to raise funds, should we desire to do so, through an equity financing and to attract and retain key employees.

OUR WHOLLY OWNED SUBSIDIARY, SKILLSOFT CORPORATION AND SEVERAL OF ITS EXECUTIVES, THREE OF ITS KEY EMPLOYEES AND A FORMER MAJOR INVESTOR OF SKILLSOFT CORPORATION ARE DEFENDANTS IN LITIGATION WITH NETG WHICH ALLEGES, AMONG OTHER THINGS, MISAPPROPRIATION OF TRADE SECRETS; THIS LITIGATION WILL CONTINUE TO BE COSTLY, MAY DIVERT THE EFFORTS OF OUR MANAGEMENT AND MAY ULTIMATELY RESTRICT OUR ABILITY TO DO BUSINESS.

Our wholly owned subsidiary, SkillSoft Corporation, several of its executives, three of its key employees and its former largest investor are defendants in a lawsuit brought by National Education Training Group, Inc. (NETg), the former employer of these individuals. NETg alleges in substance that various of the defendants breached their fiduciary and contractual obligations to NETg in connection with the organization and operation of SkillSoft Corporation, misappropriated trade secrets from NETg, tortiously interfered with NETg's business and employees and breached provisions of a license agreement with NETg relating to the use of its software. NETg maintains that the trade secrets allegedly misappropriated by SkillSoft Corporation and the other defendants include, among other things:

- various aspects of the design and functionality of its education and training software and products;

- customer lists and information;

- relationships with service providers; and

- NETg's soft skills product line business plan.

The claims seek injunctive relief against the defendants demanding the return, and no future use by these defendants, of the alleged trade secrets. The claims also seek compensatory damages of $400 million and exemplary damages in the additional amount of $400 million, compensatory, incidental and consequential damages in an unspecified amount and punitive damages totaling $50 million or such other amount as the court deems just or appropriate. In answers to interrogatories served on NETg, an expert witness retained by NETg opined that NETg may, based on certain assumptions provided to the expert by NETg's counsel, be entitled to two categories of damages for lost profits of up to $386.8 million and damages for unjust enrichment which could total up to $616.3 million. Named as defendants in the lawsuit, in addition to SkillSoft Corporation, are Charles E. Moran, Jerald A. Nine, Jr., Mark A. Townsend, Lee A. Ritze, Dennis E. Brown, Sally H. Hovis, Warburg, Pincus Ventures, L.P. (Warburg), a major investor of SkillSoft Corporation, and each general partner of Warburg.

In addition, NETg also filed suit against SkillSoft Corporation in July 2000 alleging that its educational and training software products infringe a patent allegedly owned by NETg. The complaint seeks both monetary damages and injunctive relief. SkillSoft Corporation filed an answer and a counterclaim for a declaration of invalidity of the NETg patent. On April 17, 2001 SkillSoft Corporation filed a request for reexamination of the patent in suit with the United States Patent and Trademark Office (PTO). After a series of interim actions by the PTO and filings by NETg, on April 10, 2002, the PTO issued an office action rejecting all of the claims of the patent. In 2002, the lawsuit was dismissed "without prejudice with leave to reinstate upon full and final resolution of the reexamination proceedings" with the PTO. The patent owner's

appeal of the PTO's Office Action rejecting all the claims of the patent remains pending.

If we do not prevail in the NETg cases it could have any or all of the following significant adverse effects on our business and financial performance:

- injunctive relief against SkillSoft Corporation, us and our officers and employees, which could significantly restrict our ability to conduct our business;

- an adverse judgment against us for monetary damages;

- a settlement on unfavorable terms to us;

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- our obligations to indemnify our employees and directors for liabilities and expenses they incur in connection with the lawsuits;

- obligations to customers for breach of warranties of noninfringement; or

- a requirement to reengineer our products to avoid patent infringement, which would likely result in additional expense and delay.

In addition, these cases, regardless of their outcome, will continue to result in significant expenses in defending the lawsuits. Our legal expenses related to the defense of these lawsuits totaled approximately $1.4 million in the fiscal year ended January 31, 2001, $1.7 million in the fiscal year ended January 31, 2002 and $4.3 million in the fiscal year ended January 31, 2003. Moreover, these lawsuits may divert the efforts and attention of our management team from normal business operations. While there have been certain settlement discussions between the parties in the lawsuits, at this time, the outcome of these discussions cannot be predicted. Accordingly, we have not recorded any liability related to this matter in our Consolidated Financial Statements.

PENDING AND ANY FUTURE 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. In April 2002 and May 2002, IP Learn, LLC (IP Learn) filed lawsuits against us and SkillSoft Corporation, respectively, alleging infringement of certain of IP Learn's patents, and asking the court for a preliminary and permanent injunction as well as unspecified damages. These lawsuits were consolidated in December 2002. We believe we have meritorious defenses and are vigorously defending ourselves.

On June 13, 2002, Lionet Limited, a limited liability company incorporated and doing business in Ireland, filed a claim against us in Dublin, alleging, among other things, that we breached the terms of our software license agreement with Lionet Limited in that we permitted or failed to prevent the decompilation of the provided software products and have failed to cooperate in audits to determine the nature of such alleged copying or de-compilation. Lionet Limited is seeking damages for lost license fees of $6.8 million and seeks other damages. We are in the process of reviewing the statement of claim and intend to

vigorously defend ourselves in this matter.

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 ARE SUBJECT TO OTHER PENDING LEGAL PROCEEDINGS AND WE MAY BECOME SUBJECT TO ADDITIONAL LEGAL PROCEEDINGS. ADVERSE DETERMINATIONS IN THESE PROCEEDINGS COULD MATERIALLY HARM OUR BUSINESS.

Since the end of the third quarter of 1998, a class action lawsuit has been pending in the United States District Court for the Northern District of California against us, one of our subsidiaries, SmartForce USA, and certain of our former and current officers and directors, alleging violation of the federal securities laws. It has been alleged in this lawsuit that we misrepresented or omitted to state material facts regarding our business and financial condition and prospects in order to artificially inflate and maintain the price of our ADSs, and misrepresented or omitted to state material facts in our registration statement and prospectus issued in connection with our merger with Forefront, which also is alleged to have artificially inflated the price of our ADSs.



Although we cannot presently determine the outcome of this action, an adverse resolution of this matter could significantly negatively impact our financial position and results of operations. We believe that we have meritorious defenses to this action and intend to defend ourselves vigorously.

We may be from time to time involved in various lawsuits and legal proceedings, which arise in the ordinary course of business. An adverse resolution of these matters could significantly negatively impact our financial position and results of operations.

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

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

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

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

RISKS RELATED TO THE MERGER BETWEEN SKILLSOFT CORPORATION AND SMARTFORCE

WE MAY NOT BE SUCCESSFUL IN COMPLETING FINAL ASPECTS OF THE INTEGRATION RELATED TO THE BUSINESSES OPERATED BY SKILLSOFT CORPORATION AND SMARTFORCE PRIOR TO THE MERGER AND, AS A RESULT, MAY NOT REALIZE BENEFITS FROM THE MERGER.

We have substantially completed many of the key aspects of the integration of the businesses operated by SkillSoft Corporation and SmartForce prior to the Merger, which was consummated on September 6, 2002. However, the ultimate successful integration of the two businesses will require, among other things, the following:

- completion of the integration of the two companies' products and services, information and software systems and other operations;

- coordination of ongoing and future research and development efforts and marketing activities;

- retention of existing customers of both companies and attraction of additional customers;

- retention of strategic partners of each company and attraction of new strategic partners;

- developing and maintaining uniform standards, controls, procedures and policies;

- identifying and eliminating redundant and underperforming operations and assets;

- effectively leveraging our indirect sales presence;

- capitalizing on cross-selling opportunities;

- the successful migration of the companies' platforms;

- minimization of disruption of each company's ongoing business and distraction of its management;



- limiting expenses related to integration; and

- improving its internal control environment due to challenges in the integration.

We may not succeed in addressing these risks or any other problems encountered in connection with the Merger. The diversion of the attention of management and any difficulties encountered in the process of combining the companies could cause the disruption of, or a loss of momentum in, the activities of our business or could cause the impairment of relationships with customers and business partners. Further, the process of combining the two companies' businesses could negatively affect employee morale and our ability to retain some key employees, and could cause customers to cancel existing license agreements or choose not to purchase new products from us. In addition, we intend to develop new products and services that combine both companies' assets. Difficulties in combining the technology, products and service offerings of the two companies could result in disruption of customer service and longer sales cycles and product implementations, which could cause existing customers to reduce or cease doing business with us altogether, and could cause revenue and operating income to fluctuate and fail to meet expectations.

CERTAIN ASPECTS OF THE MERGER COULD HARM OUR FINANCIAL RESULTS.

In connection with the Merger, certain aspects of the integration of the two companies moving forward could harm our financial results. For example, we have made certain changes in contracting practices, which will have attendant accounting implications. For example, prior to the Merger, SmartForce recorded license revenues with respect to contracts that provide for perpetual licenses to software at the time that it sold the perpetual licenses. Since the Merger, we have been delivering perpetual licenses as part of a bundled offering including services. As a result, the revenue from both the perpetual licenses and services will be recognized as revenues as the services are delivered over time. This means that rather than recognizing substantial license revenue at the time of the execution of these contracts, we will now recognize license revenue ratably over the term of these contracts. In addition, due to purchase accounting in connection with the Merger, a portion of the SmartForce deferred revenue as of September 6, 2002 will be reclassified to goodwill and will therefore not be recognized as revenue.

As a result of the integration, we may not obtain some revenue we otherwise might have obtained. For example, although the products and customer bases of the two companies are complementary and should provide us with numerous cross selling opportunities, we do expect some degree of commercial overlap that could negatively impact revenue. Also, we intend to de-emphasize customer service revenue activities to focus on higher margin segments of the business, which we expect will result in lost revenue. In addition, volume discounting of mutual customers now combined as a result of the Merger may result in lower revenues.

If the benefits of the Merger do not exceed the associated costs, including costs associated with integrating the two companies, lost or deferred revenues and dilution of our shareholders resulting from the issuance of our ADSs in connection with the Merger, our financial results, including earnings per share, could be materially harmed.

IF WE ARE UNABLE TO TAKE ADVANTAGE OF OPPORTUNITIES TO MARKET AND SELL THE PRODUCTS AND SERVICES OF THE TWO COMPANIES TO EACH OTHER'S TRADITIONAL CUSTOMERS, DISTRIBUTION CHANNELS AND BUSINESS PARTNERS, WE MAY NOT REALIZE SOME OF THE EXPECTED BENEFITS OF THE MERGER.

Prior to the Merger, we and SkillSoft Corporation each maintained separate and distinct customer bases, distribution channels and business partners specific to our respective businesses. Following the Merger, we are attempting to take advantage of the customer bases and distribution channels of the formerly separate businesses in order to promote and sell the products and services of one company to the traditional customers and business partners of the other company. The products and services of the two companies are highly technical and the salespersons of one company may not be successful in marketing the products and services of the other company. In the event that the traditional customers and business partners of either company are not receptive to the products and services of the other, we may not realize some of the expected benefits of the merger, and our business may be harmed.



WE ARE OPERATING UNDER A NEW NAME, WHICH MAY ADVERSELY AFFECT OUR BUSINESS.

Following the consummation of the Merger, we changed our name from SmartForce PLC to SkillSoft PLC. The adoption of this new name may prevent us from taking advantage of certain goodwill existing customers and strategic partners associate with our former name. Further, we expect to incur an expense in effecting the name change and in marketing efforts to promote brand recognition of the new name.

RISKS RELATED TO THE OPERATION OF OUR BUSINESS

WE AND SKILLSOFT CORPORATION HAVE EXPERIENCED NET LOSSES IN THE PAST, AND WE MAY BE UNABLE TO ACHIEVE OR MAINTAIN PROFITABILITY.

SmartForce incurred substantial net losses both recently and in the past, including net losses of $37.7 million in the three months ended June 30, 2002 and $19.1 million in the three months ended March 31, 2002. SkillSoft Corporation incurred substantial net losses in every fiscal quarter prior to its fiscal quarter ended January 31, 2002. In addition, the combined company recorded a net loss of $269.9 million for the fiscal quarter ended January 31, 2003. We expect to incur significant expenses in connection with the completion of the migration to a unified platform and the continued expansion of this combined business, and, as a result, the business will need to generate significant revenues to achieve and maintain profitability. We cannot guarantee whether our combined business will achieve or 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:

- 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 fourth quarter of our fiscal year and weakest in the first quarter;
- 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.

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, 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.

WE RELY ON STRATEGIC ALLIANCES FOR MARKETING, WHICH ALLIANCES ARE NOT EXCLUSIVE, MAY BE TERMINATED OR MAY FAIL TO MEET OUR REQUIREMENTS IN THE FUTURE.

We have developed strategic alliances to market many of our products. However, these relationships are not exclusive, and our marketing partners could market other products in preference to, and in competition with, those developed by us. In addition, we may be unable to continue to market future products through



these alliances or may be unable to negotiate additional alliances in the future on acceptable terms, if at all. The marketing efforts of our strategic partners may also disrupt our direct sales efforts.

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

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

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.

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 down times, 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 its 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 connection with the Merger, we recorded $30.3 million in merger and exit costs and $19.3 million of restructuring and other non-recurring charges; see Note 4 of the Notes to the Consolidated Financial Statements. 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 restoring 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. In addition, certain of our senior



executives left the company in connection with the Merger. If we fail to adequately replace these executives or fail to manage the transition to new management effectively, our results of operations could be negatively affected.

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 is considering whether to require all companies to treat the value of stock options granted to employees as an expense. The United States Congress and other governmental and regulatory authorities have also considered requiring companies to expense stock options. If this change were to become mandatory, we and other companies would be required to record a compensation expense equal to the value of each stock option granted. This expense would be spread over the vesting period of the stock option. Currently, we are generally not required to record compensation expenses in connection with stock option grants. If we were required to expense stock option grants, it would 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, in the event we are required to expense stock option grants, either our profitability, or our ability to use stock options as an employee recruitment and retention tool would be adversely impacted.

INCREASED COMPETITION MAY RESULT IN DECREASED DEMAND FOR OUR PRODUCTS AND SERVICES, WHICH MAY RESULT IN REDUCED REVENUES AND GROSS MARGINS AND LOSS OR 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 and vendors of application software, 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;

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

- internal education and training departments of potential customers; and

- value-added resellers and network integrators.

Growing competition may result in price reductions, reduced revenue and gross margins 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.

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. See Note 2(e) of the Notes to the Consolidated Financial Statements.

OUR CORPORATE TAX RATE MAY INCREASE, WHICH COULD ADVERSELY AFFECT OUR CASH FLOW, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Our corporate tax rate may increase, which could adversely affect our cash flow, financial condition and results of operations. We currently have significant foreign operations and generate a majority of our taxable income in Ireland, and some of our Irish operating subsidiaries are taxed at rates substantially lower than tax rates in effect in the United States and other countries in which we have operations. As we have substantial assets and properties located in, and our business operations are principally conducted in, the United States, we are in the process of exploring the reorganization of our operations and repatriating certain assets to Ireland in order to maintain an effective tax rate at the level currently applicable to us. If we are unable to effect such a reorganization, or if at any time our Irish subsidiaries were no longer to qualify for these lower tax rates or if the applicable tax laws were rescinded or later changed, our operating results could be materially adversely affected. Moreover, because we will incur income tax in several countries, an increase in our profitability in one or more of these countries could result in a higher overall tax rate. In addition, if U.S. or other foreign tax authorities were to change applicable tax laws or successfully challenge the manner in which our subsidiaries' profits are currently recognized, our taxes could increase, and our business, cash flow, financial condition and results of operations could be materially adversely affected. In addition, there may be limitations imposed on the level and timing of the utilization of historic net operating losses for tax purposes as a result of the Merger. These limitations may adversely impact cash flow depending on the extent of any such limitation.

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

Our success depends to a degree upon the protection of our rights in intellectual property. We rely upon a combination of patent, copyright, and trademark laws to protect our proprietary rights. We have also entered into, and will continue to enter into, confidentiality agreements with our employees, consultants and third parties to seek to limit and protect the distribution of confidential information. However, we have not signed protective agreements in every case.

Although we have taken steps to protect our proprietary rights, these steps may be inadequate. Existing patent, copyright, and trademark laws offer only limited protection. Moreover, the laws of other countries in which we market our products may afford little or no effective protection of our intellectual property. Additionally, unauthorized parties may copy aspects of our products,

services or technology or obtain and use information that we regard as proprietary. Other parties may also breach protective contracts we have executed or will in the future execute. We may not become aware of, or have adequate remedies in the event of, a breach. Litigation may be necessary in the future to enforce or to determine the validity and scope of our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Even if we were to prevail, such litigation could result in substantial costs and diversion of management and technical resources.

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

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

- difficulties or delays in developing and supporting non-English language versions of our products and services;
- political and economic conditions in various jurisdictions;
- difficulties in staffing and managing foreign subsidiary operations;
- longer sales cycles and account receivable payment cycles;
- multiple, conflicting and changing governmental laws and regulations;
- foreign currency exchange rate fluctuations;
- protectionist laws and business practices that may favor local competitors;
- difficulties in finding and managing local resellers;
- potential adverse tax consequences; and
- the absence or significant lack of legal protection for intellectual property rights.

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

THE MARKET PRICE OF OUR ADSS MAY FLUCTUATE AND MAY NOT BE SUSTAINABLE.

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

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 (not including SmartCertify) by that customer typically ranges from three to twelve months. 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, which typically range from three to twelve months or more, 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.

THE CONVICTION OF ARTHUR ANDERSEN LLP ON OBSTRUCTION OF JUSTICE CHARGES MAY ADVERSELY AFFECT ARTHUR ANDERSEN LLP'S ABILITY TO SATISFY ANY CLAIMS ARISING FROM THE PROVISION OF AUDITING SERVICES TO SKILLSOFT CORPORATION AND MAY IMPEDE OUR ACCESS TO CAPITAL MARKETS AFTER THE MERGER.

Arthur Andersen LLP audited SkillSoft Corporation's financial statements for the fiscal years ended January 31, 2002, January 31, 2001 and January 31, 2000. On March 14, 2002, an indictment was unsealed charging it with federal obstruction of justice arising from the government's investigation of Enron Corp. On June 15, 2002, Arthur Andersen LLP was convicted of these charges. It is possible that the effect of this conviction on Arthur Andersen LLP's financial condition may adversely affect the ability of Arthur Andersen LLP to satisfy any claims arising from its provision of auditing services to SkillSoft Corporation.

Should we seek to access the public capital markets, SEC rules will require us to include or incorporate by reference in any prospectus three years of audited financial statements. The SEC's current rules would require us to present audited financial statements for one or more fiscal years audited by Arthur Andersen LLP and use reasonable efforts to obtain its consent until the audited financial statements for the fiscal year ending January 31, 2005 become available. If prior to that time the SEC ceases accepting financial statements audited by Arthur Andersen LLP, it is possible that the available audited financial statements for the fiscal years ended January 31, 2002, January 31, 2001 and January 31, 2000 audited by Arthur Andersen LLP might not satisfy the SEC's requirements. In that case, we would be unable to access the public capital markets unless Ernst & Young LLP, our current independent accounting

firm, or another independent accounting firm, is able to audit the financial statements originally audited by Arthur Andersen LLP. Any delay or inability to access the public capital markets caused by these circumstances could have a material adverse effect on our business, profitability and growth prospects.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of January 31, 2003, 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 and pound sterling relative to the U.S. dollar, which could adversely affect our business and the results of operations.



ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Incorporated by reference from Appendix B attached hereto.

PART III

ITEM 14. CONTROLS AND PROCEDURES

Following the merger of SmartForce PLC and SkillSoft Corporation on September 6, 2002, we integrated the business processes, human resources, disclosure controls and procedures, and internal controls of the two companies. During this process, significant deficiencies in disclosure controls and procedures and internal controls were identified predominantly with respect to financial reporting at non-U.S. subsidiaries of the former SmartForce PLC and our ability to process the consolidated financial closing cycle. These deficiencies resulted in a significant strain to the internal resources and on the infrastructure of the finance organization and adversely impacted the year-end financial closing process. External resources were engaged to assist management in the year-end financial closing process and in identifying areas for improvement. In addition, permanent resources and accounting process improvements have been and will continue to be added and implemented to improve the non-U.S. finance operations, the financial closing process, and the overall internal control environment.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, and with the

assistance of outside consultants, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures within 90 days prior to the filing date of this annual report on Form 10-K. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures need significant improvements with respect to certain aspects of our financial reporting at predominantly the non-U.S. subsidiaries of the former SmartForce PLC and in our ability to process the consolidated financial closing cycle. Our independent auditors have informed us that they believe we have material weaknesses and reportable events in internal control in certain of these areas. We have implemented interim mitigating control procedures as part of the process of preparing our financial statements for the year ended January 31, 2003. Although progress has been made, additional changes to the disclosure controls and procedures, and internal controls will be on-going.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Financial Statements, Financial Statement Schedule, and Exhibits

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

   Financial Statements:

   Report of Independent Auditors

   Report of Independent Public Accountants

   Consolidated Balance Sheets

   Consolidated Statements of Operations

   Consolidated Statements of Stockholders' Equity (Deficit) 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 to this Form 10-K.

(b) Reports on Form 8-K.

We previously disclosed the following Current Reports on Form 8-K in our Quarterly Report on Form 10-Q for the quarter ended October 31, 2002:

On November 14, 2002, we filed a Current Report on Form 8-K dated September 4, 2002 that reported under Item 5 the amendment of certain deposit agreements with The Bank of New York.

On November 18, 2002, we filed a Current Report on Form 8-K dated June 10, 2002 that reported under Item 5 amendments to our Declaration of Subscription Rights.

On November 20, 2002, we filed a Current Report on Form 8-K dated November 19, 2002 that reported under Item 5 our intent to restate certain historical financial statements of SmartForce PLC.



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: May 22, 2003

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 PLC, and in the capacities and on the date set forth below.

| SIGNATURE | TITLE | D |
| --- | --- | --- |
| /s/ CHARLES E. MORAN<br>Charles E. Moran | President and Chief Executive Officer and Director (Principal Executive Officer) | May 2 |
| /s/ THOMAS J. MCDONALD<br>Thomas J. McDonald | Chief Financial Officer (Principal Financial and Accounting Officer) | May 2 |
| /s/ GREGORY M. PRIEST<br>Gregory M. Priest | Director | May 2 |
| /s/ WILLIAM T. COLEMAN III<br>William T. Coleman III | Director | May 2 |
| /s/ P. HOWARD EDELSTEIN<br>P. Howard Edelstein | Director | May 2 |

| | | |
|---|---|---|
| /s/ STEWART K. P. GROSS<br>------------------------------------------------<br>Stewart K. P. Gross | Director | May 2 |
| /s/ JAMES S. KRZYWICKI<br>------------------------------------------------<br>James S. Krzywicki | Director | May 2 |
| /s/ FERDINAND VON PRONDZYNSKI<br>------------------------------------------------<br>Ferdinand von Prondzynski | Director | May 2 |



CERTIFICATIONS

I, Charles E. Moran, certify that:

1. I have reviewed this annual report on Form 10-K/A of SkillSoft Public Limited Company;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record,

process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ CHARLES E. MORAN

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Charles E. Moran
President and Chief Executive Officer

Dated: May 22, 2003



CERTIFICATIONS

I, Thomas J. McDonald, certify that:

1. I have reviewed this annual report on Form 10-K/A of SkillSoft Public Limited Company;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the

equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ THOMAS J. MCDONALD
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Thomas J. McDonald
Chief Financial Officer

Dated: May 22, 2003



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. The consolidated statements of operations data for the fiscal year ended January 31, 2003 and the consolidated balance sheet data as of January 31, 2003 are derived from our consolidated financial statements, audited by Ernst & Young LLP, independent public accountants, which are included elsewhere in this Form 10-K. The consolidated statements of operations data for the fiscal years ended January 31, 2001 and 2002 and the consolidated balance sheet data as of January 31, 2002 are derived from our consolidated financial statements, audited by Arthur Andersen LLP, independent public accountants, which are included elsewhere in this Form 10-K. The consolidated statement of operations data for the years ended January 31, 1999 and 2000 and the consolidated balance sheet data as of January 31, 1999, 2000 and 2001 are derived from our consolidated financial statements, audited by Arthur Andersen LLP, independent public accountants, not included in this Form 10-K.

| | YEAR ENDED JANUARY 31, 1999 | YEAR ENDED JANUARY 31, 2000 | YEAR ENDED JANUARY 31, 2001 | YEAR ENDED JANUARY 31, 2002 | YE JA |
|---|---|---|---|---|---|
| | (IN THOUSANDS, EXCEPT PER SHARE DATA) | | | | |
| Statement of Operations Data: | | | | | |
| Revenue............................ | $ -- | $ 4,191 | $ 19,297 | $44,271 | $ |
| Cost of revenue.................... | -- | 758 | 1,506 | 2,552 | |
| Gross Profit................... | -- | 3,433 | 17,791 | 41,719 | |

| | | | | |
|---|---|---|---|---|
| Operating expenses: | | | | |
| Research and development | 4,117 | 8,647 | 14,047 | 17,698 |
| Selling and marketing | 1,671 | 8,961 | 20,946 | 27,602 |
| General and administrative | 2,821 | 4,371 | 5,776 | 7,199 |
| Amortization of stock-based compensation | -- | 372 | 814 | 793 |
| Amortization of intangible assets | -- | -- | -- | 27 |
| Impairment charge | -- | -- | -- | -- |
| Restructuring and other non-recurring charges | -- | -- | -- | -- |
| Total operating expenses | 8,609 | 22,351 | 41,583 | 53,319 |
| Operating loss | (8,609) | (18,918) | (23,792) | (11,600) |
| Other income (expense), net | (9) | (333) | 6 | 150 |
| Interest income, net | 345 | 68 | 1,826 | 1,810 |
| Loss before provision for income taxes | (8,273) | (19,183) | (21,960) | (9,640) |
| Provision for income taxes | -- | -- | -- | -- |
| Net loss | (8,273) | (19,183) | (21,960) | (9,640) |
| Preferred stock dividend | -- | 3,765 | -- | -- |
| Net loss attributable to common shareholders | $(8,273) | $(22,948) | $(21,960) | $(9,640) |
| Net loss per share(2): | | | | |
| Basic and diluted loss per share | $ (2.38) | $ (5.06) | $ (0.73) | $ (0.27) |
| Basic and diluted weighted average shares outstanding | 3,471 | 4,533 | 29,990 | 35,324 |

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| | AS OF JANUARY 31, 1999 | AS OF JANUARY 31, 2000 | AS OF JANUARY 31, 2001 | AS OF JANUARY 31, 2002 |
|---|---|---|---|---|
| | | | (IN THOUSANDS) | |
| BALANCE SHEET DATA: | | | | |
| Cash, cash equivalents and short-term investments | $3,965 | $ 735 | $23,907 | $ 68,946 |
| Working capital (deficit) | 2,726 | (6,915) | 18,130 | 48,650 |
| Long-term investments & other assets | -- | -- | 28 | 13,814 |
| Total assets | 4,551 | 4,801 | 38,624 | 153,458 |
| Stockholders' equity (deficit) | $3,195 | $(6,357) | $19,668 | $113,750 |

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(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 and a full year of operating results for Books24x7.com, Inc.

(2) See Note 2(d) of the Notes to the Consolidated Financial Statements for the determination of shares used in computing basic and diluted net loss per common share.



APPENDIX B

FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and
Shareholders of SkillSoft PLC:

We have audited the accompanying consolidated balance sheet of SkillSoft PLC (formerly known as SmartForce PLC) as of January 31, 2003 and the related consolidated statements of operations, stockholders' equity (deficit) and comprehensive loss and cash flows for the year ended January 31, 2003. 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 audit. The comparative financial statements as of January 31, 2002 and for each of the two years in the period ended January 31, 2002 were audited by other auditors who have ceased operations and whose report dated February 20, 2002 expressed an unqualified opinion on those statements before the restatement adjustments described in Notes 1, 3 and 10.

We conducted our audit in accordance with auditing standards generally accepted in the 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 audit provides a reasonable basis

for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of SkillSoft PLC at January 31, 2003 and the results of its operations and its cash flows for the year ended January 31, 2003, in conformity with accounting principles generally accepted in the United States.

The comparative financial statements presented as of January 31, 2002 and for each of the two years then ended were audited by other auditors who have ceased operations. As described in Notes 1, 3 and 10 on September 6, 2002, the Company completed a merger with SmartForce PLC which was treated as a reverse merger for accounting purposes. All references to the number of shares and per share information in the financial statements have been adjusted to reflect the reverse merger on a retroactive basis. We audited the adjustments that were applied to restate the number of shares and per share information reflected in the 2002 and 2001 financial statements. Our procedures included (a) agreeing the share conversion for the merger to the Company's underlying records obtained from management, and (b) testing the mathematical accuracy of the retroactive restatement of the number of common shares and per share amounts. In our opinion, such adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2002 and 2001 financial statements of the Company other than with respect to such adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2002 and 2001 financial statements taken as a whole.

/s/ ERNST & YOUNG LLP

Boston, Massachusetts
May 16, 2003

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This is a copy of the audit report previously issued by Arthur Andersen LLP in connection with the financial statements of SkillSoft Corporation as of January 31, 2002 and 2001 and each of the three years in the period ended January 31, 2002 included in the Annual Report on Form 10-K of SkillSoft Corporation for the fiscal year ended January 31, 2002. This audit report has not been reissued by Arthur Andersen LLP in connection with the filing of this Annual Report on Form 10-K for the fiscal year ended January 31, 2003.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To SkillSoft Corporation:

We have audited the accompanying consolidated balance sheets of SkillSoft Corporation (a Delaware corporation) as of January 31, 2001 and 2002 and the related consolidated statements of income, shareholders' equity (deficit) and comprehensive loss and cash flows for each of the three years in the period ended January 31, 2002. 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 auditing standards generally accepted in the 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 financial position of SkillSoft Corporation as of January 31, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2002, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP

Boston, Massachusetts
February 20, 2002

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SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

| | JANUARY 31, 2002 | JANUARY 31, 2003 |
|---|---|---|
| | (IN THOUSANDS EXCEPT SHARE DATA AND PER SHARE DATA) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 25,185 | $ 45,990 |
| Short-term investments | 43,761 | 79,041 |
| Accounts receivable, less reserves of approximately $269 and $668 as of January 31, 2002 and 2003, respectively | 17,963 | 66,892 |
| Prepaid expenses and other current assets | 1,449 | 19,401 |
| Total current assets | 88,358 | 211,324 |
| Property and equipment, at cost: | | |
| Computer equipment | 3,196 | 15,679 |
| Furniture and fixtures | 648 | 1,430 |
| Leasehold improvements | 464 | 878 |
| | 4,308 | 17,987 |
| Less -- accumulated depreciation and amortization | 1,723 | 6,023 |
| | 2,585 | 11,964 |
| Intangible assets: | | |
| Acquired intangible assets, net | 1,973 | 34,290 |
| Goodwill | 46,728 | 119,427 |
| | 48,701 | 153,717 |
| Long term investments | 13,786 | 633 |
| Other assets | 28 | 499 |
| | $153,458 | $ 378,137 |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | |
|---|---|---|
| Current liabilities: | | |
| Accounts payable | $ 5,717 | $ 10,672 |
| Accrued expenses | 11,367 | 59,821 |
| Deferred revenue | 22,624 | 109,009 |
| Total current liabilities | 39,708 | 179,502 |
| Long term liabilities | -- | 7,548 |
| Stockholders' equity: | | |
| Ordinary Shares, E0.11 par value -- Authorized -- 120,000,000 and 250,000,000 shares authorized at January 31, 2002 and 2003, respectively; 40,988,314 and 99,598,146 issued and outstanding at January 31, 2002 and January 31, 2003, respectively | 4,348 | 10,737 |
| Additional paid-in capital | 175,902 | 530,929 |
| Accumulated deficit | (63,645) | (347,642) |
| Deferred compensation | (2,563) | (4,345) |
| Notes receivable from stockholders | (338) | (58) |
| Accumulated other comprehensive income | 46 | 1,466 |
| Total stockholders' equity | 113,750 | 191,087 |
| | $153,458 | $ 378,137 |

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 OPERATIONS

| | YEARS ENDED JANUARY 31, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| | (IN THOUSANDS, EXCEPT PER SHARE DAT | | |
| Revenue | $ 19,297 | $ 44,271 | $ 101,47 |
| Cost of revenue(1) | 1,506 | 2,552 | 11,54 |
| Gross profit | 17,791 | 41,719 | 89,92 |
| Operating expenses: | | | |
| Research and development(1) | 14,047 | 17,698 | 29,10 |
| Selling and marketing(1) | 20,946 | 27,602 | 52,69 |
| General and administrative(1) | 5,776 | 7,199 | 17,91 |
| Amortization of stock-based compensation(1) | 814 | 793 | 1,63 |
| Amortization of intangible assets | -- | 27 | 4,68 |
| Impairment charge | -- | -- | 250,10 |
| Restructuring and other non-recurring charges | -- | -- | 19,28 |
| Total operating expenses | 41,583 | 53,319 | 375,41 |
| Operating loss | (23,792) | (11,600) | (285,49 |
| Other income (expense), net | 6 | 150 | (28 |
| Interest income, net | 1,826 | 1,810 | 2,16 |
| Loss before provision for income taxes | (21,960) | (9,640) | (283,61 |

| | | | |
|---|---|---|---|
| Provision for income taxes | -- | -- | (38 |
| Net loss | $(21,960) | $ (9,640) | $(283,99 |
| Net loss per share (Note 2(d)): | | | |
| Basic and diluted loss per share | $ (0.73) | $ (0.27) | $ (4.4 |
| Basic and diluted weighted average common shares outstanding | 29,990 | 35,324 | 64,47 |

---------------

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

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Cost of revenue | $ 4 | $ 4 | $ 4 |
| Research and development | 106 | 127 | 704 |
| Selling and marketing | 406 | 360 | 416 |
| General and administrative | 298 | 302 | 510 |
| | $ 814 | $ 793 | $ 1,634 |

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



SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE LOSS
(IN THOUSANDS EXCEPT PER SHARE DATA)

| | CONVERTIBLE PREFERRED STOCK | | CLASS A COMMON STOCK | | COMMON STOCK | |
|---|---|---|---|---|---|---|
| | NUMBER OF SHARES | CARRYING VALUE | NUMBER OF SHARES | $.001 PAR VALUE | NUMBER OF SHARES | E0.11 PAR VALUE |
| BALANCE, JANUARY 31, 2000 | 9,957,143 | $ 20,711 | 2,848,072 | $ 3 | -- | $ - |
| Issuance of common stock, net of issuance costs of $4,852 | -- | -- | -- | -- | 8,777,981 | 95 |
| Conversion of Class A common stock into common stock | -- | -- | (2,848,072) | (3) | 6,742,526 | 73 |
| Conversion of convertible preferred stock into common stock | (9,957,143) | (20,711) | -- | -- | 15,715,026 | 1,71 |
| Exercise of stock options | -- | -- | -- | -- | 237,585 | 2 |
| Amortization of deferred compensation | -- | -- | -- | -- | -- | - |

| | | | | | | |
|---|---|---|---|---|---|---|
| Issuance of stock options to a non-employee.................. | -- | -- | -- | -- | -- | - |
| Deferred compensation reversal due to termination of employees..................... | -- | -- | -- | -- | -- | - |
| Translation adjustment......... | -- | -- | -- | -- | -- | - |
| Net loss...................... | -- | -- | -- | -- | -- | - |
| | ---------- | -------- | ---------- | --- | ---------- | ------ |
| Comprehensive net loss for the year ended January 31, 2001... | | | | | | |
| BALANCE, JANUARY 31, 2001...... | -- | -- | -- | -- | 31,473,118 | 3,42 |
| Issuance of common stock, net of issuance costs of $836..... | -- | -- | -- | -- | 6,619,842 | 63 |
| Exercise of stock options...... | -- | -- | -- | -- | 520,653 | 4 |
| Issuance common stock under Employee Stock Purchase Plan.. | -- | -- | -- | -- | 26,513 | |
| Issuance of common stock related to exercise of common stock warrants................ | -- | -- | -- | -- | 88,421 | |
| Issuance of common stock and assumption of common stock options in the purchase of a business...................... | -- | -- | -- | -- | 2,259,767 | 22 |
| Deferred compensation associated with assumed stock options in the purchase of a business...................... | -- | -- | -- | -- | -- | - |
| Amortization of deferred compensation.................. | -- | -- | -- | -- | -- | - |
| Repayment of note receivable... | -- | -- | -- | -- | -- | - |
| Translation adjustment......... | -- | -- | -- | -- | -- | - |
| Net loss...................... | -- | -- | -- | -- | -- | - |
| | ---------- | -------- | ---------- | --- | ---------- | ------ |
| Comprehensive net loss for the year ended January 31, 2002... | | | | | | |

| | ACCUMULATED DEFICIT | DEFERRED COMPENSATION | NOTES RECEIVABLE FROM STOCKHOLDERS | ACCUMULATED OTHER COMPREHENSIVE INCOME | STOC E (D |
|---|---|---|---|---|---|
| | ----------- | ------------ | ------------ | ------------- | ---- |
| BALANCE, JANUARY 31, 2000...... | $ (32,045) | $(2,480) | $(339) | $ 14 | $ |
| Issuance of common stock, net of issuance costs of $4,852... | -- | -- | -- | -- | |
| Conversion of Class A common stock into common stock....... | -- | -- | -- | -- | |
| Conversion of convertible preferred stock into common stock........................ | -- | -- | -- | -- | |
| Exercise of stock options...... | -- | -- | -- | -- | |
| Amortization of deferred compensation.................. | -- | 753 | -- | -- | |
| Issuance of stock options to a non-employee.................. | -- | -- | -- | -- | |
| Deferred compensation reversal due to termination of employees..................... | -- | 123 | -- | -- | |
| Translation adjustment......... | -- | -- | -- | 45 | |
| Net loss...................... | (21,960) | -- | -- | -- | ( |

| | | | | | |
|---|---|---|---|---|---|
| Comprehensive net loss for the year ended January 31, 2001... | | | | | |
| BALANCE, JANUARY 31, 2001...... | (54,005) | (1,604) | (339) | 59 | |
| Issuance of common stock, net of issuance costs of $836..... | -- | -- | -- | -- | |
| Exercise of stock options...... | -- | -- | -- | -- | |
| Issuance common stock under Employee Stock Purchase Plan.. | -- | -- | -- | -- | |
| Issuance of common stock related to exercise of common stock warrants................ | -- | -- | -- | -- | |
| Issuance of common stock and assumption of common stock options in the purchase of a business...................... | -- | -- | -- | -- | |
| Deferred compensation associated with assumed stock options in the purchase of a business...................... | -- | (1,752) | -- | -- | |
| Amortization of deferred compensation.................. | -- | 793 | -- | -- | |
| Repayment of note receivable... | -- | -- | 1 | -- | |
| Translation adjustment......... | -- | -- | -- | (13) | |
| Net loss....................... | (9,640) | -- | -- | -- | |
| Comprehensive net loss for the year ended January 31, 2002... | | | | | |



SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE LOSS -- (CONTINUED)
(IN THOUSANDS EXCEPT PER SHARE DATA)

| | CONVERTIBLE PREFERRED STOCK | | CLASS A COMMON STOCK | | COMMON STOCK | |
|---|---|---|---|---|---|---|
| | NUMBER OF SHARES | CARRYING VALUE | NUMBER OF SHARES | $.001 PAR VALUE | NUMBER OF SHARES | E0.1 PAR VALU |
| BALANCE, JANUARY 31, 2002....... | -- | $ -- | -- | $-- | 40,988,314 | $ 4,3 |
| Exercise of stock options....... | -- | -- | -- | -- | 826,316 | |
| Issuance of common stock and assumption of common stock options in the purchase of a business....................... | -- | -- | -- | -- | 57,392,542 | 6,2 |
| Issuance of common stock under employee stock purchase plan... | -- | -- | -- | -- | 390,974 | |
| Deferred compensation associated with unvested stock options assumed in the purchase of a business....................... | -- | -- | -- | -- | -- | |
| Amortization of deferred | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| compensation.................. | -- | -- | -- | -- | -- | |
| Net unrealized loss on marketable securities reclassified from of held-to-maturity to available-for-sale............ | -- | -- | -- | -- | -- | |
| Repayment of note receivable.... | -- | -- | -- | -- | -- | |
| Unrealized gains/(losses) on marketable securities.......... | -- | -- | -- | -- | -- | |
| Translation adjustment.......... | -- | -- | -- | -- | -- | |
| Net loss....................... | -- | -- | -- | -- | -- | |
| | ---------- | ----- | ---------- | --- | ---------- | ----- |
| Comprehensive net loss for the year ended January 31, 2003.... | | | | | | |
| BALANCE, JANUARY 31, 2003....... | -- | $ -- | -- | $-- | 99,598,146 | $10,7 |

| | ACCUMULATED DEFICIT | DEFERRED COMPENSATION | NOTES RECEIVABLE FROM STOCKHOLDERS | ACCUMULATED OTHER COMPREHENSIVE INCOME | STO ( |
|---|---|---|---|---|---|
| BALANCE, JANUARY 31, 2002....... | $ (63,645) | $(2,563) | $(338) | $ 46 | $ |
| Exercise of stock options....... | -- | -- | -- | -- | |
| Issuance of common stock and assumption of common stock options in the purchase of a business...................... | -- | -- | -- | -- | |
| Issuance of common stock under employee stock purchase plan... | -- | -- | -- | -- | |
| Deferred compensation associated with unvested stock options assumed in the purchase of a business...................... | -- | (3,416) | -- | -- | |
| Amortization of deferred compensation.................. | -- | 1,634 | -- | -- | |
| Net unrealized loss on marketable securities reclassified from of held-to-maturity to available-for-sale............ | -- | -- | -- | (548) | |
| Repayment of note receivable.... | -- | -- | 280 | -- | |
| Unrealized gains/(losses) on marketable securities.......... | -- | -- | | 2,335 | |
| Translation adjustment.......... | -- | -- | | (367) | |
| Net loss....................... | $(283,997) | -- | -- | -- | |
| | --------- | ------- | ----- | ------ | - |
| Comprehensive net loss for the year ended January 31, 2003.... | | | | | |
| BALANCE, JANUARY 31, 2003....... | $(347,642) | $(4,345) | $ (58) | $1,466 | $ |

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



SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | YEARS ENDED JANUARY 31, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| | (IN THOUSANDS) | | |
| Cash flows from operating activities: | | | |
| Net loss | $(21,960) | $ (9,640) | $(283,997) |
| Adjustments to reconcile net loss to net cash used in operating activities -- | | | |
| Stock-based compensation | 814 | 793 | 1,634 |
| Depreciation | 466 | 976 | 8,712 |
| Impairment charge | -- | -- | 250,107 |
| Amortization of intangibles | -- | -- | 4,683 |
| Provision for bad debts | 21 | 164 | 399 |
| Changes in current assets and liabilities, net of acquisitions | | | |
| Accounts receivable | (9,784) | (6,366) | (21,064) |
| Prepaid expenses and other current assets | 62 | 510 | (8,506) |
| Accounts payable | 665 | 621 | 2,647 |
| Accrued expenses | 948 | 1,103 | (28,396) |
| Deferred revenue | 10,738 | 5,217 | 35,028 |
| Net cash used in operating activities | (18,030) | (6,622) | (38,753) |
| Cash flows from investing activities: | | | |
| Purchases of property and equipment | (1,423) | (1,867) | (8,886) |
| Purchase of short-term investments | (39,991) | (43,636) | (96,173) |
| Maturity of short-term investments | 28,631 | 11,235 | 40,604 |
| Sales of short-term investments | -- | -- | 73,776 |
| Disposition of net assets | -- | -- | (1,087) |
| Purchase of long-term investments | -- | (13,785) | (669) |
| Net cash (used for) received in a business combination | -- | (6,313) | 49,333 |
| Increase in other assets | (28) | -- | (2,244) |
| Net cash provided by (used in) investing activities | (12,811) | (54,366) | 54,654 |
| Cash flows from financing activities: | | | |
| Issuance of common stock, net of issuance costs | 47,059 | 71,977 | -- |
| Exercise of stock options | 68 | 1,407 | 419 |
| Proceeds from employee stock purchase plan | -- | 247 | 1,241 |
| Repayment of note receivable | -- | 1 | 280 |
| Payments on line of credit | (4,500) | -- | -- |
| Net cash provided by financing activities | 42,627 | 73,632 | 1,940 |
| Effect of exchange rate changes on cash and cash equivalents | 26 | (6) | 2,965 |
| Net increase (decrease) in cash and cash equivalents | 11,812 | 12,638 | 20,806 |
| Cash and cash equivalents, beginning of year | 735 | 12,547 | 25,185 |
| Cash and cash equivalents, end of year | $ 12,547 | $ 25,185 | $ 45,991 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid for interest | $ 21 | $ -- | $ -- |
| Supplemental disclosure of non-cash financing transactions: | | | |
| Issuance of common stock related to exercise of common stock warrant | $ -- | $ 319 | $ -- |

| | | |
|---|---|---|
| Supplemental disclosure of cash flows related to acquisitions (see Note 3): | | |
| The acquisitions are summarized as follows: | | |
| Fair value of assets acquired, excluding cash............ | $ 49,513 | $ 439,946 |
| Payments in connection with the acquisition, net of cash acquired........................................... | (6,313) | 49,333 |
| Issuance of common stock and assumption of common stock options............................................ | (29,310) | (356,339) |
| Liabilities assumed................................ | $ 13,890 | $ 132,940 |

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, formerly known as SmartForce PLC (the Company or SkillSoft), was incorporated in Ireland on August 8, 1989. The Company is a provider of web-based training resources that cover a variety of professional, effectiveness, business and information technology topics. On September 6, 2002, the Company completed its merger with SkillSoft Corporation (the Merger). Due to a number of factors, including composition of the board of directors, management team, and concentrated shareholder interest, all of which had SkillSoft Corporation being in a control or majority position, the Merger was accounted for as a reverse acquisition, with SkillSoft Corporation as the accounting acquirer. Accordingly, the historical financial statements of SkillSoft Corporation are the historical financial statements of the combined company, and the assets and liabilities of the Company are accounted for as required under the purchase method of accounting. The results of operations and cash flow of the former SmartForce PLC, the acquired entity for accounting purposes, are included in the financial statements of the combined company from September 6, 2002, the date on which the Merger was consummated. In connection with the Merger, the Company changed its name to SkillSoft PLC and its fiscal year end to January 31 (the fiscal year end of SkillSoft Corporation) from December 31 (the Company's historical fiscal year end).

(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. Actual results could differ from those estimates.

(C) REVENUE RECOGNITION

The Company generates revenue from the license of products and services and from providing hosting/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 on-line mentoring services, are separately licensed for an additional fee.

The pricing for the Company's multi-modal learning (MML) licenses varies based on the content offering selected by the customer, the number of users within the customer's organization and the length of





the license agreement. A MML license provides customers access to a full range of learning products including courseware, Referenceware, simulations, mentoring and prescriptive assessment.

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

The Company generally bills the annual license fee for the first year of a multi-year agreement in advance. The Company recognizes revenue with respect to courseware licenses either at the time of delivery of products or over the term of the contract, depending on the products included in the license and specific contract terms. In the event that the customer specifies all licensed courses to be delivered at the outset and those courses are available and delivered on or before the contract start date, the Company recognizes license revenue for the first year of the contract upon execution of the contract and delivery of the courses. The Company generally bills license fees for subsequent years of multi-year license arrangements on the anniversary date of the agreement, and if the customer exchanges courses and receives the exchanged courses by the renewal date, revenue is recognized in the manner described above.

In some circumstances, the Company offers payment terms of up to six months from the initial shipment date or anniversary date for multi-year agreements to its customers. To the extent that a customer is given extended payment terms, revenue is recognized as cash becomes due, assuming all of the other elements of revenue recognition have been satisfied.

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.

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 in which the service agreements are provided to the extent the Company has VSOE for those services. If the Company does not have VSOE for these services, revenue from the entire arrangement including any implementation fees, is recognized on a straight-line basis over the period in which the services are provided. For multi-element agreements where the Company provides these services, VSOE is the basis used to allocate the total fee to the elements of the arrangement.

The Company recognizes revenue on Referenceware and MML licenses ratably over the term of the agreement, which matches the period the future products or services are delivered.

The Company commences the recognition of revenue from resellers upon final sale to the end user. 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.

The Company provides professional services, including instructor led training, customized content, websites, and implementation services. The Company recognizes service revenue as the services are performed.

The cost of satisfying any post contract support (PCS), which essentially represents a warranty obligation, is accrued at the time license revenue is recognized, as PCS fees are included in the annual license fee. The estimated cost of providing PCS during the agreements is insignificant and the Company does not





offer it separately. The accrued PCS costs are included in deferred revenue in the accompanying consolidated balance sheets.

The Company records deferred revenue when either cash is received or amounts have been billed in advance of products or services provided. Deferred revenue includes the unrecognized portion of revenue associated with license fees for which the Company has received payment or for which amounts have been billed and are currently due for payment in 180 days or less. In addition, deferred revenue includes amounts which have been billed and not collected for which revenue is being recognized ratably over the license period. In addition, the Company acquired approximately $47 million of deferred revenue in connection with the Merger based upon the cost to fulfill the remaining contractual and performance obligations plus a normal operating profit on fulfilling such obligations.

(D) NET LOSS PER SHARE

As a result of the reverse acquisition, historical SkillSoft Corporation shares have been converted into SmartForce ADSs using the Merger exchange ratio of 2.3674 SkillSoft Corporation shares per SmartForce ADS. Historical SkillSoft Corporation shares for all periods presented have been adjusted to reflect this exchange ratio. See Note 10(a).

Basic and diluted net loss per common share was determined by dividing net loss by the weighted average common shares outstanding during the period. Weighted average shares outstanding exclude unvested restricted common shares of 493,329, 75,548, and 20,291 as of January 31, 2001, 2002 and 2003, respectively. Basic and diluted net loss per share are the same, as outstanding common stock options and warrants are anti-dilutive as the Company has recorded a net loss for all periods presented.

The calculation of basic net loss per share and diluted net loss per share is as follows (in thousands, except per share data):

| | YEAR ENDED JANUARY 31, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| Net loss applicable to ordinary shares | $(21,960) | $(9,640) | $(283,997) |
| Computation of basic and diluted net loss per share: | | | |
| Weighted average shares outstanding | 30,738 | 35,506 | 64,500 |
| Less weighted average unvested restricted common shares outstanding | 748 | 182 | 28 |
| Shares used in computing net loss per share | 29,990 | 35,324 | 64,472 |
| Basic and diluted net loss per share | $ (0.73) | $ (0.27) | $ (4.40) |

The following common share equivalents, warrants, and unvested restricted shares have been excluded from the computation of diluted weighted average shares outstanding as of January 31, 2001, 2002 and 2003, respectively as they would be anti-dilutive.

| | YEAR ENDED JANUARY 31, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| Options outstanding | 3,253,149 | 7,080,041 | 25,604,086 |
| Warrants outstanding | 143,479 | 143,479 | -- |
| Unvested restricted shares | 493,329 | 75,548 | 20,291 |

(E) 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 Company is the U.S. dollar (dollar). The functional currency of the Company's subsidiaries in the United States, 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 Ireland, the Commonwealth of the Bahamas and the Grand Cayman is the 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 as a separate component of stockholders' equity (deficit). 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. Gains/(losses) arising from transactions denominated in foreign currencies were approximately $13,000, $139,000 and ($130,000) for the years ended January 31, 2001, 2002, and 2003, respectively and are included in Other income (expense), net in the accompanying consolidated statement of operations.

(F) CASH, CASH EQUIVALENTS, SHORT-TERM INVESTMENTS AND LONG-TERM INVESTMENTS

The Company accounts for its 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 has the positive intent and ability to hold to maturity are reported at amortized cost, which approximates market value, and are classified as held-to-maturity. All other securities have been classified as available for sale. 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, 2002 and 2003, cash equivalents consisted mainly of commercial paper, short-term notes and money market funds. The investments in short-term notes are classified as current assets in the accompanying consolidated balance sheets as they mature within one year.

During the year ended January 31, 2003, as a result of the sale of certain investments classified as held-to-maturity prior to maturity, the Company transferred all of its investments from held-to-maturity to available-for-sale. Accordingly, the Company recorded an unrealized loss on its investments of approximately $548,000 at the time it revised its investment policy and an unrealized gain of approximately $2,335,000 for the remainder of the year as a component of other comprehensive income in the Company's consolidated statement of equity.





Cash, cash equivalents, short-term investments and long-term investments that were accounted as held for maturity as of January 31, 2002 were as follows (in thousands).

| DESCRIPTION | CONTRACTED MATURITY | AMORTIZED COST |
| --- | --- | --- |

| | | |
|---|---|---|
| Cash and cash equivalents: | | |
| Cash | N/A | $ 5,922 |
| Commercial paper | 0-3 months | 4,764 |
| Federal agency notes | 0-3 months | 14,239 |
| Money market funds | 0-3 months | 260 |
| | | 25,185 |
| Short-term investments: | | |
| Money market fund | 4-12 months | 3,418 |
| Commercial paper | 4-12 months | 12,100 |
| Federal agency notes | 4-12 months | 28,243 |
| | | 43,761 |
| Long-term investments: | | |
| Federal agency notes | 13-24 months | 13,786 |
| | | $82,732 |

Cash, cash equivalents, short-term investments and long-term investments that were accounted for as available for sale as of January 31, 2003 are as follows (in thousands).

| DESCRIPTION | CONTRACTED MATURITY | COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | FAIR VALUE |
|---|---|---|---|---|---|
| Cash and cash equivalents: | | | | | |
| Cash | N/A | $ 37,648 | $ -- | $ -- | $ 37,648 |
| Federal agency notes | 0-3 months | 1,048 | -- | -- | 1,048 |
| Money market funds | 0-3 months | 7,293 | 1 | -- | 7,294 |
| | | 45,989 | 1 | -- | 45,990 |
| Short-term investments: | | | | | |
| Commercial paper | 4-12 months | 27,927 | 9 | -- | 27,936 |
| Federal agency notes | 4-12 months | 46,791 | 5 | (176) | 46,620 |
| Public equity securities | N/A | 2,501 | 1,984 | -- | 4,485 |
| | | 77,219 | 1,998 | (176) | 79,041 |
| Long-term investments: | | | | | |
| Federal agency notes | 13-24 months | 531 | -- | (11) | 520 |
| Public equity securities | N/A | 138 | -- | (25) | 113 |
| | | 669 | -- | (36) | 633 |
| | | $123,877 | $1,999 | $(212) | $125,664 |

(G) 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, as follows:

| | ESTIMATED USEFUL LIVES |
|---|---|
| Computer equipment | 2-3 years |
| Furniture and fixtures | 5 years |
| Leasehold improvements | Life of lease |

(H) SOFTWARE DEVELOPMENT COSTS AND RESEARCH AND DEVELOPMENT EXPENSES

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. 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 did not capitalize software development costs during the periods presented, with the exception of the fair value of acquired technology developed by Books that the Company purchased in connection with its acquisition during the year ended January 31, 2002 and the fair value of IT content purchased in connection with the Merger during the year ended January 31, 2003.

The Company expenses all research and development expenses, which include course content development fees, to operations as incurred. In addition, the Company enters into agreements with content providers requiring the Company to make up front minimum commitments for rights to published content. The Company's policy is to expense these costs to research and development upon receipt of content.

(I) 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 for the years ended January 31, 2002, and 2003 are as follows (in thousands):

| | YEAR ENDED JANUARY 31, | |
|---|---|---|
| | 2002 | 2003 |
| Unrealized holding gains | $-- | $1,787 |
| Foreign currency adjustment | 46 | (321) |
| Total accumulated other comprehensive income | $46 | $1,466 |

(J) FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments consist mainly of cash and cash equivalents, short-term investments, long-term investments, 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.





(K) CONCENTRATIONS OF CREDIT RISK AND OFF-BALANCE-SHEET RISK

For the years ended and as of January 31, 2001, 2002 and 2003, 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.

(L) 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 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 and the Chief Financial Officer. Prior to the Merger, the Company had viewed its operations and managed its business as principally one operating segment. Subsequent to the Merger, the Company has viewed its operations and manages its business as principally two operating segments: multi-modal learning and retail certification. Multi-modal learning 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.

(M) LONG LIVED ASSETS

The Company follows the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). SFAS No. 144 requires that long-lived assets be reviewed for impairment by comparing the future undiscounted cash flows from the assets with the carrying amount. Any write-downs are to be treated as permanent reductions in the carrying amount of the assets.

(N) ADVERTISING COSTS

Costs incurred for producing and communicating advertising are expensed when incurred. Advertising expenses amounted to approximately $389,000, $201,000, and $1,488,000 for the years ended January 31, 2001, 2002 and 2003, respectively.

(O) 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 of the SmartForce personnel resulting from the Merger, the Company will not fullfill all the obligations associated with certain grants, and therefore, has reflected grants subject to refund as a liability in the accompanying consolidated balance sheet. As of January 31, 2003, there are $1.4 million of grants subject to repayment, which are included in accrued liabilities on the consolidated balance sheet.





(P) ACCOUNTING FOR STOCK-BASED COMPENSATION

At January 31, 2003, the Company had stock-based employee compensation plans which are described in Note 10 to the consolidated financial statements. The Company accounts for those plans 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 of the compensation expense determined under the fair value provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123). See Note 10 to the Consolidated Financial Statements.

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. The Company has computed the pro forma disclosures required under SFAS No. 123 for options granted in the years ended January 31, 2001, 2002 and 2003 using the Black-Scholes option-pricing model prescribed by SFAS No. 123. The weighted average information and assumptions used for the grants is as follows:

| | YEAR ENDED JANUARY 31, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| Risk-free interest rates | 5.28 - 6.72% | 3.58 - 5.01% | 3.50 - 5.14% |
| Expected dividend yield | -- | -- | -- |
| Volatility factor | 102% | 93% | 104% |
| Expected lives | 7 years | 7 years | 7 years |
| Weighted average fair value of options granted | $5.47 | $4.04 | $3.82 |

| | | | |
|---|---|---|---|
| Weighted average remaining contractual life of options outstanding.................. | 8.9 years | 9.0 years | 8.3 years |

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

| | YEAR ENDED JANUARY 31, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| Net loss -- | | | |
| As reported...................................... | $(21,960) | $ (9,640) | $(283,997) |
| Add: Stock-based compensation expense recognized under APB No. 25............................. | 814 | 793 | 1,634 |
| Less: Total stock-based compensation expense determined under fair value based method for all awards.................................. | (2,715) | (7,377) | (25,191) |
| Pro forma........................................ | $(23,861) | $(16,224) | $(307,554) |
| Basic and diluted net loss per share -- | | | |
| As reported...................................... | $ (0.73) | $ (0.27) | $ (4.40) |
| Pro forma........................................ | $ (0.77) | $ (0.44) | $ (4.77) |

Because additional option grants are expected to be made in future periods, the above pro forma disclosures may not be representative of pro forma effects on results for future periods.





(Q) RECENT ACCOUNTING PRONOUNCEMENTS

In April 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 145, "Rescission of Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" (SFAS No. 145). Under SFAS No. 145, gains and losses on extinguishments of debt are to be classified as income or loss from continuing operations rather than extraordinary items. The Company is required to adopt SFAS No. 145 in the first quarter of fiscal 2004 and does not expect the adoption of this statement to have a material impact on its financial condition or results of operations.

In July 2002, the FASB issued Statement of Financial Accounting Standards SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS No. 146). The statement requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to exit or disposal plan. Costs covered by SFAS No. 146 include lease termination costs and certain employee severance costs that are associated with a restructuring, branch closing, or other exit disposal activity. This statement is effective for exit or disposal activities initiated after December

31, 2002. SFAS No. 146 may affect the timing of the Company's recognition of future exit or disposal costs, if any.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN No. 45). FIN No. 45 requires a guarantor to record certain guarantees at fair value and to make significant new disclosures, even when the likelihood of making any payments under the guarantee is remote. The interpretation and its disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The interpretation's initial recognition and initial measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The guarantor's previous accounting for guarantees issued prior to December 31, 2002 should not be revised or restated due to the adoption of this interpretation. The adoption of FIN No. 45 did not have a material impact on the financial condition or results of operations of the Company.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN No. 46) which requires the consolidation of a variable interest entity, as defined, by its primary beneficiary. Primary beneficiaries are those companies that are subject to a majority of the risk of loss or entitled to receive a majority of the entity's residual returns, or both. In determining whether it is the primary beneficiary of a variable interest entity, an entity with a variable interest shall treat variable interests in that same entity held by its related parties as its own interests. The Company is currently evaluating the existence of variable interest entities, if any, and the impact of adopting the interpretation on the consolidated financial statements. Refer to Note 3 and Note 8 to the Consolidated Financial Statements for additional disclosures regarding related parties, and commitments and contingencies, respectively.

In January 2003, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" (SFAS No. 148), an amendment of SFAS No. 123, which provides alternative methods of transition for a voluntary change to fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in annual financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has elected to continue to account for stock-based compensation under APB No. 25, and related Interpretations under FIN 44 and elect the disclosure-only alternative under SFAS No. 123 and the enhanced disclosures as required by SFAS No. 148 (see Note 2(p)).





## (3) ACQUISITIONS AND DISPOSITIONS

### (A) SKILLSOFT CORPORATION

On September 6, 2002, the Company completed the Merger with SkillSoft Corporation, a leading provider of e-Learning courseware and Referenceware for business and IT professionals. As a result of the Merger, each issued and outstanding share of common stock, par value $0.001 per share, of SkillSoft Corporation (the SkillSoft Common Stock) was automatically converted into the right to receive 2.3674 (the Exchange Ratio) validly issued and fully paid ordinary shares, nominal value E0.11 per share, of the Company, with each ordinary share represented by an American Depository Share of the Company (ADS).

The Company also assumed each outstanding option to purchase SkillSoft Common Stock, which had been granted under SkillSoft Corporation's existing stock option plans, under the same exchange ratio. As discussed in Note 1, the Company determined SkillSoft Corporation to be the acquirer for accounting purposes. Therefore, SkillSoft Corporation is the accounting acquirer in the transaction, the calculation of the stock consideration is calculated based on SmartForce ordinary shares and options outstanding. Consequently, this transaction resulted in the issuance of approximately 57.4 million ordinary shares (represented by ADSs) of the Company with a fair value of approximately $317.4 million, the assumption of options to purchase approximately 15.7 million ordinary shares (represented by ADSs) with a Black-Scholes fair value of approximately $38.9 million, and estimated direct transaction costs of $15.4 million. The number of ordinary shares issued and options assumed was fixed in the agreement related to the Merger and was not subject to change prior to closing. The fair value of the Company's ADSs was derived using a market price per ADS of $5.53, which was based on an average of the closing prices for a range of six trading days around the announcement date (June 10, 2002) of the acquisition. Immediately following the Merger, the former stockholders of SkillSoft Corporation owned approximately 42% of the outstanding ordinary shares of the Company. The Company paid a premium to obtain a broader distribution channel and a stronger presence in the e-Learning sector.

Subsequent to the Merger, certain accounting matters were identified relating to the historical financial statements of SmartForce PLC (which, following the Merger, are no longer the Company's historical financial statements -- see Note 1.) On November 19, 2002, the Company announced its intent to restate the SmartForce PLC historical financial statements for 1999, 2000, 2001 and the first two quarters of 2002. Although the aforementioned analysis has not yet been completed, management does not believe the impact of such revisions to the purchase price and its allocation, if any, will have a material impact on the consolidated financial position or results of operations of the Company.

Based on valuations prepared by a third party appraisal firm using assumptions provided by management, the total purchase price of approximately $371.7 million has been allocated as follows (in thousands):

| DESCRIPTION | AMOUNT |
|---|---|
| Cash and cash equivalents | $ 50,231 |
| Short-term investments | 34,830 |
| Accounts receivable, net | 23,351 |
| Prepaid expenses and other current assets | 8,753 |
| Property and equipment | 9,131 |
| Goodwill | 323,681 |
| Amortizable intangible assets | 37,000 |





| DESCRIPTION | AMOUNT |
|---|---|

| | |
|---|---|
| Other assets | 3,199 |
| Accounts payable | (2,326) |
| Accrued expenses | (69,519) |
| Deferred revenue | (46,619) |
| Total | $ 371,712 |

The components of the consideration paid are as follows (in thousands):

| DESCRIPTION | AMOUNT |
|---|---|
| Issuance of common stock (shares) | $317,440 |
| Valuation of common stock options assumed | 38,899 |
| Cash paid, including acquisition costs | 15,373 |
| Total purchase price | 371,712 |
| Liabilities incurred (exit costs) | 29,923 |
| Tangible assets acquired in excess of liabilities assumed, net | (40,954) |
| Total purchase price to be allocated to intangible assets | $360,681 |

The consideration was allocated to the fair value of assets acquired and liabilities assumed as follows (in thousands):

| DESCRIPTION | AMOUNT | LIFE |
|---|---|---|
| Total purchase price to be allocated to intangible assets | $360,681 | -- |
| Less -- Value assigned to content | 25,000 | 4 years |
| Less -- Value assigned to customer contracts | 12,000 | 5 years |
| Goodwill | $323,681 | -- |

In connection with the Merger, the Company's management approved and initiated plans to restructure pre-acquisition SmartForce PLC, to eliminate redundant facilities and headcount, reduce cost structure and better align operating expenses with existing economic conditions (Note 4).

The Company allocated the purchase price to the tangible assets, liabilities and intangible assets acquired, based on their estimated fair values. The excess purchase price over those fair values was recorded as goodwill. The fair value assigned to the intangible assets acquired was based on valuations prepared by a third party appraisal firm using assumptions provided by management. The goodwill recorded as a result of this acquisition is not expected to be deductible for tax purposes. The goodwill was allocated to the Company's two reporting units: multi-modal learning and retail certification.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," (SFAS No. 142) goodwill and purchased intangibles with indefinite lives acquired

after June 30, 2001 are not amortized but are reviewed periodically for impairment. In accordance with SFAS No. 142, the Company completed a two-step fair-value based assessment of the goodwill and intangible assets for impairment in the quarter ended January 31, 2003, its annual test date. The analysis indicated the multi-modal learning reporting unit was impaired and the Company recorded a $250.1 million non-cash charge (Note 5).





### Amortizable Intangible Assets

Approximately $37 million of the purchase price has been allocated to amortizable intangible assets comprised of $12 million for contractual customer relationships and $25 million for course content. Contractual customer relationships are existing contracts that relate to underlying customer relationships pertaining to the services provided by the acquired company.

### Deferred Revenue

At the Merger, due to the nature of the Company's business, the Company has remaining contractual obligations to customers of SmartForce PLC. The obligations principally involve delivery of future products and services. The Company has recorded deferred revenue as of the Merger date based on a valuation prepared by a third party appraisal firm using estimates and assumptions provided by management of these estimated obligations in accordance with Emerging Issues Task Force (EITF) 01-03, "Accounting in a Business Combination for Deferred Revenue of an Acquiree". The Company is amortizing deferred revenue over the average remaining term of the contracts, which reflects the estimated period to satisfy these customer obligations.

### Deferred Compensation

The Company has recorded approximately $3,416,000 of deferred compensation attributable to unvested stock options assumed in the Merger, which will be amortized over the remaining vesting period of the underlying options.

### Deferred Taxes

The Company has recorded as part of purchase accounting a deferred tax liability on the separately identified intangible assets. In addition, through purchase accounting, the Company has recognized a deferred tax asset of $8.2 million related to book tax differences and net operating losses in the opening balance sheet and has provided a valuation allowance for that amount as it is more likely than not the assets will not be realized.

### Pro Forma Financial Information

The following unaudited pro forma data summarizes the results of operations of the Company for the year ended January 31, 2002 as if the Merger had been completed as of the beginning of the year ended January 31, 2002. The pro forma data gives effect to actual operating results prior to the Merger, adjusted to include the pro forma effect of the amortization of intangibles. This information does not reflect the impact of the pending restatement discussed above. This pro forma information for the year ended January 31, 2002 will be updated to reflect the restated historical SmartForce PLC financial statements, which will be included in the Company's Form 8-K, as amended.

| | YEAR ENDED JANUARY 31, 2002 (IN THOUSANDS, EXCEPT PER SHARE DATA) |
|---|---|
| Revenues | $305,146 |
| Net loss | $ (4,167) |
| Loss per share | $ (0.05) |



SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(B) BOOKS

On December 28, 2001, the Company acquired Books, a provider of Web-based digital technical and business reference content. The Company acquired 100% of the outstanding shares of Books for consideration of $35.9 million plus assumed liabilities. This acquisition was accounted for as a purchase, and accordingly, the results of Books' operations from the date of acquisition are included in the Company's consolidated statements of operations.

The components of the consideration paid are as follows (in thousands):

| DESCRIPTION | AMOUNT |
|---|---|
| Issuance of common stock (2,259,766 shares) | $22,934 |
| Valuation of common stock options assumed (options to purchase 808,799 shares) | 6,376 |
| Cash paid, including acquisition costs | 6,632 |
| Total purchase price | 35,942 |
| Liabilities incurred (exit costs) | 1,843 |
| Liabilities assumed in excess of tangible assets, net | 10,068 |
| Total purchase price to be allocated to intangible assets | $47,853 |

The consideration was allocated to the fair value of assets acquired and liabilities assumed as follows (in thousands):

| DESCRIPTION | AMOUNT | LIFE |
|---|---|---|
| Total purchase price to be allocated to intangible assets | $47,853 | -- |
| Less -- Value assigned to trademark and trade name | 900 | Indefinite |
| Less -- Value assigned to internally developed software | 600 | 3 years |

| | | |
|---|---|---|
| Less -- Value assigned to customer contracts | 500 | 4 years |
| Goodwill | $45,853 | |

In connection with the acquisition of Books, the Company's management approved and initiated plans to restructure pre-acquisition Books, to eliminate redundant facilities and headcount, reduce cost structure and better align operating expenses with existing economic conditions (Note 4).

Allocation of the purchase price for the acquisition was based on estimates of the fair value of the net assets acquired. The fair market value of intangible assets acquired, including the estimates of their useful lives, was based on independent appraisals. In making the purchase price allocation, the Company considered present value calculations of income, an analysis of project accomplishments and remaining outstanding items and an assessment of overall contributions, as well as project risks. The goodwill resulting from the Books acquisition was included in the multi-modal reporting unit.

PRO FORMA INFORMATION

The following unaudited pro forma data summarizes the results of operations of the Company for the year ended January 31, 2002 as if the Books acquisition had been completed as of the beginning of the year. The





pro forma data gives effect to actual operating results prior to the acquisition, adjusted to include the pro forma effect of the amortization of intangibles:

| | YEAR ENDED JANUARY 31, 2002 (IN THOUSANDS, EXCEPT PER SHARE DATA) |
|---|---|
| Revenues | $ 48,437 |
| Net loss | $(21,197) |
| Loss per share | $ (1.42) |

(C) TELCOM DISPOSITION

On January 31, 2003, the Company and its wholly-owned subsidiary SmartForce-Telcom (U.S.) Corporation and its wholly-owned subsidiary SmartForce-Telcom (Canada) Corporation entered into an asset purchase agreement with Advanced Education Corporation (AEC) whereby AEC purchased certain of the assets of SmartForce-Telcom (U.S.) Corporation and SmartForce-Telcom (Canada) Corporation and certain assets of the Company and assumed certain liabilities. In addition, AEC agreed to pay a royalty to the Company on all future revenues in an amount ranging from 2.5% to 11% based on the amount of revenue and year.

The Company will record any royalties received as an adjustment to goodwill.

As a result of the uncertainties associated with the future royalty payments, the Company did not value the assets of the Telcom business acquired in the Merger. In addition, in accordance with EITF 95-3, the Company accrued the costs to dispose of the business as of the date of the Merger. The net operating loss of the business disposed of for the period from September 6, 2002 to January 31, 2003 is included as a component of Other income (expense), net. Results of operations for the period from September 6, 2002 through January 31, 2003 of SmartForce-Telcom (U.S.) Corporation including SmartForce-Telcom (Canada) were as follows (in thousands):

| | FOR THE PERIOD ENDED JANUARY 31, 2003 |
|---|---|
| Revenue | $2,400 |
| Cost of revenue | 1,664 |
| Gross profit | 736 |
| Operating expenses: | |
| Sales and marketing | 291 |
| General and administrative | 548 |
| Total operating expenses | 839 |
| Net loss | $ (103) |

(D) MERGER AND EXIT COSTS

SmartForce

In connection with the Merger, the Company's management approved and initiated plans prior to December 31, 2002 to restructure the operations of pre-Merger SmartForce PLC to eliminate redundant facilities and headcount, reduce cost structure, and better align the Company's operating expenses with existing economic conditions. Consequently, the Company recorded $30.3 million of costs primarily 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 were recognized as a liability assumed in the purchase business combination and included in the allocation of the purchase price, and have been included as an increase to goodwill.

The reductions in employee headcount totaled approximately 632 employees from the administrative, sales, marketing and development functions, and amounted to a charge of approximately $14.5 million. Approximately $8.6 million was paid out against the exit plan accrual during the year ended January 31, 2003, and the remaining amount of $5.9 million is expected to be paid by October

2003.

In connection with the exit plan, the Company decided to abandon or downsize certain leased facilities. For the year ended January 31, 2003, facilities consolidation charges of $12.7 million, consisting of sublease losses, broker commissions and other facility costs, were recorded in connection with the downsizing and closing of sites. As of January 31, 2003, 8 sites had been vacated and 3 sites had been downsized and actions related to the remaining identified sites are scheduled to occur by the end of fiscal 2004. To determine the sublease loss, which is the loss after the Company's cost recovery efforts from subleasing the building, 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" and represents the low end of the range and will be adjusted in the future upon triggering events including a change in estimate of time to sublease, actual sublease rates, etc. The Company has estimated that the high end of the lease loss could be $16.4 million if operating lease rental rates continue to decrease in these markets or should it take longer than expected to find a suitable tenant to sublease the facility.

The merger and exit costs consist of the following (in thousands):

| | EMPLOYEE SEVERANCE AND RELATED COSTS | CLOSEDOWN OF FACILITIES | OTHER | TOTAL |
|---|---|---|---|---|
| Exit costs incurred in acquisition....... | $14,495 | $12,725 | $3,041 | $ 30,261 |
| Payments made during the year ended January 31, 2003...................... | (8,528) | (1,342) | (1,832) | $(11,702) |
| Acquisition cost accrual, January 31, 2003.................................. | $ 5,967 | $11,383 | $1,209 | $ 18,559 |
| Long term obligation.................... | -- | 6,255 | -- | 6,255 |
| Current obligation...................... | $ 5,967 | $ 5,128 | $1,209 | $ 12,304 |

Other merger accruals primarily include operating equipment leases.

Books

As part of the acquisition of Books, the Company undertook a plan to exit certain activities of Books. The cost associated with the exit plan was included in the purchase price and was composed of severance related to reductions in employee headcount and remaining lease obligations related to canceled leases. The reductions in employee headcount totaled 11 employees from the administrative and development functions, and amounted to a charge of approximately $1.6 million, which included severance and other termination costs.





The remaining lease obligations related to the vacating of space associated with

these functions and amounted to a charge of approximately $200,000. The acquisition exit cost consists of the following (in thousands):

| | EMPLOYEE SEVERANCE AND RELATED COSTS | CLOSEDOWN OF FACILITIES | TOTAL |
|---|---|---|---|
| Exit costs incurred in acquisition................ | $ 1,561 | $ 282 | $ 1,843 |
| Payments made during the year ended January 31, 2002.......................................... | (14) | (6) | (20) |
| Acquisition cost accrual, January 31, 2002......... | 1,547 | 276 | 1,823 |
| Payments made during the year ended January 31, 2003.......................................... | (1,456) | (276) | (1,732) |
| Acquisition cost accrual, January 31, 2003......... | $ 91 | $ -- | $ 91 |

The remainder of the accrual was paid by March 2003.

(4) RESTRUCTURING AND OTHER NON-RECURRING CHARGES

(A) RESTRUCTURING

The Company recorded a $14.2 million restructuring charge for the year ended January 31, 2003, which is included in the statement of operations. Approximately $10.2 million of this charge represents 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 non-recurring compensation costs to terminated and continuing employees of the Company. Also included in the $14.2 million charge are certain other non-recurring costs incurred by SkillSoft Corporation as a result of the Merger. These costs primarily consist of employee severance and related costs and contractual obligations.

The components of the restructuring charges are as follows (in thousands):

| | EMPLOYEE SEVERANCE AND RELATED COSTS | CONTRACTUAL OBLIGATIONS | TOTAL |
|---|---|---|---|
| Total restructuring provision..................... | $10,192 | $ 3,987 | $14,179 |
| Payments made during the year ended January 31, 2003.......................................... | (6,938) | (2,431) | (9,369) |
| | $ 3,254 | $ 1,556 | $ 4,810 |

The Company anticipates that the remaining restructuring accruals will be settled by January, 2004. It is expected that the payments of employee-related expenses will be substantially complete by January, 2004.

The net restructuring charges for the fiscal year ended January 31, 2003 would have been allocated as follows had the Company recorded the expense and

adjustments within the functional department of the restructured activities (in thousands):

| | YEAR ENDED JANUARY 31, 2003 |
|---|---|
| Cost of Sales | $ 990 |
| Research & Development | 1,761 |
| Sales & Marketing | 7,922 |
| General & Administrative | 3,506 |
| Total | $14,179 |

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SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(B) OTHER NON-RECURRING CHARGES

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 end January 31, 2003. All other costs associated with the restatement are expensed as the work is performed. For the year ended January 31, 2003, the Company recorded $5.1 million in expenses related to the restatement effort consisting primarily of professional fees, including legal, accounting and other consulting fees. The Company expects to incur additional costs in this matter which will be expensed as incurred.

(5) GOODWILL AND INTANGIBLE ASSETS

On February 1, 2002, the Company adopted SFAS No. 142, which requires companies to discontinue amortizing goodwill and certain intangible assets with indefinite useful lives and requires an annual review for impairment. The non-amortization provisions of SFAS No. 142 apply to goodwill and intangible assets acquired after June 30, 2001. The Company's goodwill and intangible assets relate to both the Merger and its acquisition of Books, which were accounted for in accordance with the non-amortization provisions of SFAS No. 142. Therefore, there is no impact on the comparability of the accompanying condensed consolidated statements of operations as a result of discontinuing the amortization of goodwill.

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

| | JANUARY 31, 2002 | | | JANUARY 31, 2003 | | |
|---|---|---|---|---|---|---|
| | GROSS CARRYING AMOUNT | ACCUMULATED AMORTIZATION | NET CARRYING AMOUNT | GROSS CARRYING AMOUNT | ACCUMULATED AMORTIZATION | NET CARRYING AMOUNT |
| Internally developed | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| software/courseware... | $ 600 | $17 | $ 583 | $ 25,600 | $2,822 | $ 22,778 |
| Customer contracts..... | 500 | 10 | 490 | 12,500 | 1,888 | 10,612 |
| Books trademark........ | 900 | -- | 900 | 900 | -- | 900 |
| | 2,000 | 27 | 1,973 | 39,000 | 4,710 | 34,290 |
| Goodwill............... | 46,728 | -- | 46,728 | 119,427 | -- | 119,427 |
| | $48,728 | $27 | $48,701 | $158,427 | $4,710 | $153,717 |

Customer contracts are existing contracts that relate to underlying customer relationships pertaining to the services provided by the acquired company. The Company expects to amortize the fair value of customer contracts on an accelerated basis over a weighted average estimated useful life. Internally developed software/courseware relates to the Books platform and the SmartForce PLC content. Course content includes courses in both soft skills and information technology. All courseware is deployable via the Internet or corporate intranets.





A roll-forward of the net carrying amount of intangible assets as of January 31, 2003 from January 31, 2002 is as follows (in thousands):

| | NET CARRYING AMOUNT |
|---|---|
| Balance at January 31, 2002................................ | $ 48,701 |
| Acquired intangibles....................................... | 360,681 |
| Goodwill impairment........................................ | (250,107) |
| Goodwill adjustment........................................ | (875) |
| Amortization expense....................................... | (4,683) |
| Balance at January 31, 2003................................ | $ 153,717 |

The goodwill adjustment resulted from the revision of certain estimates related to the Books acquisition.

Amortization expense for the fiscal years ended January 31, 2002 and 2003 is as follows (in thousands):

| | FISCAL YEAR ENDED | |
|---|---|---|
| | JANUARY 31, 2002 | JANUARY 31, 2003 |
| Internal developed software/courseware..................... | $17 | $2,805 |
| Customer contracts......................................... | 10 | 1,878 |

| | | |
|---|---|---|
| | $27 | $4,683 |

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

| FISCAL YEAR | AMORTIZATION EXPENSE |
|---|---|
| 2004 | $ 9,623 |
| 2005 | 8,996 |
| 2006 | 8,316 |
| 2007 | 4,686 |
| 2008 | 1,248 |
| Thereafter | 521 |
| Total | $33,390 |

Goodwill Impairment

In response to several factors in the fourth quarter of fiscal 2003, the Company re-evaluated the fair value of the goodwill established in connection with the Merger and the Books acquisition. The Company prepared a cash flow analysis by reporting segment comparing the discounted cash flows to the net book values of the direct assets, goodwill and intangibles associated with the two reporting units: multi-modal learning and retail certification. The discounted cash flows did not support the direct assets, goodwill and intangibles of the multi-modal learning business unit. However, the discounted cash flows did support the retail certification reporting unit.

The enterprise value of the two reporting units and the identifiable intangible assets were based on valuations prepared by a third party appraisal firm using assumptions provided by management. The Company's management prepared a discounted cash flow analysis by reportable segment for each reporting unit comparing the discounted cash flows to the net book values of the direct assets, goodwill and intangibles





associated with each reporting unit. The enterprise value was based upon a discounted cash flow analysis. The cash flow analysis indicated the discounted cash flows were not sufficient to recover the assets. Accordingly, the Company recorded a $250.1 million impairment to goodwill in the fourth quarter of fiscal 2003.

The impairment of goodwill results from the following factors:

- A significant reduction in expected revenues for the fiscal year ending January 31, 2004 and in subsequent years due to the elimination of the Company's non-core businesses of Telcom, Prokoda Services and Custom Global Services and to a lesser extent, lower than anticipated revenues;

- The overall value of the securities exchanged in the Merger decreased significantly from the measurement date, for accounting purposes to the closing date of the transaction;

- Although market analysts continue to indicate strong growth in the e-Learning sector, the Company has projected it to be a lower growth rate than originally considered at the time the consideration to be paid was fixed; and

- As required by SFAS 142, the Company considered the value of certain assets that have zero book basis in the allocation of the enterprise value, including primarily the value of its current customer base (including synergies from cross selling its products, content, technology and trademarks).

(6) RELATED PARTY TRANSACTIONS

(A) NOTES RECEIVABLE FROM STOCKHOLDERS

In December 1997, the Company issued 1,499,353 shares of Class A common stock to a founder of the Company in exchange for a $166,000 full recourse note receivable with interest at 6.2% per annum which was equal to the fair market value of the shares at the date of the transaction. As of January 31, 2002, the balance on this note receivable was $166,000 and was included as a reduction of stockholders' equity in the accompanying consolidated balance sheets and consolidated statements of stockholders' equity (deficit) and comprehensive loss. The note receivable and accrued interest was repaid in December 2002.

During the fiscal years ended January 31, 1999 and 2000, the Company issued a total of 1,558,538 shares of Class A restricted common stock to three officers and several key employees of the Company in exchange for $173,000 full recourse notes receivable equal to the fair market value of the shares. The shares vest ratably on a monthly basis over three years (Note 10(c)). The notes receivable accrue interest at rates of 4.83% - 5.77% per annum and the principal and all outstanding interest are due upon the maturity of the notes through March 2004. The total balance of these notes receivable was $172,000 and $58,000 at January 31, 2002 and 2003, respectively, and is included as a reduction of stockholders' equity in the accompanying consolidated balance sheets and consolidated statements of stockholders' equity (deficit) and comprehensive loss.

All of the shares of Class A common stock converted into an equal number of shares of common stock in connection with the Company's initial public offering of common stock in February 2000.

(B) OWNERSHIP OF 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 SmartForce PLC (the predecessor entity, for accounting purposes, of SkillSoft PLC). These key employees do not include any of the Company's directors or executive officers.





All of the voting securities of CBT T are owned by Fidalco Limited, a wholly owned subsidiary of SmartForce 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. 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 SmartForce PLC, there is no relationship between SmartForce PLC and Stargazer.

(C) SPHERION CORPORATION

In April 2000, the Company sold 338,200 shares of common stock to Spherion Corporation (Spherion) (formerly Interim Services, Inc.), at a price of $5.91 per share, for approximately $2 million, which approximated the fair market value at that date. In addition, the Company entered into a separate license arrangement with Spherion, under which the Company recognized approximately $383,000, $493,000 and $461,000 of product revenue in the years ended, January 31, 2001, 2002, and 2003, respectively. The Company believes that all transactions with Spherion are rendered at arms' length.

(D) BUSINESS PERFORMANCE TECHNOLOGIES, LLP

During the year ended January 31, 2001, the Company invested approximately $100,000 in Business Performance Technologies, LLP (BPT), a provider of consulting services to the Company's customers. The investment represented a minority interest in BPT which was accounted for using the cost method. The Company valued the investment at zero during the year ended January 31, 2001 because the ultimate value of its interest in BPT was permanently impaired.

Included in accounts payable on the accompanying consolidated balance sheets as of January 31, 2002 and 2003 was approximately $168,000 and $31,000 due to BPT, respectively. The Company earns a referral fee for any services referred to BPT. As such, the Company records the services revenue on a net basis. Net revenue recorded by the Company associated with work performed by BPT during the years ended January 31, 2002 and 2003 was approximately $920,000 and $483,000, respectively. Revenue associated with work performed by BPT during the year ended January 31, 2001 was not material.

(7) INCOME TAXES

Loss before provision for income taxes consist of the following (in thousands):

| | JANUARY 31, | |
|---|---|---|
| | 2002 | 2003 |
| Ireland | $ -- | $ 49,241 |
| United States | 9,640 | 209,884 |
| Rest of World | -- | 24,489 |
| | $9,640 | $283,614 |



SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

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

| | JANUARY 31, 2002 | JANUARY 31, 2003 |
|---|---|---|
| Current: | | |
| Ireland | $ -- | $ -- |
| United States | -- | -- |
| Rest of World | -- | 383 |
| | $ -- | $383 |
| Deferred: | | |
| Ireland | $ -- | $ -- |
| United States | -- | -- |
| Rest of World | -- | -- |
| | $ | $ -- |
| Tax provision | $ -- | $383 |

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

| | JANUARY 31, 2002 | JANUARY 31, 2003 |
|---|---|---|
| Net operating loss carryforwards | $ 19,760 | $ 129,470 |
| Nondeductible expenses and reserves | 4,076 | 3,352 |
| Tax credits | 980 | 1,443 |
| Nondeductible non-goodwill intangibles | -- | (8,178) |
| | 24,816 | 126,087 |
| Less -- valuation allowance | (24,816) | (126,087) |
| | $ -- | $ -- |

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

| | JANUARY 31, 2001 | JANUARY 31, 2002 | JANUARY 31, 2003 |
|---|---|---|---|
| Income tax provision at statutory rate | (34.0)% | (34.0)% | (15.7)% |
| Increase (decrease) in tax resulting from: | | | |

| | | | |
|---|---|---|---|
| State tax provision, net of federal benefit............... | (4.6) | (4.6) | 0.0 |
| Foreign differential...................................... | 0.0 | 0.0 | 0.1 |
| Nondeductible items, primarily the impairment charge....... | 0.0 | 0.0 | 13.8 |
| Unbenefitted current activity............................. | 38.6 | 38.6 | 1.7 |
| Effective tax rate........................................ | 0.0% | 0.0% | (0.1)% |

During 2003, the Company merged with SmartForce PLC (see Note 3).

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.

A total provision for income taxes has been recorded at $383,000. This relates to income generated in foreign countries, which cannot be offset through loss carryforwards.

As of January 31, 2003, the Company had worldwide net operating loss carryforwards of approximately $358,961,000 for income tax purposes available to reduce future income taxes, if any.

As of January 31, 2003, the Company had net operating loss carryforwards of approximately $282,269,000 for U.S. federal income tax purposes available to reduce future U.S. income taxes, if any. The Company also has available U.S. federal tax credit carryforwards of approximately $1,443,000 at January 31, 2003. In addition, the Company has approximately $76,692,000 of net operating losses related to its non-U.S. jurisdictions. If not utilized, these carryforwards expire at various dates through the year ending January 31, 2023.

At January 31, 2003, the Company had approximately $215,285,000 of the U.S. net operating loss carryforwards and $365,000 of tax credits in the U.S. that were acquired from the acquisition of Books and the Merger. In addition, the Company had approximately $60,186,000 of net operating loss carryforwards related to their non-U.S. jurisdictions acquired from the acquisition of Books and the Merger. These tax attributes will reduce the Company's future cash payments to the taxing authorities. The cash benefits of the majority of these attributes will be reflected as an adjustment through goodwill. The adjustments will not be recorded as a tax benefit in the Company's consolidated statement of operations.

At January 31, 2003, the Company had approximately $688,000 of the net operating loss carry forwards in the United States resulting from disqualifying dispositions. The tax value of the net operating losses resulting from disqualifying dispositions has not been recognized in the tax reconciliation note as it is not expected that it will be realized.

The Company has completed several financings since its inception and has

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

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. The Company has recorded as part of purchase accounting in the Merger a deferred tax liability of $8,178,000 on the separately identified intangible assets. In addition, through purchase accounting in the Merger, the Company has recognized a deferred tax asset relative to the acquired net operating loss carryforwards of a similar amount. Accordingly, the Company has provided a full valuation allowance against its otherwise realizable deferred tax assets as of January 31, 2002 and 2003, except for the amounts realized to offset this liability.

(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 $909,000 $1,102,000 and $3,252,000 for the fiscal years ended January 31, 2001, 2002 and 2003, respectively.





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

| | FACILITIES | OTHER | TOTAL |
|---|---|---|---|
| Fiscal year ended January 31: | | | |
| 2004 | $ 6,051 | $1,695 | $ 7,746 |
| 2005 | 5,291 | 814 | 6,105 |
| 2006 | 4,098 | 77 | 4,175 |
| 2007 | 3,344 | 12 | 3,356 |
| 2008 | 3,199 | 2 | 3,201 |
| Thereafter | 11,366 | -- | 11,366 |
| | $33,349 | $2,600 | $35,949 |

Total future minimum lease payments have been reduced by estimated future minimum sublease rentals of approximately $5.9 million.

(B) MINIMUM COMMITMENTS

The Company has entered into certain long-term agreements with third parties to provide services and subject matter expertise. Future minimum

obligations under these arrangements are as follows (in thousands):

| Fiscal year ended January 31: | |
|---|---|
| 2004 | $5,787 |
| 2005 | 2,286 |
| Total | $8,073 |

(C) LITIGATION

SEC Investigation

On or about February 4, 2003, the Securities Exchange Commission (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. The Company continues to cooperate with the SEC in this matter.

Class Action Lawsuits

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; the first action was





filed on November 22, 2002, the second action was filed on December 4, 2002 and the third and fourth actions were filed on December 11, 2002, the fifth action was filed on December 23, 2002, and the sixth action was filed on January 16, 2003. These lawsuits allege that the Company misrepresented or omitted to state material facts in its SEC filings and press releases regarding its 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. These lawsuits seek unspecified monetary damages, including punitive damages together with interest, costs, fees and expenses. These lawsuits have all been assigned to Chief Judge Paul J. Barbadoro. On March 26, 2003, Judge Barbadoro consolidated the lawsuits under the caption "In re SmartForce Securities Litigation," Civil Action No. 02-544-B, appointed as lead plaintiffs the Teacher's Retirement System of Louisiana and the Louisiana Sheriff's Pension & Relief Fund, and approved the lead plaintiffs' choice of lead counsel and local counsel. The Company is awaiting plaintiffs' consolidated amended complaint. The Company believes that it has meritorious defenses to

these actions and intend to vigorously defend ourselves.

At the end of the Company's third quarter of 1998, several purported class action lawsuits were filed in the United States District Court for the Northern District of California against it, one of its subsidiaries and certain of its former and current officers and directors alleging violations of the federal securities laws. It has been alleged in these lawsuits that the Company misrepresented or omitted to state material facts regarding its business and financial condition and prospects in order to artificially inflate and maintain the price of its ADSs, and misrepresented or omitted to state material facts in its registration statement and prospectus issued in connection with its merger with ForeFront, which also is alleged to have artificially inflated the price of its ADSs. The court has set a trial date of September 2003. The Company believes that it has meritorious defenses to these actions and intends to vigorously defend itself against them. Although the Company cannot presently determine the outcome of these actions, an adverse resolution of these matters could significantly negatively impact the Company's financial position and results of operations.

NETg Litigation

The Company's subsidiary, SkillSoft Corporation, several of its executive officers and key employees, and a former major investor of SkillSoft Corporation are named as defendants in a lawsuit pending in the Circuit Court of Cook County, Illinois filed by National Education Training Group, Inc. (NETg), the former employer of several of those individuals.

NETg's most recent complaint alleges in substance that:

- Charles E. Moran, as the former President of NETg, breached his fiduciary duty to NETg by usurping NETg's corporate opportunities, by commencing a rival business while still employed by NETg and by soliciting NETg personnel to join his rival business while still employed by NETg;

- Jerald A. Nine, as the former Vice President of Sales and Marketing of NETg, breached his fiduciary duty to NETg by assisting Mr. Moran in the creation, commencement and operation of the rival concern prior to Mr. Nine's resignation from NETg, by assisting Mr. Moran in the usurpation of corporate opportunities, by failing to inform his superiors at NETg of Mr. Moran's plans to form a rival business and by otherwise failing to use his best efforts on behalf of NETg while still employed there;

- SkillSoft Corporation, Mr. Moran, Mr. Nine, Mark A. Townsend, Dennis E. Brown, Lee A. Ritze and Sally Hovis misappropriated trade secrets of NETg, and SkillSoft Corporation and Mr. Moran tortiously interfered with NETg's "prospective economic advantage;"

- Mr. Moran, Mr. Townsend, Mr. Nine, Mr. Ritze, Mr. Brown and Ms. Hovis breached certain confidentiality and proprietary matters policies of NETg by misappropriating trade secrets and disclosing confidential and proprietary information during and after their employment with NETg;





- Mr. Moran, Mr. Townsend, Mr. Nine, Mr. Ritze and Mr. Brown breached the conflict of interest policy of NETg's former corporate parent, National Education Corporation, by failing to disclose that Mr. Moran formed and solicited funding for SkillSoft Corporation, that Messrs. Townsend, Nine,

Ritze and Brown had employment-related discussions with SkillSoft Corporation, and that Mr. Nine participated in forming and soliciting funding for SkillSoft Corporation, during their employment with NETg;

- SkillSoft Corporation and Mr. Moran tortiously interfered with NETg's contractual relations with Mr. Townsend, Mr. Nine, Mr. Brown, Mr. Ritze and Ms. Hovis by offering them employment and inducing them to breach their confidentiality and trade secret obligations to NETg;

- SkillSoft Corporation breached provisions of a license agreement with NETg relating to the use of NETg's software; and

- Warburg Pincus Ventures, L.P., a former major investor in SkillSoft Corporation, tortiously interfered with Mr. Moran's and Mr. Nine's fiduciary duties to NETg.

NETg maintains that the trade secrets allegedly misappropriated by the other defendants and SkillSoft Corporation include, among other things:

- various aspects of the design and functionality of its education and training software and products;

- customer lists and information;

- relationships with service providers; and

- NETg's soft skills product line business plan.

The claims seek injunctive relief against SkillSoft Corporation and Messrs. Moran, Nine, Townsend, Brown and Ritze and Ms. Hovis and demand the return, and no future use by SkillSoft Corporation and these defendants, of the alleged trade secrets. The claims also seek compensatory damages of $400 million, exemplary damages in the additional amount of $400 million, additional compensatory, incidental and consequential damages in an unspecified amount and punitive damages of $50 million or such other amount as the court deems just or appropriate. In answers to interrogatories served on NETg, an expert witness retained by NETg opined that NETg may, based on certain assumptions provided to the expert by NETg's counsel, be entitled to two categories of damages, including damages for lost profits of up to $386.8 million and damages for unjust enrichment of up to $616.3 million. On April 30, 2001, the court denied SkillSoft Corporation's motion to dismiss all of NETg's claims against SkillSoft Corporation and its executive officers and key employees and granted Warburg, Pincus Ventures, L.P.'s motion to dismiss claims related to its alleged tortious interference with NETg's prospective economic advantage and unfair competition. The case is currently in discovery and a trial has been scheduled for February 2004. While there have been certain settlement discussions between the parties in this matter, no settlement has yet been reached and the Company intends to continue to vigorously contest NETg's claims. The current progress and state of the proceedings do not permit an evaluation of the likelihood of an unfavorable outcome or a fair estimate of the amount or range of potential loss, if any.

In addition, on July 26, 2000, NETg filed suit against SkillSoft Corporation in the United States District Court for the Northern District of Illinois alleging that SkillSoft Corporation's educational and training software products infringe United States Patent No. 6,039,575, which was issued on March 21, 2000 and is allegedly owned by NETg. The complaint seeks both monetary damages and injunctive relief. SkillSoft Corporation filed its answer and a counterclaim for a declaration of invalidity of the NETg patent on August 17, 2000. NETg filed its reply and affirmative defenses to SkillSoft Corporation's counterclaim on February 2, 2001.

SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

On April 17, 2001, SkillSoft Corporation filed a request for reexamination of the patent in suit with the United States Patent and Trademark Office (the PTO). On May 11, 2001, the United States District Court for the Northern District of Illinois entered an order staying the proceedings in NETg's patent infringement action, with certain exceptions, pending resolution of SkillSoft Corporation's request to the PTO to reexamine the patentability of the claims of the patent on which NETg bases the lawsuit and any resulting reexamination proceedings. After a series of interim actions by the PTO and filings by the patent owner, on April 10, 2002 the PTO issued an Office Action rejecting all of the claims of the patent. On September 6, 2002, an order was issued dismissing the Federal Court litigation "without prejudice with leave to reinstate upon full and final resolution of the reexamination proceedings." NETg's appeal of the PTO's Office Action rejecting all of the claims of the patent remains pending and, on or about September 10, 2002, the patent owner filed with the PTO its brief in support of its appeal. On May 5, 2003, the Examiner mailed the Examiner's Answer in response to the patent owner's appeal brief. The Examiner's Answer concluded that, for the reasons set forth in the Answer, "it is believed that the rejections should be sustained."

SkillSoft Corporation and the other defendants are vigorously defending themselves against NETg's allegations, and the Company believes that both SkillSoft Corporation and the other defendants have meritorious defenses to the claims made in the lawsuits. None of the defendants in the first lawsuit were bound by written non-competition or non-solicitation agreements with NETg. The Company is not yet able to assess its potential liability or the potential liability of the other defendants. Nonetheless, SkillSoft Corporation's failure to prevail in this litigation could have any or all of the following significant adverse effects on the Company's business and financial performance:

- injunctive relief issued against SkillSoft Corporation and its officers and employees, which could significantly restrict the Company's ability to conduct its business;

- an adverse judgment against SkillSoft Corporation for monetary damages;

- a settlement on unfavorable terms;

- obligations SkillSoft Corporation has to indemnify its employees for liabilities and expenses they incur in connection with the lawsuits;

- obligations to customers for breach of SkillSoft Corporation's warranty of noninfringement; or

- a requirement to reengineer SkillSoft Corporation's products to avoid patent infringement, which would likely result in additional expense and delay.

In addition, this litigation, regardless of its outcome, will continue to result in significant expenses in defending the lawsuit and may divert the efforts and attention of the Company's management team from normal business operations. While there have been certain settlement discussions between the parties in the lawsuit, at this time, the outcome of these discussions cannot be predicted. Accordingly, the Company has not recorded any liability related to this matter in the Consolidated Financial Statements.

IP Learn

On April 23, 2002, IP Learn, LLC (IP Learn) filed a complaint in the United States District Court for the Northern District of California against the Company. The complaint alleges that the Company infringed on five United States patents assigned to IP Learn. The complaint was subsequently amended to add an additional patent. The IP Learn patents in question are U.S. Patent Nos. 6,126,448; 6,118,973; 5,934,909; 5,779,486, 5,743,746; and 6,398,556. The Company believes that these patents are related primarily to computer-aided learning methods and systems. In the complaint, IP Learn asked the court for a preliminary and permanent injunction as well as unspecified damages. On June 27, 2002, the Company filed its answer to IP Learn's amended complaint, denying infringement and asserting counterclaims seeking declaratory relief that the patents-in-suit are invalid and that the Company has not infringed the patents-in-suit.





On July 1, 2002, IP Learn served the Company's subsidiary SkillSoft Corporation with an amended complaint alleging that SkillSoft Corporation infringed U.S. Patent Nos. 6,126,448; 6,118,973; 5,934,909; 5,779,486 and 6,398,556. The complaint seeks both monetary damages and injunctive relief. In response to the amended complaint, SkillSoft Corporation filed a motion to dismiss or, in the alternative, for a more definite statement. The United States District Court for the Northern District of California granted SkillSoft Corporation's motion to dismiss on October 15, 2002, and on October 25, 2002, IP Learn filed its Second Amended Complaint alleging again that SkillSoft Corporation is infringing the five IP United States patents assigned to IP Learn listed above. The Second Amended Complaint seeks both monetary damages in an unspecified amount and injunctive relief. On November 8, 2002, SkillSoft Corporation filed its Answer to the Second Amended Complaint, in which it denied liability and asserted counterclaims seeking declaratory relief that the specified patents are invalid and that SkillSoft Corporation has not infringed the specified patents.

On December 6, 2002, the court ordered that the IP Learn cases against the Company and SkillSoft Corporation be consolidated. On February 5, 2003, the court conducted a new case management conference for the consolidated case. As a result of that case management conference, the court scheduled the claim construction hearing in the consolidated case for November 12, 2003 and scheduled trial in the matter for August 30, 2004.

KPMG

In May 2002, KPMG International Investments B.V. (KPMG) filed suit against the Company for breach of contract in the Superior Court of the State of California, County of San Mateo. KPMG alleged that the Company failed to deliver a customized e-Learning platform and sought damages in the amount of approximately $5 million. The Company filed a counterclaim against KPMG for its material breach of the same contract and it sought damages in the amount of approximately $2.8 million, which represented the balance due under the contract. On September 26, 2002, the Company settled the lawsuit and the counterclaim. Neither party made a monetary payment in connection with the settlement, and both parties dismissed their claims against the other with prejudice.

Lionet

On June 13, 2002, Lionet Limited, a limited liability company incorporated and doing business in Ireland, filed a claim against the Company in Ireland, alleging, among other things, that the Company breached the terms of its

software license agreement with Lionet Limited in that the Company permitted or failed to prevent the decompilation of the provided software products and that the Company has failed to cooperate in audits to determine the nature of such alleged copying or de-compilation. Lionet Limited is seeking damages for lost license fees of $6.8 million and seeks other damages. The Company intends to vigorously defend itself in this matter.

The Company is not a party to any other material legal proceedings.

(D) CREDIT FACILITY

On April 28, 2003, the Company signed a term sheet to obtain a $25 million one-year, secured line of credit from a bank. The Company expects to execute the definitive loan documents by May 31, 2003. Under the terms of the line of credit, the facility is to be initially secured by cash held in a certificate of deposit in the amount of the line, plus a first security interest in all domestic business assets. The cash held in the certificate of deposit is to be released on a quarterly basis beginning the quarter following the achievement of two consecutive minimum levels of operating income. All borrowings under the line of credit bear interest at the lesser of the bank's prime rate or the 30 or 60-day Libor rate plus 2.75%.





(9) CONVERTIBLE PREFERRED STOCK

Prior to its initial public offering, the Company authorized the issuance of 13,000,000 shares of convertible preferred stock (the Preferred Stock), $.001 par value, of which 4,000,000, 4,761,905, and 3,174,603 shares were designated as Series A, Series B and Series C Preferred Stock, respectively. At January 31, 2000, 1,063,492 shares of preferred stock were undesignated for a particular series.

In January 1998, the Company issued 4,000,000 shares of Series A Preferred Stock for gross proceeds of approximately $7,000,000. In August 1998, the Company issued 2,380,953 shares of Series B Preferred Stock for gross proceeds of approximately $5,000,000. In February 1999, the Company issued the remaining 2,380,952 shares of Series B Preferred Stock for gross proceeds of approximately $5,000,000. In August 1999, the Company issued 1,195,238 shares of Series C Preferred Stock for gross proceeds of approximately $3,765,000, and an amount of $3,765,000 was allocated to the beneficial conversion feature in accordance with Emerging Issues Task Force Issue No. 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingency Adjustable Conversion Ratios," and was fully amortized through accumulated deficit on the date of issuance.

In connection with the Company's initial public offering, all outstanding shares of Preferred Stock automatically converted into 15,715,026 shares of common stock.

(10) STOCKHOLDERS' EQUITY

(A) REVERSE ACQUISITION ACCOUNTING

As a result of the Merger, each issued and outstanding share of SkillSoft Common Stock, par value $0.001 per share, was automatically converted into the right to receive 2.3674 (the Exchange Ratio) validly issued and fully paid ordinary shares, nominal value E0.11 per share, of the Company, with each

ordinary share represented by an ADS. The Company also assumed each outstanding option to purchase SkillSoft Common Stock, which had been granted under SkillSoft Corporation's existing stock option plans, under the same Exchange Ratio of 2.3674. As a result of the Merger, all discussions and notes regarding common shares include the effect of the aforementioned SmartForce reverse acquisition.

In accordance with the preceding paragraph, the outstanding shares as of January 31, 2002 and the weighted average shares outstanding for the year ended January 31, 2001 and 2002 were restated as follows.

| | AS OF JANUARY 31, 2002 |
|---|---|
| Outstanding shares, as previously reported | 17,313,641 |
| Multiplied times exchange ratio | 2.3674 |
| Shares, as restated | 40,988,314 |

| | FOR THE YEAR ENDED JANUARY 31, 2001 | FOR THE YEAR ENDED JANUARY 31, 2002 |
|---|---|---|
| Weighted average shares outstanding (in thousands) as previously reported | 12,668 | 14,921 |
| Multiplied times exchange ratio | 2.3674 | 2.3674 |
| Weighted average shares outstanding (in thousands) as restated | 29,990 | 35,324 |





(B) CAPITALIZATION

The Company has authorized capital stock of 250,000,000 shares of E0.11 par value ordinary shares.

On February 4, 2000, the Company closed its initial public offering of 7,338,940 shares of common stock at a public offering price of $5.91 per share. On February 15, 2000, in connection with the exercise of the underwriters' over-allotment option, the Company issued an additional 1,100,841 shares of common stock at the initial public offering price of $5.91 per share. Net proceeds to the Company from the initial public offering and the exercise of the over-allotment option were approximately $45,000,000.

On July 30, 2001, the Company closed a public offering of 6,619,842 shares

of common stock at a public offering price of $11.83 per share. Net proceeds to the Company from this offering were approximately $72,000,000. In addition to shares issued by the Company, certain members of management and a key investor of the Company sold 603,687 and 1,420,440 shares of common stock, respectively, at a public offering price of $11.83 per share.

(C) COMMON SHARES

Prior to the Company's initial public offering, the Company authorized shares of Class A and Class B common stock, $0.001 par value. The voting, dividend and liquidation rights of the holders of the common stock were subject to, and qualified by, the rights of the holders of the Preferred Stock.

The Company issued 1,340,000 shares of Class A common stock, which were not part of the 1998 Stock Incentive Plan, to a founder of the Company and to several private investors in December 1997. Of these shares, 633,333 shares were issued to a founder of the Company in exchange for a full recourse note receivable (see Note 6).

During the fiscal years ended January 31, 1999 and 2000, the Company issued 1,124,000 and 340,000 shares of Class A restricted common stock, respectively, pursuant to the 1998 Stock Incentive Plan. Of these shares, 658,333 were issued to three officers and several key employees of the Company in exchange for full recourse notes receivable (see Note 6). These shares all vest ratably on a monthly basis over a three-year period; unvested shares are subject to the right of repurchase by the Company at the original sales price of the shares. In addition, these shares are subject to a restriction on transfer of ownership, and the Company holds a right of first refusal option upon the sale of the shares. As of January 31, 2003, a total of 20,291 shares of common stock are subject to the right of repurchase by the Company.

In connection with the Company's initial public offering on February 4, 2000, all issued and outstanding shares of Class A common stock and Class A restricted common stock were converted to a new class of common stock, and the certificate of incorporation was amended to eliminate the designation of the Class A and Class B common stock.

In December 1999, the Company granted warrants to purchase 143,479 shares of Class A common stock at an exercise price of $3.48 per share to a financial institution. The Company valued the warrants at $319,228 using the Black-Scholes option-pricing model. This amount was charged to interest expense during the year ended January 31, 2000, the period representing the estimated term of the borrowings. During the year ended January 31, 2002, the warrant was exercised through a net cash issuance, resulting in the issuance of 88,421 shares of common stock.

(D) STOCK OPTION PLANS

In February 1998, the Company adopted the 1998 Stock Incentive Plan (the 1998 Plan), pursuant to which up to 7,402,071 shares of common stock may be 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 may be issued, subject to increase in accordance with the terms of the 2001 Plan. Under the 1998 Plan and the 2001





Plan, the Company may grant 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. Incentive stock options may 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 may be 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 optionees' death. There are certain exceptions for exercises following retirement or death.

All option plans of SkillSoft in existence upon the closing of the Merger on September 6, 2002 have been terminated, except insofar as they relate to the outstanding options.

In connection with the Merger on September 6, 2002, the Company assumed the SmartForce plans, consisting of options to purchase 15,941,705 shares. Under the 1990 Plan, options to acquire ordinary shares in the Company may be granted to any director or employee of the Company. Under the 1994 Plan, all employees and directors of the Company and any independent contractor who performs services for the Company are eligible to receive grants of non-statutory options (NSO's). Employees are also eligible to receive grants of incentive share options intended to qualify under Section 422 of the Internal Revenue Code. Under the Outside Director Plan all outside directors of the Company are eligible to receive option grants upon election to the Board of Directors and each subsequent year thereafter. Under the 1996 Plan all employees, with the exception of directors and executive officers, are eligible to receive grants of NSO's. Under the ForeFront92 Plan, (the FF92 Plan) NSO's and ISO's were granted to any employee or director of ForeFront. Under the ForeFront96 Plan, (the FF96 Plan) NSO's were granted to employees and directors of ForeFront. 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. 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 NSO's. Employees of KWL and KWGL were also eligible to receive grants of ISO's 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. 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 ISO's granted under the 1994 Plan cannot be less than the fair market value of ordinary shares on the date of grant. In the case of ISO's 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 NSO's is set by the Committee at its discretion. The exercise price of option grants under the Outside Director Plan is 100% of the fair market value per share on the date of grant. 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 90 days following termination of employment or service or six months following an optionees' 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, 2003:

| PLAN NAME | AUTHORIZED | OUTSTANDING | AVAILABLE FOR GRANT |
|---|---|---|---|
| 1990 Share Option Scheme (the 1990 Plan).... | 4,700,000 | 234,917 | -- |
| 1994 Share Option Plan (the 1994 Plan)...... | 11,747,036 | 5,301,815 | 1,286,133 |
| 1996 Supplemental Stock Plan (the 1996 Plan).................................... | 14,000,000 | 6,345,216 | 4,785,342 |
| 2001 Outside Director Option Plan (the Outside Director Plan)................... | 350,000 | 155,000 | 195,000 |
| ForeFront Group Inc. Amended and Restated 1992 Stock Option Plan (the FF92 Plan).... | 289,184 | -- | -- |
| 1996 ForeFront Group Inc. Non-Qualified Stock Option Plan (the FF96 Plan)......... | 798,924 | 6,567 | 337,230 |
| ForeFront 1996 Non-Employee Directors' Stock Plan (the FF Directors' 1996 Plan)........ | 18,822 | -- | 2 |
| Knowledge Well Limited 1998 Share Option Plan (the KWL Plan)...................... | 654,800 | 610 | 233,659 |
| Knowledge Well Group Limited 1998 Share Option Plan (the KWGL Plan).............. | 654,800 | 3,424 | 624,205 |
| Books24x7.com, Inc. 1994 Stock Option Plan.................................... | 867,436 | 242,783 | -- |
| 1998 Stock Incentive Plan (the 1998 Plan)... | 7,402,071 | 2,194,782 | -- |
| 1999 Stock Incentive Plan (the 1999 Plan)... | 568,176 | 94,696 | -- |
| 2001 Stock Incentive Plan (the 2001 Plan)... | 11,354,512 | 9,160,108 | -- |
| 2002 Stock Incentive Plan (the 2002 Plan)... | 2,350,000 | 1,864,168 | -- |
| | 55,755,761 | 25,604,086 | 7,461,567 |

Due to the reverse acquisition accounting, the SkillSoft options were converted using the Exchange Ratio.





All stock option activity under the Plans for the fiscal years ended January 31, 2001, 2002 and 2003 is as follows:

| | SHARES | EXERCISE PRICE | WEIGHTED AVERAGE EXERCISE PRICE |
|---|---|---|---|
| Outstanding, January 31, 2000 | 1,971,748 | $0.11 - $ 5.49 | $ 1.44 |
| Granted | 1,790,027 | 3.72 - 12.67 | 6.37 |
| Exercised | (237,585) | 0.11 - 4.43 | 0.28 |
| Canceled | (271,041) | 0.11 - 11.61 | 3.94 |
| Outstanding, January 31, 2001 | 3,253,149 | 0.11 - 12.67 | 4.03 |
| Granted | 4,046,031 | 0.25 - 15.26 | 7.23 |
| Acquired from acquisition | 808,799 | 0.25 - 2.55 | 0.33 |
| Exercised | (520,653) | 0.11 - 16.03 | 2.68 |
| Canceled | (507,185) | 0.11 - 14.55 | 6.85 |
| Outstanding, January 31, 2002 | 7,080,041 | 0.11 - 15.26 | 6.18 |
| Granted | 6,509,496 | 2.75 - 10.67 | 4.47 |
| Acquired from merger | 15,941,705 | 3.05 - 44.25 | 11.99 |
| Exercised | (826,316) | 0.11 - 9.03 | 0.50 |
| Canceled | (3,100,840) | 0.11 - 44.25 | 13.32 |
| Outstanding, January 31, 2003 | 25,604,086 | $0.11 - $44.25 | $ 8.69 |
| Exercisable, January 31, 2003 | 9,883,805 | $0.11 - $44.25 | $12.71 |
| Exercisable, January 31, 2002 | 1,709,443 | $0.11 - $15.26 | $ 2.53 |
| Exercisable, January 31, 2001 | 529,973 | $0.11 - $ 5.80 | $ 1.35 |

The following table summarizes certain information relating to the outstanding and exercisable options as of January 31, 2003:

| | OUTSTANDING | | | EXERCISABLE | |
|---|---|---|---|---|---|
| RANGE OF EXERCISE PRICES | NUMBER OF SHARES | WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS) | WEIGHTED AVERAGE EXERCISE PRICE | NUMBER OF SHARES | WEIGHTED AVERAGE EXERCISE PRICE |
| $ 0.11 - $ 3.30 | 4,477,312 | 9.02 | $ 2.78 | 692,179 | $ 0.69 |
| 3.34 - 4.06 | 5,700,294 | 9.53 | 4.05 | 14,699 | 3.84 |
| 4.07 - 6.36 | 5,598,681 | 8.69 | 5.75 | 2,059,261 | 5.74 |
| 6.65 - 16.44 | 6,461,867 | 6.91 | 12.23 | 4,954,680 | 12.76 |
| 16.50 - 44.25 | 3,365,932 | 7.55 | 22.48 | 2,162,986 | 23.14 |
| $ 0.11 - $44.25 | 25,604,086 | 8.34 | $ 8.69 | 9,883,805 | $12.71 |

In connection with certain issuances of Class A restricted common stock and stock option grants during the year ended January 31, 2000, the Company recorded deferred compensation of $2,852,000, which represents the aggregate difference

between the exercise or sale price and the fair market value of the common stock as determined for accounting purposes. The deferred compensation will be recognized as an operating expense over the vesting period of the restricted common stock and the underlying stock options. The





Company recorded compensation expense of $753,000, $736,000 and $602,000 in the years ended January 31, 2001, 2002 and 2003, respectively, related to these restricted shares and options.

During the year ended January 31, 2001, the Company granted options to purchase 11,837 shares of common stock to a non-employee in consideration for rendered services. These options were fully vested at the date of grant. The Company recorded stock-based compensation of $61,000, which represents the value of such options as calculated using the Black-Scholes option pricing model.

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 will be amortized to expense over the vesting period of the stock options. The Company recorded compensation expense of $57,000 and $660,000 in the years ended January 31, 2002 and 2003, 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 will be amortized to expense over the vesting period of the stock options. The Company recorded compensation expense of $372,000 in the year ended January 31, 2003 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.

(D) EMPLOYEE STOCK PURCHASE PLANS

In 2001, the Company's Board of Directors and stockholders approved the 2001 Employee Stock Purchase Plan, under which a maximum of 624,994 shares may be issued. In 2001, the Company's Board of Directors approved the 2001 International Employee Stock Purchase Plan, under which a maximum of 118,370 shares may be issued.

Participants in each of the 2001 Employee Stock Purchase Plan and the 2001 International Employee Stock Purchase Plan are granted options to purchase shares of common stock on the last business day of each six-month payment period ending each June 30 and December 31 for 85% of the market price of the common stock on the first or last business day of each payment period, whichever is

less. The purchase price for such shares is paid through payroll deductions, and the current maximum allowable payroll deduction is 15% of each eligible employee's compensation. On August 26, 2002, the Board of Directors approved an acceleration of the purchase date scheduled for December 31, 2002 to September 5, 2002. Under these Employee Stock Purchase Plans, the Company issued 160,690 shares during the period ending September 6, 2002. As of September 6, 2002, there were 463,045 shares available for future issuance under the 2001 Employee Stock Purchase Plan and 93,156 shares available for future issuance under the 2001 International Employee Stock Purchase Plan. Such shares are no longer available for issuance.

On August 26, 2002, the Board of Directors terminated the 2001 Employee Stock Purchase Plan and the 2001 International Employee Stock Purchase Plan, leaving the 1995 Employee Share Purchase Plan as the primary plan for all employee stock purchases. Participants in the 1995 Employee Share Purchase Plan are granted options to purchase ordinary shares on the last business day of each six-month payment period ending





each May 31 and November 30 for 85% of the market price of the ADSs on the first or last business day of each payment 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 compensation. The Company issued 230,284 shares during the period from September 7, 2003 to January 31, 2003. As of January 31, 2003, there were 923,400 shares available for future issuance under the 1995 Employee Share Purchase Plan.

## (11) EMPLOYEE BENEFIT PLAN

The Company has a 401(k) plan covering all 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, and may make a discretionary contribution to the 401(k) plan. As a result of the merger with SmartForce on September 6, 2002, the Company assumed a second 401(k) plan. Under this plan, contributions of approximately $87,000 were made for the year ended January 31, 2003.

## (12) DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE

The Company follows the provisions of SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" (SFAS No. 131). SFAS No. 131 established standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to 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 and the Chief Financial Officer. Prior to the Merger, the Company had viewed its operations and managed its business as principally one operating segment. Subsequent to the Merger, the Company has viewed its operations and manages its business as principally two operating segments -- multi-modal learning and retail certification (which was part of the acquisition).

SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

The following tables set forth the Company's statement of operations by segment with additional disclosures as required by SFAS No. 131:

| | YEAR ENDED JANUARY 31, 2003 | | |
|---|---|---|---|
| | MULTI-MODAL | RETAIL CERTIFICATION | COMBINED |
| | (IN THOUSANDS) | | |
| Revenue | $ 94,402 | $ 7,068 | $ 101,470 |
| Cost of revenues | 10,825 | 723 | 11,548 |
| Gross profit | 83,577 | 6,345 | 89,922 |
| Operating expenses: | | | |
| Research and development | 28,687 | 417 | 29,104 |
| Selling and marketing | 47,032 | 5,659 | 52,691 |
| General and administrative | 17,326 | 588 | 17,914 |
| Amortization of stock based compensation | 1,634 | -- | 1,634 |
| Amortization of intangible assets | 4,683 | -- | 4,683 |
| Impairment charge | 250,107 | -- | 250,107 |
| Restructuring and other non-recurring items | 19,286 | -- | 19,286 |
| Total operating expenses | 368,755 | 6,664 | 375,419 |
| Income (loss) from operations | $(285,178) | $ (319) | $(285,497) |
| Supplemental segment disclosures: | | | |
| Depreciation and amortization expense | $ 13,302 | $ 93 | $ 13,395 |

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

| | AS OF JANUARY 31, 2003 | | |
|---|---|---|---|
| | MULTI-MODAL | RETAIL CERTIFICATION | COMBINED |
| Current assets, net | $195,107 | $16,217 | $211,324 |
| Property and equipment, net | 11,463 | 501 | 11,964 |
| Receivable from subsidiaries | 17,602 | (17,602) | -- |
| Goodwill | 101,233 | 18,301 | 119,534 |
| Other assets | 33,038 | 2,384 | 35,422 |
| Total consolidated assets | $358,443 | $19,801 | $378,244 |
| Current liabilities | $167,439 | $12,063 | $179,502 |
| Long-term liabilities | 7,423 | 125 | 7,548 |

| | | | |
|---|---|---|---|
| Total liabilities | 174,862 | 12,188 | 187,050 |
| Stockholders' equity | 183,581 | 7,613 | 191,194 |
| Total consolidated liabilities and stockholder's equity | $358,443 | $19,801 | $378,244 |





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, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| Revenue: | | | |
| United States | $17,367 | $38,959 | $ 80,991 |
| United Kingdom | -- | -- | 9,075 |
| Canada | -- | -- | 2,345 |
| Europe, excluding UK | -- | -- | 5,465 |
| Australia/New Zealand | -- | -- | 3,260 |
| Other (Countries less than 5% individually, by Region) | 1,930 | 5,312 | 334 |
| Total revenue | $19,297 | $44,271 | $101,470 |

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

(13) PREPAID EXPENSES AND OTHER CURRENT ASSETS

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

| | YEAR ENDED JANUARY 31, | |
|---|---|---|
| | 2002 | 2003 |
| Accounts receivable other | $ 10 | $ 650 |
| Advances, commissions and recoverable draw | 236 | 5,182 |
| Prepaid insurances | 352 | 1,297 |
| Prepaid facilities | 36 | 411 |
| Reclaimable taxes | 37 | 3,150 |
| Prepaid royalties | -- | 1,706 |

| | | |
|---|---|---|
| Other | 778 | 7,005 |
| Total prepaid expenses and other current assets | $1,449 | $19,401 |



SKILLSOFT PUBLIC LIMITED COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(14) ACCRUED EXPENSES -- CURRENT

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

| | YEAR ENDED JANUARY 31, | |
|---|---|---|
| | 2002 | 2003 |
| Accrued compensation and benefits | $ 3,843 | $16,655 |
| Course development fees | 801 | 1,322 |
| Professional fees | 1,537 | 10,121 |
| Accrued payables | 3,363 | 8,300 |
| Accrued merger related costs | 1,823 | 12,304 |
| Sales tax payable/VAT payable | -- | 7,723 |
| Accrued royalties | -- | 2,359 |
| Accrued hosting | -- | 1,037 |
| Total accrued expenses | $11,367 | $59,821 |

(15) VALUATION & QUALIFYING ACCOUNTS

ALLOWANCE FOR DOUBTFUL ACCOUNTS (AMOUNTS IN THOUSANDS)

| | BALANCE AT BEGINNING OF PERIOD | ADDITION CHARGED TO EXPENSE | DEDUCTIONS | OTHER | BALANCE AT END OF PERIOD |
|---|---|---|---|---|---|
| Year ended January 31, 2001 | $ 25 | $ 21 | $-- | $-- | $ 46 |
| Year ended January 31, 2002(1) | $ 46 | $164 | $-- | $59 | $269 |
| Year ended January 31, 2003 | $269 | $441 | $42 | $-- | $668 |

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(1) Other relates to amount acquired in an acquisition.



EXHIBIT INDEX

| EXHIBIT NO. | TITLE |
| --- | --- |
| 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. |
| 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)). |
| 4.5 | Declaration of Subscription Rights dated as of October 4, 1998 (Incorporated by reference to exhibit 4.1 to SkillSoft PLC's Report on Form 8-A filed with the Securities and Exchange Commission on October 5, 1998). |

| EXHIBIT NO. | TITLE |
|---|---|
| 4.6 | Amendment to Declaration of Subscription Rights, dated as of June 10, 2002, of SkillSoft PLC (Incorporated by reference to exhibit 4.1 to SkillSoft PLC's Current Report on Form 8-K dated June 10, 2002 (File No. 000-25674)). |
| 4.7 | Second Amendment to Declaration of Subscription Rights, dated as of October 9, 2002, of SkillSoft PLC (Incorporated by reference to exhibit 4.2 to SkillSoft PLC's Current Report on Form 8-K dated June 10, 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 be 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** | 1995 Employee Share Purchase Plan (Incorporated by reference to exhibit 10.3 to SkillSoft PLC's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2002 as filed with the Securities and Exchange Commission on August 14, 2002 (File No. 000-25674)). |

| EXHIBIT NO. | TITLE |
|---|---|
| 10.4** | 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 effective with the Securities and Exchange Commission on April 13, 1995 (File No. 333-89904)). |
| 10.5*** | Form of Indemnification Agreement between SmartForce (USA) and its directors and officers dated as of September 6, 2002 |
| 10.6** | 1996 Supplemental Stock Plan (Incorporated by reference to exhibit 10.16 to SkillSoft PLC's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 as filed with the Securities and Exchange Commission on March 30, 1997 (File No. 0-25674)). |
| 10.7** | 2002 Share Option Plan (Incorporated by reference to exhibit 10.34 to SkillSoft PLC's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2002 as filed with the Securities and Exchange Commission on August 14, 2002 (File No. 000-256740)). |
| 10.8** | 2001 Outside Director Option Plan (Incorporated by reference to exhibit 10.1 to SkillSoft PLC's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 as filed with |

| | |
|---|---|
| | the Securities and Exchange Commission on November 14, 2001 (File No. 000-25674)). |
| 10.9 | Agreement and Release, effective as of September 13, 2002, between SmartForce PLC and Jeff Newton (Incorporated by reference to exhibit 10.5 to SkillSoft PLC's Quarterly Report on Form 10-Q for the quarter ended October 31, 2002 as filed with the Securities and Exchange Commission on January 21, 2003 (File No. 000-25674)). |
| 10.10 | Separation Agreement and Release, effective as of May 8, 2002, between SmartForce PLC and Thomas Francis McKeagney (Incorporated by reference to exhibit 10.6 to SkillSoft PLC's Quarterly Report on Form 10-Q for the quarter ended October 31, 2002 as filed with the Securities and Exchange Commission on January 21, 2003 (File No. 000-25674)). |
| 10.11** | 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)). |
| 10.12** | 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)). |
| 10.13** | 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)). |
| 10.14 | 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)). |
| 10.15*** | Employment Agreement dated January 12, 1998 between SkillSoft Corporation and Mark A. Townsend. |
| 10.16*** | Employment Agreement dated January 12, 1998 between SkillSoft Corporation and Thomas J. McDonald. |
| 10.17*** | Employment Agreement dated effective September 6, 2002 between SkillSoft PLC and Colm Darcy. |
| 10.18**** | Lease dated February 18, 1998, as amended, between SkillSoft Corporation and Five N Associates. |
| 10.19**** | Fifth Supplemental Agreement dated November 26, 2001 to the Lease between SkillSoft Corporation and Five N Associates |
| 10.20**** | Lease dated May 25, 2001 between 1987 Tamposi Limited Partnership and SkillSoft Corporation. |

| EXHIBIT NO. | TITLE |
|---|---|
| 21.1**** | List of Significant Subsidiaries. |
| 23.1+ | Consent of Ernst & Young LLP |
| 23.2* | Information Regarding Consent of Arthur Andersen LLP. |
| 99.1* | Certifications of SkillSoft PLC's CEO and CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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* 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.

*** 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 and previously filed.

**** Previously filed.

+ To be filed by amendment.