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SKILLSOFT PUBLIC LIMITED CO
Form 10-Q
September 09, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JULY 31, 2004

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 000-25674

SKILLSOFT PUBLIC LIMITED COMPANY
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

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

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

03062
(ZIP CODE)

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

Not Applicable
(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

On August 31, 2004, the registrant had outstanding 105,740,369 Ordinary Shares (issued or issuable in exchange for the registrant's outstanding American Depository Shares).

SKILLSOFT PLC

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FORM 10-Q
FOR THE QUARTER ENDED JULY 31, 2004
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PART I

ITEM 1. - CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SKILLSOFT PLC AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED, IN THOUSANDS EXCEPT SHARE AND PER SHARE DATA)

	JULY 31, 2004	JAN -----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 72,816	\$
Short-term investments	14,027	
Restricted cash	400	
Accounts receivable, net	42,202	
Prepaid expenses and other current assets	16,947	
	-----	-----
Total current assets	146,392	
Property and equipment, net	8,532	
Acquired intangible assets, net	20,934	
Goodwill	125,570	
Long-term investments	209	
Other assets	71	
	-----	-----
Total Assets	\$ 301,708	\$
	=====	=====

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LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:			
Accounts payable		\$ 5,220	\$
Accrued expenses		52,069	
Deferred revenue		112,972	
		-----	-----
Total current liabilities		170,261	
Long term liabilities		21,678	
Stockholders' equity:			
Ordinary Shares, E0.11 par value: 250,000,000 shares authorized at July 31, 2004 and January 31, 2004, respectively; 105,707,513 and 101,857,714 shares issued and outstanding at July 31, 2004 and January 31, 2004, respectively		11,549	
Additional paid-in capital		556,907	
Accumulated deficit		(456,356)	(
Deferred compensation		(1,900)	
Accumulated other comprehensive loss		(431)	
		-----	-----
Total stockholders' equity		109,769	
		-----	-----
Total liabilities and stockholders' equity		\$ 301,708	\$
		=====	=====

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

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

	THREE MONTHS ENDED	
	JULY 31,	
	2004	2003
	----	----
Revenue	\$ 50,625	\$ 45,109
Cost of revenue	5,257	4,180
	-----	-----
Gross profit	45,368	40,929
Operating expenses:		
Research and development	12,639	12,650
Selling and marketing	22,664	23,227
General and administrative	6,182	6,401
Litigation settlement	--	44,000
Amortization of intangible assets	2,390	2,518
Amortization of stock-based compensation (1)	300	471
Restructuring and other non-recurring charges	1,090	4,986
	-----	-----
Total operating expenses	45,265	94,253
	-----	-----
Operating income/(loss)	103	(53,324)
Other (expense)/income, net	(32)	17
Interest income, net	241	231
Gain on sale of investments, net	--	--
	-----	-----

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Income/(loss) before provision for income taxes	312	(53,076)
(Benefit from)/provision for income taxes	(1,045)	150
Net income/(loss)	\$ 1,357	\$ (53,226)
Net income/(loss) per share (Note 9):		
Basic	\$ 0.01	\$ (0.53)
Basis weighted average common shares outstanding	105,421,510	99,615,128
Diluted	\$ 0.01	\$ (0.53)
Diluted weighted average common shares outstanding	110,555,106	99,615,128

(1) The following summarizes the departmental allocation of the stock-based compensation

	THREE MONTHS ENDED JULY 31,		SIX MONTHS ENDED JULY 31,	
	2004	2003	2004	2003
Cost of revenue	\$ --	\$ 1	\$ --	\$ 2
Research and development	79	116	158	239
Selling and marketing	208	163	464	336
General and administrative	13	191	26	384
	-----	-----	-----	-----
	\$ 300	\$ 471	\$ 648	\$ 961
	=====	=====	=====	=====

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

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

Cash flows from operating activities:
Net income/(loss)
Adjustments to reconcile net income/(loss) to net cash used in operating activities -
Stock-based compensation
Depreciation and amortization
Amortization of intangible assets
Provision for bad debts
Provision for income tax - non-cash

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Realized gain on sale of investments
Changes in current assets and liabilities:
 Accounts receivable
 Prepaid expenses and other current assets
 Accounts payable
 Accrued expenses
 Deferred revenue

Net cash used in operating activities
Cash flows from investing activities:
 Purchases of property and equipment
 Purchases of investments
 Maturity of investments
 Sale of investments
 Other assets
 Net cash used for a business combination
 Release/(designation) of restricted cash

Net cash provided by investing activities
Cash flows from financing activities:
 Proceeds from exercise of stock options and employee stock purchase plan
 Repayment of note receivable

Net cash provided by financing activities
Effect of exchange rate changes on cash and cash equivalents

Net increase/(decrease) in cash and cash equivalents
Cash and cash equivalents, beginning of period

Cash and cash equivalents, end of period

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

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

1. THE COMPANY

SkillSoft PLC, formerly known as SmartForce PLC (the Company or SkillSoft), was incorporated in Ireland on August 8, 1989. The Company is a leading provider of content resources and complimentary technologies for integrated enterprise learning. 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

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SkillSoft Corporation) from December 31 (the Company's historical fiscal year end).

2. BASIS OF PRESENTATION

The accompanying, unaudited condensed consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of management, the condensed consolidated financial statements reflect all material adjustments (consisting only of those of a normal and recurring nature) which are necessary to present fairly the consolidated financial position of the Company as of July 31, 2004, the results of its operations for the three and six months ended July 31, 2004 and 2003 and its cash flows for the six months ended July 31, 2004 and 2003. These condensed consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2004. The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year.

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

The Company considers all highly liquid investments with original maturities of 90 days or less at the time of purchase to be cash equivalents. At July 31, 2004 and January 31, 2004, cash equivalents consisted mainly of commercial paper, short-term notes and money market funds. The Company considers the cash held in certificates of deposit with a commercial bank to secure its letter of credit to be restricted cash. The Company accounts for its investments in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS No. 115). Under SFAS No. 115, securities that the Company does not intend to hold to maturity are reported at market value, and are classified as available-for-sale. At July 31, 2004, the Company's investments had an average maturity of approximately 38 days. These investments are classified as current assets in the accompanying consolidated balance sheets as they mature within one year.

4. 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 SkillChoice multi-modal learning (SMML) licenses varies based on the choice of SMML, content offering selected by the customer,

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the number of users within the customer's organization and the length of the license agreement. A SMML license provides customers access to a full range of learning products including courseware, Referenceware, 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 offers discounts from its ordinary pricing, and purchasers of licenses for larger numbers of courses, for larger user bases or for longer periods generally receive discounts. Generally, customers may amend their license agreements, for an additional fee, to gain access to additional courses or product lines and/or to increase the size of the user base. The Company also derives revenue from hosting fees for clients that use its solutions on an application service provider (ASP) basis, on-line mentoring services and professional services. In selected circumstances, the Company derives revenue on a pay-for-use basis under which some customers are charged based on the number of courses accessed by users. Revenue derived from pay-for-use contracts has been minimal to date.

The Company recognizes revenue ratably over the license period if the number of courses that a customer has access to is not clearly defined, available, or selected at the inception of the contract, or if the contract has additional undelivered elements for which the Company does not have vendor specific objective evidence (VSOE) of the fair value of the various elements. This may occur if the customer does not specify all licensed courses at the outset, the customer chooses to wait for future licensed courses on a when and if available basis, the customer is given exchange privileges that are exercisable other than on the contract anniversaries, or the customer licenses all courses currently available and to be developed during the term of the arrangement. Nearly all of the Company's contractual arrangements result in the recognition of revenue ratably over the license period; consequently, substantially all of the Company's revenue is recognized on a ratable basis.

The Company also derives revenue from extranet hosting/ASP services and online mentoring services. The Company recognizes revenue related to extranet hosting/ASP services and online mentoring services on a straight-line basis over the period the services are provided.

The Company generally bills the annual license fee for the first year of a multi-year agreement in advance and license fees for subsequent years of multi-year license arrangements are billed on the anniversary date of the agreement. Occasionally, the Company will bill customers on a quarterly basis. In some circumstances, the Company offers payment terms of up to six months from the initial shipment date or anniversary date for multi-year 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 on Referenceware and SMML 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 both the final sale to the end user and the receipt of cash from the reseller. With respect to reseller agreements with minimum commitments, the Company recognizes revenue related to the portion of the minimum commitment that exceeds the end user sales at the expiration of the commitment period provided the Company has

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received payment.

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

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The Company records as deferred revenue amounts that 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 90 days or less for resellers and 180 days or less for direct customers. In addition, deferred revenue includes amounts which have been billed and not collected for which revenue is being recognized ratably over the license period.

5. ACCOUNTING FOR STOCK-BASED COMPENSATION

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

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

	THREE MONTHS ENDED JULY 31, -----		SIX MONTHS JULY -----
	2004 ----	2003 ----	2004 ----
Risk-free interest rates	4.11% - 4.35%	2.84% - 3.45%	3.31%-4.35%
Expected dividend yield	--	--	--
Volatility factor	89%	98%	90%
Expected lives	7 years	7 years	7 years
Weighted average fair value of options granted	\$ 7.50	\$ 3.75	\$ 9.44
Weighted average remaining contractual life of options outstanding	7.31 years	8.04 years	7.31 years

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

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	THREE MONTHS ENDED JULY 31,	
	----- 2004 ----	----- 2003 ----
Net income/(loss) --		
As reported	\$ 1,357	\$ (53,226)
Add: Stock-based compensation expense recognized under APB No. 25	300	471
Less: Total stock-based compensation expense determined under fair value based method for all awards	(6,640)	(5,220)
Pro forma net loss	----- \$ (4,983) =====	----- \$ (57,975) =====
Basic and diluted net income/(loss) per share --		
As reported	\$ 0.01	\$ (0.53)
Pro forma net loss	----- \$ (0.05) =====	----- \$ (0.58) =====

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

6. RESTRUCTURING AND OTHER NON-RECURRING CHARGES

MERGER AND EXIT COSTS

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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 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 Emerging Issues Task Force (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 increased 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 \$14.4 million. Approximately \$11.9 million was paid out against the exit plan accrual through July 31, 2004, and the remaining amount of \$2.5 million, is expected to be paid by January 2005.

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 part of the plan, 11 sites have been vacated and 4 sites have been downsized. 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

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property will remain vacant, (2) sublease terms and (3) sublease rates. The lease loss is an estimate under SFAS No. 5 "Accounting for Contingencies" (SFAS No. 5). In the year ended January 31, 2004, the Company revised certain of its estimates made in connection with the original purchase price pertaining to unoccupied facilities under lease as a result of the Merger. This adjustment to the exit plan accrual falls within the one year purchase price allocation period prescribed by SFAS No. 141 "Business Combinations" (SFAS No. 141). The net present value of these obligations was approximately \$14.5 million.

During the six months ended July 31, 2004, activity in the Company's merger and exit costs, which are included in accrued expenses (see Note 13) and long-term liabilities, was as follows (in thousands):

	EMPLOYEE SEVERANCE AND RELATED COSTS	CLOSEDOWN OF FACILITIES	OTH
Merger and exit accrual January 31, 2004	\$ 2,831	\$ 9,073	\$
Payments made during the three months ended April 30, 2004	(241)	(1,035)	
	-----	-----	-----
Merger and exit accrual April 30, 2004	2,590	8,038	
Payments made during the three months ended July 31, 2004	(45)	(917)	
	-----	-----	-----
Merger and exit accrual July 31, 2004	\$ 2,545	\$ 7,121	\$
	=====	=====	=====

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

Year ended January 31, 2005	\$ 4,400
Year ended January 31, 2006	1,965
Year ended January 31, 2007	1,105
Year ended January 31, 2008	1,099
Thereafter	1,537

Total	\$ 10,106
	=====

RESTRUCTURING AND OTHER NON-RECURRING CHARGES

The Company recorded a \$14.2 million restructuring charge for the year ended January 31, 2003, which was 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.

During the six months ended July 31, 2004, the Company recorded and paid an additional \$322,000 of restructuring and non-recurring charges related to further restructuring of the pre-Merger SmartForce PLC operations. These restructuring costs included additional compensation to pre-Merger SmartForce

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PLC employees as well as additional facilities obligations as a result of the Merger. During the six month period ended July 31, 2004, activity in the Company's restructuring accrual related to the Merger was as follows (in

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thousands):

	EMPLOYEE SEVERANCE AND RELATED COSTS	CONTRACTUAL OBLIGATIONS
Restructuring accrual January 31, 2004	\$ --	\$ 84
Restructuring charge for the quarter ended April 30, 2004	53	94
Payments made during the quarter ended April 30, 2004	(53)	(94)
	-----	-----
Restructuring accrual April 30, 2004	--	84
Restructuring charge for the quarter ended July 31, 2004	175	--
Payments made during the quarter ended July 31, 2004	(175)	(84)
	-----	=====
Restructuring accrual July 31, 2004	\$ --	\$ --
	=====	=====

The restructuring charges for the three and six months ended July 31, 2004 would have been allocated as follows had the Company recorded the expense within the functional department of the restructured activities (in thousands):

	THREE MONTHS ENDED JULY 31, 2004	SIX MONTHS ENDED JULY 31, 2004
Cost of sales	\$ --	\$ --
Research and development	63	72
Sales and marketing	(18)	26
General and administrative	130	224
	-----	-----
Total	\$ 175	\$ 322
	=====	=====

Consistent with the Company's accounting policy and historical treatment regarding annual audit fees, the Company accrued the estimated audit fees related to the restatement of the historical SmartForce PLC financial statements, the acquired business, in the year ended January 31, 2003. All other costs associated with the restatement, the resulting SEC investigation, and the 2002 shareholder lawsuit are expensed as the work is performed. For the three and six months ended July 31, 2004, the Company recorded \$914,000 and \$1.4 million, respectively, in expenses related to the re-filing of statutory tax returns as a result of the restatement of the historical SmartForce PLC financial statements and the ongoing SEC investigation. For the three and six months ended July 31, 2003, the Company recorded \$4.6 million and \$10.0 million, respectively, in expenses related to the restatement, consisting primarily of professional fees, including legal, accounting and other consulting fees.

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7. GOODWILL AND INTANGIBLE ASSETS

On February 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangibles" (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 acquisitions of Books and GoTrain Corp. (GoTrain), 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 were as follows (in thousands):

	JULY 31, 2004			
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARRYING AMOUNT	GROSS CARRYING AMOUNT
	-----	-----	-----	-----
Internally developed software/courseware	\$ 26,610	\$ 13,065	\$ 13,545	\$ 26,610
Customer contracts	13,018	6,529	6,489	13,018
Trademarks and trade name	900	--	900	900
	-----	-----	-----	-----
	40,528	19,594	20,934	40,528
Goodwill	125,570	--	125,570	125,570
	-----	-----	-----	-----
	\$ 166,098	\$ 19,594	\$ 146,504	\$ 166,098
	=====	=====	=====	=====

Customer contracts are existing contracts that relate to underlying customer relationships pertaining to the services provided by the acquired company. The Company is amortizing 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, GoTrain content and platform, and the SmartForce PLC content.

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Course content includes courses in both soft skills and information technology. All courseware is deployable via the Internet or corporate intranets.

The change in goodwill at July 31, 2004 from the amount recorded at January 31, 2004 was due to collections of accounts receivable in excess of the estimated realizable value at the purchase date and the company's utilization of net operating loss carryforwards obtained as part of the Merger.

Amortization expense for the three and six months ended July 31, 2004 was as follows (in thousands):

THREE MONTHS ENDED JULY 31, 2004	SIX MONTHS ENDED JULY 31, 2004
-----	-----

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Internally developed software/courseware	\$ 1,714	\$ 3,454
Customer contracts	676	1,358
	-----	-----
	\$ 2,390	\$ 4,812
	=====	=====

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

FISCAL YEAR	AMORTIZATION EXPENSE
-----	-----
2005	\$ 9,575
2006	8,592
2007	5,345
2008	1,321
2009	13

The Company will be conducting its annual impairment test of goodwill in the fourth quarter of the fiscal year ending January 31, 2005.

8. COMPREHENSIVE INCOME/(LOSS)

SFAS No. 130, "Reporting Comprehensive Income" requires disclosure of all components of comprehensive income/(loss) on an annual and interim basis. Comprehensive income/(loss) is defined as the change in equity of a business enterprise during a period resulting from transactions, other events and circumstances related to non-owner sources. The components of comprehensive income/(loss) for the three and six months ended July 31, 2004 and 2003 were as follows (in thousands):

	THREE MONTHS ENDED JULY 31,		SIX
	2004	2003	2004
	----	----	----
Comprehensive income/(loss):			
Net income/(loss)	\$ 1,357	\$ (53,226)	\$ 4,5
Other comprehensive income/(loss):			
Foreign currency adjustment	(243)	567	
Unrealized holding (losses)/gains during the period	(58)	50	
Less: reclassification adjustment for gains included in net income/(loss)	--	--	
	-----	-----	-----
Comprehensive income/(loss)	\$ 1,056	\$ (52,609)	\$ 4,5
	=====	=====	=====

9. NET INCOME/(LOSS) PER SHARE

Basic net income/(loss) per share was computed using the weighted average number of shares outstanding during the period. Diluted net income/(loss) per share was computed by giving effect to all dilutive potential shares outstanding. Basic and diluted net loss per share for the three and six months ended July 31, 2003

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are the same as outstanding options, and unvested restricted shares, which aggregated 25,291,366 shares, are antidilutive as the Company recorded a net loss for the periods. The weighted average number of shares outstanding used to compute basic net income/(loss) per share and diluted net income/(loss) per share was as follows:

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	THREE MONTHS ENDED JULY 31,		
	2004	2003	
	----	----	
Basic weighted average shares outstanding	105,421,510	99,615,128	10
Effect of dilutive shares outstanding	5,133,596	--	--
	-----	-----	--
Weighted average common shares outstanding, as adjusted	110,555,106	99,615,128	11
	=====	=====	==

10. INCOME TAXES

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

The Company has significant net operating loss (NOL) carryforwards, some of which are subject to potential limitations based upon the change in control provisions of Section 382 of the Internal Revenue Code.

The (benefit from)/provision for income tax was (\$1.1) million and \$150,000 in the three months ended July 31, 2004 and 2003, respectively. During the three months ended July 31, 2004, the Company reversed approximately \$1.1 million of tax expense as the Company now expects to utilize tax attributes other than acquired NOL carryforwards, and as such has adjusted its tax provision accordingly. For the three months ended July 31, 2003 the tax provision consists of income taxes payable in certain foreign locations, which cannot be offset through NOL carryforwards, and minimum taxes.

For the six months ended July 31, 2004, the Company recorded a tax provision of approximately \$220,000, representing an effective tax rate of approximately 4.6% because the Company expects to utilize tax attributes other than acquired NOL carryforwards, and therefore, the tax provision reflects primarily foreign taxes and US alternative minimum tax.

11. COMMITMENTS AND CONTINGENCIES

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

	PAYMENTS DUE BY		
	LESS THAN	1-3	Y
TOTAL	1 YEAR	YEARS	Y
-----	-----	-----	-----

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Operating Lease Obligations	\$ 41,016	\$ 7,304	\$ 10,581	\$
	-----	-----	-----	---
TOTAL	\$ 41,016	\$ 7,304	\$ 10,581	\$
	=====	=====	=====	==

The Company has entered into agreements to settle certain litigation matters, and the future commitments under these agreements are as follows (in thousands):

LITIGATION SETTLEMENT COMMITMENTS	TOTAL	PAYMENTS DUE BY LESS THAN 1 YEAR	
-----	-----	-----	
2002 Securities class action	\$ 31,500	\$ 16,250	\$
	-----	-----	---
TOTAL	\$ 31,500	\$ 16,250	\$
	=====	=====	==

In March 2004, the Company reached a settlement of the class action litigation filed in 2002, which alleged 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. Under the terms of the settlement, the Company has agreed to pay \$30.5 million, with one-half paid in August 2004 (following preliminary approval of the settlement by the court) and the second-half to be paid in fiscal 2006. The Company is in discussions with its insurers and hopes they will contribute a portion of the settlement amount. The settlement is subject to final court approval. The Company recorded the aggregate settlement as a charge in its fiscal 2004 fourth quarter; any reimbursement from the Company's insurers will be recorded in the period in which it is executed and finalized.

On July 21, 2003, the Company entered into a settlement agreement with NETg relating to patent infringement, which resulted in a final dismissal and termination of the NETg litigation. Under the terms of the settlement agreement, the Company has agreed to pay a total of \$44,000,000 in two equal installments of \$22,000,000.

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The Company made the first payment of \$22,000,000 on July 25, 2003. The second payment of \$22,000,000 was made on July 21, 2004. The Company expensed this settlement in the three months ended July 31, 2003.

On December 1, 2003, the Company agreed to settle the securities class action lawsuit filed against it, one of its subsidiaries and certain of its former and current officers and directors in 1998. The lawsuit, which was filed in the United States District Court for the Northern District of California, asserted violations of the federal securities laws. Under the terms of the settlement, the Company made a \$10 million cash payment in January 2004 and made an additional \$6 million payment on July 2, 2004. The Company's insurance carriers will pay an additional \$16 million for total settlement payments of \$32 million. The court granted final approval of the settlement and the litigation was dismissed with prejudice on February 27, 2004.

12. DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE

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The Company follows the provisions of SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" (SFAS No. 131). SFAS No. 131 established standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to shareholders. SFAS No. 131 also established standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision-making group, in making decisions of 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 -- SkillChoice multi-modal learning and retail certification.

Revenue for the three months ended July 31, 2004 for the SkillChoice multi-modal learning and retail certification segments was approximately \$45.8 million and \$4.8 million, respectively. Revenue for the six months ended July 31, 2004 for the SkillChoice multi-modal learning and retail certification segments was approximately \$94.1 million and \$9.3 million, respectively. Revenue for the three months ended July 31, 2003 for the SkillChoice multi-modal learning and retail certification segments was approximately \$41.9 million and \$3.2 million, respectively. Revenue for the six months ended July 31, 2003 for the SkillChoice multi-modal learning and retail certification segments was approximately \$83.2 million and \$5.5 million, respectively. Net income for the three months ended July 31, 2004 for the SkillChoice multi-modal learning and retail certification segments was approximately \$1.3 million and \$0.1 million, respectively. Net income for the six months ended July 31, 2004 for the SkillChoice multi-modal learning and retail certification segments was approximately \$4.4 million and \$0.2 million, respectively. Net loss for the three months ended July 31, 2003 for the SkillChoice multi-modal learning and retail certification segments was approximately \$52.3 million and \$0.9 million, respectively. Net loss for the six months ended July 31, 2003 for the SkillChoice multi-modal learning and retail certification segments was approximately \$63.4 million and \$2.4 million, respectively.

The Company attributes revenues to different geographical areas on the basis of the location of the customer. Revenues by geographical area for the three and six months ended July 31, 2004 and 2003 were as follows (in thousands):

	THREE MONTHS ENDED JULY 31, -----		SIX MONTHS ENDED JULY 31, -----	
	2004 ----	2003 ----	2004 ----	2003 ----
Revenue:				
United States	\$ 40,014	\$ 35,356	\$ 80,936	\$ 71,996
United Kingdom	4,071	3,234	8,351	5,196
Canada	1,881	1,674	3,917	2,619
Europe, excluding UK	2,214	3,685	4,677	7,032
Australia/New Zealand	1,532	951	3,279	1,568
Other	913	209	2,282	311
	-----	-----	-----	-----
Total revenue	\$ 50,625	\$ 45,109	\$ 103,442	\$ 88,722
	=====	=====	=====	=====

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

13. ACCRUED EXPENSES

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

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	JULY 31, 2004	JANUARY 31, 2004
	-----	-----
Accrued compensation and benefits	\$ 12,176	\$ 19,787
Course development fees	1,249	1,518
Professional fees	2,594	3,410
Accrued payables	1,873	2,703
Accrued misc. taxes	2,357	2,357
Accrued merger related costs*	6,515	6,919
Sales tax payable/VAT payable	2,140	2,513
Accrued royalties	1,747	1,351
Accrued litigation settlements	16,250	44,250
Other accrued liabilities	5,168	7,309
	-----	-----
Total accrued expenses	\$ 52,069	\$ 92,117
	=====	=====

* Includes \$2,238 of accrued income taxes

14. LINE OF CREDIT

On July 23, 2004, the Company entered into a \$25 million two year, working capital line of credit with a bank. Under the terms of the line of credit, the bank has a first security interest in all domestic business assets. All borrowings under the line of credit bear interest at the bank's prime rate. The facility is subject to a commitment fee of \$50,000 to secure the line of credit and unused commitment fees of 0.125% based upon the daily average of un-advanced amounts under the revolving line of credit. In addition, the line of credit contains certain financial and non-financial covenants. At July 31, 2004, the Company is in compliance with all financial and non-financial covenants. As of July 31, 2004, there were no borrowings on the line of credit; however, the Company had an outstanding letter of credit of \$400,000 that was secured with a certificate of deposit.

15. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2003, the FASB issued Interpretation No. 46 (FIN 46R) (revised December 2003), "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51" (ARB 51), which addressed how a business enterprise should evaluate whether it has a controlling interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaced FASB Interpretation No. 46 (FIN 46), which was issued in January 2003. Before concluding that it is appropriate to apply ARB 51 voting interest consolidation model to an entity, an enterprise must first determine that the entity is not a variable interest entity (VIE). As of the effective date of FIN 46R, an enterprise must evaluate its involvement with all entities or legal structures created before February 15, 2003 and no later than the end

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of the first reporting period that ends after March 15, 2004 for all other entities. The adoption of FIN 46 had no effect on the Company's consolidated financial position, results of operations or cash flows.

In August 2003, the FASB issued EITF 03-05 ("EITF 03-05"), "Applicability of AICPA Statement of Position 97-2, Software Revenue Recognition, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software," which provides guidance on whether non-software deliverables (e.g., non-software related equipment or services) included in an arrangement that contains software that is more than incidental to the products or services as a whole are included within the scope of AICPA Statement of Position 97-2, Software Revenue Recognition. The guidance in EITF 03-05 is effective for arrangements entered into in the first reporting period (annual or interim) beginning after August 13, 2003. The adoption of EITF 03-05 did not have a material impact on the Company's financial position or results of operations.

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

Any statement in this Quarterly Report on Form 10-Q about our future expectations, plans and prospects, including statements containing the words "believes," "anticipates," "plans," "expects," "will" and similar expressions, constitute forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those indicated by such forward-looking statements as a result of various important factors, including those set forth in this Item 2 under the heading "Future Operating Results."

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

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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 information technology (IT) e-learning content with SkillSoft Corporation's extensive suite of business skills e-learning courseware, as well as its IT and business Referenceware libraries.

The merger of SmartForce PLC 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.

We are a leading provider of multi-modal content resources and complimentary technologies for integrated enterprise learning. SkillChoice multi-modal learning (SMML) solutions offer powerful tools to support and enhance the speed and effectiveness of both formal and informal learning processes. SMML solutions integrate our in-depth courseware, learning management platform technology and support services to meet our customers' learning needs.

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We primarily derive revenue from 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.

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

A Referenceware license from our subsidiary, Books24x7.com (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 recognize revenue ratably over the license period if the number of courses that a customer has access to is not clearly defined, available, or selected at the inception of the contract, or if the contract has additional undelivered elements for which we do not have vendor specific objective evidence (VSOE) of the fair value of the various elements. This may occur if the customer does not specify all licensed courses at the outset, the customer chooses to wait for future licensed courses on a when and if available basis, the customer is given exchange privileges that are exercisable other than on the contract anniversaries, or the customer licenses all courses currently available and to be developed during the term of the arrangement. Nearly all of our contractual arrangements result in the recognition of revenue ratably over the license period; consequently, substantially all of our revenue is recognized on a ratable basis.

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

We generally bill the annual license fee for the first year of a multi-year agreement in advance and license fees for subsequent years of multi year license arrangements are billed on the anniversary date of the agreement. Occasionally, we bill customers on a quarterly basis. In some circumstances, we offer payment terms of up to six months from the initial shipment date or anniversary date for

multi-year agreements to our customers. To the extent that a customer is given

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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 on Referenceware and SMML 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 both the final sale to the end user and the receipt of cash from the reseller. 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 provided we have received payment.

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

We record as deferred revenue amounts that have been billed in advance of products or services provided. Deferred revenue that 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 90 days or less for resellers and 180 days or less for direct customers. In addition, deferred revenue includes amounts, which have been billed and not collected, for which revenue is being recognized ratably over the license period.

Cost of revenue includes the cost of materials (such as storage media), packaging, shipping and handling, CD duplication, the cost of online mentoring and hosting services, royalties and certain infrastructure and occupancy expenses. We generally recognize these costs as incurred. Research and development expenses consist primarily of salaries and benefits, certain infrastructure and occupancy expenses, fees to consultants and course content development fees. We account for software development costs in accordance with Statement of Financial Accounting Standards (SFAS) No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed," which requires the capitalization of certain computer software development costs incurred after technological feasibility is established. To date 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 vested options assumed in the Books acquisition and the Merger, and (2) difference between the exercise or sale price of share 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 share option or shares.

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

Restructuring and other non-recurring charges primarily consist of charges associated with, and as a result of, the restatement of SmartForce's financial statements for 1999, 2000, 2001 and the first two quarters of 2002, the re-filing of statutory tax returns as a result of the restatement, charges for the ongoing SEC investigation, and costs associated with international restructuring activities.

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CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are more fully described in Note 2 of the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K as filed with the SEC on April 15, 2004. However, we believe the accounting policies described below are particularly important to the portrayal and understanding of our financial position and results of operations and require application of significant judgment by our management. In applying these policies, management uses its judgment in making certain assumptions and estimates.

REVENUE RECOGNITION

We 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 (SAB) No. 104 "Revenue Recognition".

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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 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 of this Item 2 concerning how we recognize revenue.

IMPAIRMENT OF GOODWILL

We review the carrying value of goodwill in each fiscal fourth quarter 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. We reevaluate goodwill for possible impairment quarterly. An independent third party valuation of the goodwill asset is conducted in each fiscal fourth quarter.

LEGAL CONTINGENCIES

In connection with any material legal proceedings that we may become involved in, management periodically reviews estimates of potential costs to be incurred by us in connection with the adjudication or settlement, if any, of these

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proceedings. These estimates are developed in consultation with our outside counsel and are based on an analysis of potential litigation outcomes and settlement strategies. In accordance with SFAS No. 5, "Accounting for Contingencies", loss contingencies are accrued if, in the opinion of management, an adverse outcome is probable and such outcome can be reasonably estimated. In accordance with SFAS No. 5, gain contingencies are accrued if, in the opinion of management, a favorable outcome is probable and such outcome can be reasonably estimated. We note that legal costs are expensed as incurred.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JULY 31, 2004 VERSUS THREE MONTHS ENDED JULY 31, 2003

	DOLLAR INCREASE/ (DECREASE) 2003/2004 (IN THOUSANDS)	QUARTER ENDED JULY 31 PERCENT CHANGE INCREASE/ (DECREASE) 2003/2004
	-----	-----
Revenue	\$ 5,516	12%
Cost of revenue	1,077	26%
	-----	-----
Gross margin	4,439	11%
	-----	-----
Operating expenses:		
Research and development	(11)	0%
Selling and marketing	(563)	(2%)
General and administrative	(219)	(3%)
Legal settlements	(44,000)	(100%)
Amortization of intangible assets	(128)	(5%)
Amortization of stock-based compensation	(171)	(36%)
Restructuring and other non-recurring charges	(3,896)	(78%)
	-----	-----
Total operating expenses	(48,988)	(52%)
	-----	-----
Operating income/(loss)	53,427	100%
	-----	-----

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	DOLLAR INCREASE/ (DECREASE) 2003/2004 (IN THOUSANDS)	QUARTER ENDED JULY 31 PERCENT CHANGE INCREASE/ (DECREASE) 2003/2004
	-----	-----
Other income/(expense), net	(49)	(288%)
Interest income, net	10	4%
Gain on sale of investments, net	--	--
	-----	-----
Income/(loss) before provision for income taxes	53,388	101%
(Benefit from)/provision for income taxes	(1,195)	(797%)
	-----	-----
Net income/(loss)	\$ 54,583	103%
	=====	=====

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COMPARISON OF THE QUARTERS ENDED JULY 31, 2004 AND 2003

REVENUE

Revenue increased \$5.5 million, or 12%, to \$50.6 million in the quarter ended July 31, 2004 from \$45.1 million in the quarter ended July 31, 2003. This increase was primarily due to revenue generated from new business and renewal business. For the fiscal year ended January 31, 2004, we experienced improvement in renewal rates. We exited the year ended January 31, 2004 with noncancellable backlog, which consists of deferred revenue and committed contracts, of approximately \$170 million as compared to \$135 million at January 31, 2003. The increase in noncancellable backlog was due primarily to improved renewal rates, expanded offerings for SMML customers and new customers. These factors contributed favorably to revenue in the quarter ended July 31, 2004 when compared to the year ago quarter. Our review of the sales forecast for the remainder of the fiscal year indicates we expect to achieve our planned total annual booking number.

(IN THOUSANDS)	QUARTERS ENDED JULY 31,		
-----	2004	2003	CHANGE
-----	----	----	-----
Revenue:			
United States	\$ 40,014	\$ 35,356	\$ 4,658
International	10,611	9,753	858
-----	-----	-----	-----
Total	\$ 50,625	\$ 45,109	\$ 5,516
	=====	=====	=====

Revenue increased by 13% and 9% in the United States and internationally, respectively, in the quarter ended July 31, 2004 as compared to the quarter ended July 31, 2003. The international revenue increase was due, in addition to the factors discussed above, to increased reseller revenue due to the timing of receipt of sell-through reporting and cash from resellers. The United States represented 79% and 78% of revenue for the quarters ended July 31, 2004 and 2003, respectively.

(IN THOUSANDS)	QUARTERS ENDED JULY 31,		
-----	2004	2003	CHANGE
-----	----	----	-----
Revenue:			
SkillChoice Multi-Modal Learning	\$ 45,848	\$ 41,901	\$ 3,947
Retail Certification	4,777	3,208	1,569
-----	-----	-----	-----
Total	\$ 50,625	\$ 45,109	\$ 5,516
	=====	=====	=====

The SkillChoice multi-modal learning segment represented 91% and 93% of revenue for the quarters ended July 31, 2004 and 2003, respectively.

COSTS AND EXPENSES

Cost of revenue increased \$1.1 million, or 26%, to \$5.3 million in the quarter ended July 31, 2004 from \$4.2 million in the quarter ended July 31, 2003. Cost of revenue as a percentage of total revenue was 10% in the quarter ended July

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31, 2004 versus 9% in the quarter ended July 31, 2003. These increases were primarily due to a higher mix of royalty bearing revenue as well as increased headcount and infrastructure charges incurred in connection with the our efforts to consolidate hosting sites.

Research and development expenses decreased nominally in the quarter ended July 31, 2004 as compared to the quarter ended July 31, 2003. Research and development expenses as a percentage of total revenue decreased to 25% in the quarter ended July 31, 2004 from 28% in the quarter ended July 31, 2003. Research and development expenses for the quarter ended July 31, 2004 included a charge of \$2.3 million related to the purchase of technology and costs to modify and enhance the technology related to the development of our Virtual Classroom product offerings. We anticipate incurring approximately \$2.2 million of additional development expenses over the second half of fiscal 2005 to bring our Virtual Classroom offerings to market.

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Excluding the effects of the charge of \$2.3 million in the quarter ended July 31, 2004, research and development expenses decreased even more significantly when compared to the quarter ended July 31, 2003. This decrease was primarily due to the completion of initiatives related to content and platform improvements in the quarter ended January 31, 2004. With the substantial completion of the incremental investment in research and development, we expect research and development expenses to decrease in both absolute dollars and as a percentage of total revenue in the fiscal year ending January 31, 2005 when compared to the prior year.

Selling and marketing expenses decreased \$563,000, or 2%, to \$22.7 million in the quarter ended July 31, 2004 from \$23.2 million in the quarter ended July 31, 2003. The decrease was primarily due to lower marketing expenditures as well as a decline in certain infrastructure and occupancy charges. Selling and marketing expenses as a percentage of total revenue decreased to 45% in the quarter ended July 31, 2004 from 51% in the quarter ended July 31, 2003. The percentage decrease was primarily due to the increase in revenue from the quarter ended July 31, 2003 to the quarter ended July 31, 2004. We anticipate incurring incremental selling and marketing expenses over the second half of the year to introduce the Virtual Classroom offerings to the market. 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 in absolute dollars, but decrease as a percentage of total revenue when comparing fiscal 2005 results to fiscal 2004 results.

General and administrative expenses decreased \$219,000, or 3%, to \$6.2 million in the quarter ended July 31, 2004 from \$6.4 million in the quarter ended July 31, 2003. General and administrative expenses as a percentage of total revenue decreased to 12% in the quarter ended July 31, 2004 from 14% in the quarter ended July 31, 2003. General and administrative expenses decreased primarily due to a reduction of litigation costs of \$681,000 and a decline in certain infrastructure and occupancy charges of \$150,000. These decreases were offset in part by increases in accounting and other consulting services of \$620,000. We anticipate that general and administrative expenses will increase in absolute dollars in the next several quarters, as compared to the three months ended July 31, 2004, due primarily to increases in the costs of operating as a public company such as Sarbanes-Oxley Act compliance, audit, legal and insurance.

Restructuring and other non-recurring charges decreased \$3.9 million, or 78%, to \$1.1 million in the quarter ended July 31, 2004 from \$5.0 million in the quarter ended July 31, 2003. The restructuring and non-recurring charges relate to the SmartForce-SkillSoft merger. The restructuring costs primarily consist of

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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. This was completed in the fiscal year ended January 31, 2004 and is the primary reason for the decrease in restructuring and other non-recurring items when comparing the three months ended July 31, 2004 to the three months ended July 31, 2003. Charges for the three months ended July 31, 2004 consist primarily of the re-filing of statutory tax returns as a result of the restatement of the SmartForce PLC historical financial statements, the ongoing SEC investigation and costs associated with international restructuring activities.

OTHER INCOME/(EXPENSE), NET

Other income/(expense) in the quarter ended July 31, 2004 was (\$32,000) as compared to \$17,000 in the quarter ended July 31, 2003. This change was primarily due to foreign currency fluctuations. Due to our multinational operations, our business is subject to fluctuations based upon changes in the exchange rates between the currencies we do business in.

(BENEFIT FROM)/PROVISION FOR INCOME TAXES

The (benefit from)/provision for income taxes was (\$1.1) million and \$150,000 in the quarters ended July 31, 2004 and 2003, respectively. During the second quarter ended July 31, 2004, we reversed approximately \$1.1 million of tax expense as we now expect to utilize tax attributes other than acquired NOL carryforwards, and as such have adjusted the tax provision accordingly.

SIX MONTHS ENDED JULY 31, 2004 VERSUS SIX MONTHS ENDED JULY 31, 2003

	DOLLAR INCREASE/(DECREASE) 2003/2004 (IN THOUSANDS)	SIX MONTHS ENDED JULY PERCENT CHANGE INCREASE/(DECREASE) 2003/2004
	-----	-----
Revenue	\$ 14,720	17%
Cost of revenue	658	7%
	-----	-----
Gross margin	14,062	18%
	-----	-----

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	DOLLAR INCREASE/(DECREASE) 2003/2004 (IN THOUSANDS)	SIX MONTHS ENDED JULY PERCENT CHANGE INCREASE/(DECREASE) 2003/2004
	-----	-----
Operating expenses:		
Research and development	(3,349)	(13%)
Selling and marketing	452	1%
General and administrative	(849)	(6%)
Legal settlements	(46,250)	(100%)
Amortization of intangible assets	(112)	(2%)
Amortization of stock-based compensation	(313)	(33%)

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Restructuring and other non-recurring charges	(9,863)	(85%)
	-----	-----
Total operating expenses	(60,284)	(41%)
	-----	-----
Operating income/(loss)	74,346	107%
	-----	-----
Other income/(expense), net	(232)	(1,105%)
Interest income, net	(230)	(39%)
Gain on sale of investments, net	(3,682)	(100%)
	-----	-----
Income/(loss) before provision for income taxes	70,202	107%
(Benefit from)/provision for income taxes	(159)	(42%)
	-----	-----
Net income/(loss)	\$ 70,361	107%
	=====	=====

COMPARISON OF THE SIX MONTHS ENDED JULY 31, 2004 AND 2003

REVENUE

Revenue increased \$14.7 million, or 17%, to \$103.4 million in the six months ended July 31, 2004 from \$88.7 million in the six months ended July 31, 2003. This increase was primarily due to revenue generated from new business and renewal business. For the fiscal year ended January 31, 2004, we experienced improvement in renewal rates. We exited the year ended January 31, 2004 with noncancellable backlog, which consists of deferred revenue and committed contracts, of approximately \$170 million as compared to \$135 million at January 31, 2003. The increase in noncancellable backlog was due primarily to improved renewal rates, expanded offerings for SMML customers and new customers. These factors contributed favorably to revenue in the six months ended July 31, 2004 when compared to the year ago six month period.

(IN THOUSANDS)	QUARTERS ENDED JULY 31,		
	2004	2003	CHANGE
-----	----	----	-----
Revenue:			
United States	\$ 80,936	\$ 71,996	\$ 8,940
International	22,506	16,726	5,780
	-----	-----	-----
Total	\$ 103,442	\$ 88,722	\$ 14,720
	=====	=====	=====

Revenue increased by 12% and 35% in the United States and internationally, respectively, in the six months ended July 31, 2004 as compared to the six months ended July 31, 2003. The international revenue increase was due, in addition to the factors discussed above, to increased reseller revenue due to the timing of receipt of sell-through reporting and cash from resellers. The United States represented 78% and 81% of revenue for the six months ended July 31, 2004 and 2003, respectively.

(IN THOUSANDS)	QUARTERS ENDED JULY 31,		
	2004	2003	CHANGE
-----	----	----	-----
Revenue:			

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SkillChoice Multi-Modal Learning	\$ 94,081	\$ 83,166	\$ 10,915
Retail Certification	9,361	5,556	3,805
	-----	-----	-----
Total	\$ 103,442	\$ 88,722	\$ 14,720
	=====	=====	=====

The SkillChoice multi-modal learning segment represented 91% and 94% of revenue for the six months ended July 31, 2004 and 2003, respectively.

COSTS AND EXPENSES

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Cost of revenue increased \$658,000, or 7%, to \$10.3 million in the six months ended July 31, 2004 from \$9.7 million in the six months ended July 31, 2003. This increase was primarily due to a higher mix of royalty bearing revenue as well as increased headcount and infrastructure charges incurred in connection with our efforts to consolidate hosting sites. Cost of revenue as a percentage of total revenue was 10% in the six months ended July 31, 2004 versus 11% in the six months ended July 31, 2003. The percentage decrease was primarily due to the increase in revenue from the six months ended July 31, 2003 to the six months ended July 31, 2004.

Research and development expenses decreased \$3.3 million, or 13%, to \$22.1 million in the six months ended July 31, 2004 from \$25.4 million in the six months ended July 31, 2003. Research and development expenses as a percentage of total revenue decreased to 21% in the six months ended July 31, 2004 from 29% in the six months ended July 31, 2003. Research and development for the six months ended July 31, 2004 included a charge of \$2.3 million related to the purchase of technology and costs to modify and enhance the technology related to the development of our Virtual Classroom product offerings. We anticipate incurring approximately \$2.2 million of additional development expenses over the second half of fiscal 2005 to bring our Virtual Classroom offerings to market. Excluding the effects of the \$2.3 million charge in the six months ended July 31, 2004, research and development decreased even more significantly when compared to the six months ended July 31, 2003. This decrease was primarily due to our completion of the initiative for content and platform improvements in the quarter ended January 31, 2004. With the substantial completion of the incremental investment in research and development we expect research and development expenses to decrease in both absolute dollars and as a percentage of total revenue in the fiscal year ending January 31, 2005 when compared to the prior year.

Selling and marketing expenses increased \$452,000, or 1%, to \$47.0 million in the six months ended July 31, 2004 from \$46.6 million in the six months ended July 31, 2003. The increase was primarily due to increased compensation and benefit costs of approximately \$1.5 million. This increase was partially offset by a decline in certain infrastructure and occupancy charges of \$830,000. Selling and marketing expenses as a percentage of total revenue decreased to 45% in the six months ended July 31, 2004 from 52% in the six months ended July 31, 2003. The percentage decrease was primarily due to the increase in revenue from the six months ended July 31, 2003 to the six months ended July 31, 2004. We anticipate incurring incremental selling and marketing expenses over the second half of the year to introduce the Virtual Classroom offerings to the market. 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 in absolute dollars, but decrease as a percentage of total revenue when comparing fiscal 2005 results to fiscal 2004 results.

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General and administrative expenses decreased \$849,000, or 6%, to \$12.2 million in the six months ended July 31, 2004 from \$13.1 million in the six months ended July 31, 2003. General and administrative expenses as a percentage of total revenue decreased to 12% in the six months ended July 31, 2004 from 15% in the six months ended July 31, 2003. General and administrative expenses decreased primarily due to a reduction of litigation costs of \$2.5 million and decline in certain infrastructure and occupancy charges of \$324,000 in the six months ended July 31, 2004 compared to the six months ended July 31, 2003. This decrease was offset in part by increases in accounting and other consulting services of \$1.6 million and increases in compensation related expenses of \$437,000. We anticipate that general and administrative expenses will increase in absolute dollars over the second half of the year due primarily to increases in the costs of operating as a public company such as Sarbanes-Oxley Act compliance, audit, legal and insurance.

Restructuring and other non-recurring charges decreased \$9.8 million, or 85%, to \$1.7 million in the six months ended July 31, 2004 from \$11.5 million in the six months ended July 31, 2003. The restructuring and non-recurring charges relate to the SmartForce-SkillSoft merger. 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. This was completed in the fiscal year ended January 31, 2004 and is the primary reason for the decrease in restructuring and other non-recurring items when comparing the six months ended July 31, 2004 to the six months ended July 31, 2003. Charges for the six months ended July 31, 2004 consist primarily of the re-filing of statutory tax returns as a result of the restatement of the SmartForce PLC historical financial statements, the ongoing SEC investigation and costs associated with international restructuring activities.

OTHER INCOME/(EXPENSE), NET

Other (expense)/income in the six months ended July 31, 2004 was (\$211,000) as compared to \$21,000 in the six months ended July 31, 2003. This change was primarily due to foreign currency fluctuations. Due to our multinational operations, our business is subject to fluctuations based upon changes in the exchange rates between the currencies we do business in.

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PROVISION FOR INCOME TAXES

The provision for income taxes was \$220,000 and \$379,000 in the six months ended July 31, 2004 and 2003, respectively. For the six months ended July 31, 2004 we have recorded an income tax provision of \$220,000, reflecting management's expectations that the effective tax rate for fiscal 2005 will be in a range of 4.5% to 6.0%.

LIQUIDITY AND CAPITAL RESOURCES

As of July 31, 2004, our principal source of liquidity was our cash and cash equivalents and short-term investments, which totaled \$86.8 million. This compares to \$61.3 million at January 31, 2004. In addition, we have \$400,000 in restricted cash securing a letter of credit.

Net cash used in operating activities was \$12.9 million for the six months ended July 31, 2004. Our net cash used in operating activities in the six months ended July 31, 2004 reflects primarily our net income of \$4.6 million, depreciation and amortization of \$7.2 million, a decrease in prepaid expenses and other current assets of \$7.8 million, and a decrease in accounts receivable of \$30.4 million, which was partially offset by a decrease of \$41.1 million in accrued

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expenses, primarily due to payments of \$28.0 million in litigation settlements, and a decrease in deferred revenue of \$20.9 million due to an increase in the percentage of quarterly billings as well as the seasonality of renewals.

Net cash provided by investing activities was \$24.4 million for the six months ended July 31, 2004. Maturity of investments, net of purchases (short and long-term), generated a net cash inflow of approximately \$4.4 million in the six months ended July 31, 2004. In addition, the reduction of designated restricted cash generated a cash inflow of \$24.6 million. These inflows were partially offset by expenditures for property, plant and equipment of \$4.7 million.

Net cash provided by financing activities was \$18.8 million for the six months ended July 31, 2004. These proceeds related to the exercise of stock options and stock purchases under our various stock plans and stock purchases under our 1995 Employee Share Purchase Plan.

Working capital deficit was approximately (\$23.9) million and (\$49.1) million as of July 31, 2004 and January 31, 2004, respectively. The increase in working capital in the six months ended July 31, 2004 was primarily due to net income of \$4.6 million, proceeds from exercises of stock options under our various stock plans and stock purchases under the 1995 Employee Share Purchase Plan of \$18.8 million, depreciation and amortization of \$7.2 million, which was offset primarily by purchases of property and equipment of \$4.7 million. Total assets were approximately \$301.7 million and \$342.4 million as of July 31, 2004 and January 31, 2004, respectively. As of July 31, 2004 and January 31, 2004, goodwill and separately identifiable intangible assets were \$146.5 million and \$151.6 million, respectively.

On July 23, 2004, we entered into a \$25 million two year, working capital line of credit with a bank. Under the terms of the line of credit, the bank has a first security interest in all domestic business assets. All borrowings under the line of credit bear interest at the bank's prime rate. The facility is subject to a commitment fee of \$50,000 to secure the line of credit and unused commitment fees of 0.125% based upon the daily average of un-advanced amounts under the revolving line of credit. In addition, the line of credit contains certain financial and non-financial covenants. At July 31, 2004, we are in compliance with all financial and non-financial covenants. As of July 31, 2004, there were no borrowings on the line of credit; however, we had an outstanding letter of credit of \$400,000 that was secured with a certificate of deposit.

As of January 31, 2004, prior to the filing of the Skillsoft Consolidated Group's federal tax return for the year ended January 31, 2004, which we anticipate filing on October 15, 2004, we had U.S. federal net operating loss carryforwards of approximately \$350.1 million, which are subject to potential limitations based upon change in control provisions of Section 382 of the Internal Revenue Code, available to reduce future income taxes, if any. We also had U.S. federal tax credit carryforwards of approximately \$3.0 million at January 31, 2004. Additionally, we had approximately \$86.7 million of net operating loss carryforwards in jurisdictions outside of the U.S. If not utilized, these carryforwards expire at various dates through the year ending January 31, 2024. Included in the \$350.1 million are approximately \$217.7 million of U.S. net operating loss carryforwards and \$365,000 of U.S. tax credit carryforwards that were acquired in the Merger and the purchase of Books. In addition, included in the \$86.7 million we have approximately \$62.7 million of net operating loss carryforwards in jurisdictions outside the U.S. acquired in the Merger and the purchase of Books. We will realize the benefits of these acquired net operating losses through reductions to goodwill and non-goodwill intangibles during the period that the losses are utilized to reduce tax payments. At January 31, 2004, we have approximately \$3.4 million of net operating loss carryforwards in the United States resulting from disqualifying dispositions. We will realize the benefit of these losses through increases to stockholder's equity in the periods in which the losses are utilized to reduce

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tax payments.

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

	TOTAL	LESS THAN 1 YEAR	PAYMENTS DUE BY PERIOD	
			1-3 YEARS	3-5 YEARS
	-----	-----	-----	-----
Contractual Obligations				
Operating Lease Obligations	\$ 41,016	\$ 7,304	\$ 10,581	\$ 7,424
	-----	-----	-----	-----
TOTAL	\$ 41,016	\$ 7,304	\$ 10,581	\$ 7,424
	=====	=====	=====	=====

We have entered into agreements to settle certain litigation matters, and the future commitments under these agreements are as follows (in thousands):

LITIGATION SETTLEMENT COMMITMENTS	TOTAL	PAYMENTS DUE BY PERIOD	
		LESS THAN 1 YEAR	1-3 YEARS
-----	-----	-----	-----
2002 Securities class action	\$ 31,500	\$ 16,250	\$ 15,250
	-----	-----	-----
TOTAL	\$ 31,500	\$ 16,250	\$ 15,250
	=====	=====	=====

We expect to continue to experience growth in capital expenditures and operating expenses, particularly in sales and marketing, through the end of the fiscal year ending January 31, 2005 as compared to the fiscal year ended January 31, 2004 in order to execute our business plan and achieve expected revenue growth. To the extent that our execution of the business plan results in increased sales, we expect to experience corresponding increases in deferred revenue, cash flow and prepaid expenses. In addition, we are required to make litigation settlement payments totaling \$31.5 million subsequent to July 31, 2004, of which \$15.25 million was paid in August 2004. We anticipate a payout of \$1.0 million before January 31, 2005 with the remaining \$15.25 due in the fiscal year ending January 31, 2006. We are in discussions with our insurers to determine how much, if any, of the settlement related to the 2002 securities class action lawsuits will be paid by them. Capital expenditures for the fiscal year ending January 31, 2005 are expected to be approximately \$9.5 million of which \$4.7 million has been expended through July 31, 2004. Also, we expect to disburse approximately \$6.9 million throughout the fiscal year ending January 31, 2005 against exit and restructuring plan accruals recorded in the fiscal years ended January 31, 2003 and 2004. We expect that the principal sources of funding for our operating expenses, capital expenditures, litigation settlement payments and other liquidity needs will be a combination of our available cash and cash equivalents and short-term investments (which totaled approximately \$86.8 million as of July

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31, 2004), and funds generated from future cash flows. 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. In addition, our cash needs may increase due to factors such as unanticipated developments in our business or significant acquisitions. The amount of cash generated from operations will be dependent upon the successful execution of our business plan. Although we do not foresee the need to raise additional capital, any unanticipated economic or business events could require us to raise additional capital to support operations.

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. We have settled several class action lawsuits that were filed following the announcement of the restatement.

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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. In March 2004, we reached a settlement, subject to final court approval for total settlement payments of \$30.5 million, one-half of which was paid in August 2004 following receipt of preliminary approval by the court and the balance to be paid one year later. Although we are in discussions with our insurers to determine how much, if any, of this settlement amount will be paid by them, we may not be able to recover any amount from our insurers.

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

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

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

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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 HAVE IDENTIFIED SIGNIFICANT DEFICIENCIES IN OUR DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS.

During the process of integrating the business processes, human resources, disclosure controls and procedures, and internal controls of SmartForce PLC and SkillSoft Corporation, 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 both the year-end and quarter-end financial closing process for the fiscal year ended January 31, 2003. External resources were engaged to assist management in both the year-end and quarter-end financial closing process and in identifying areas for improvement for the fiscal year ended January 31, 2003. In addition, in fiscal years ended January 31, 2003 and 2004, permanent resources and accounting process improvements were added and implemented to improve the non-U.S. finance operations, the financial closing process, and the overall internal control environment. Our independent auditors have informed us that they believe we have no material weaknesses in internal controls at January 31, 2004. However they have informed us of certain reportable conditions at that date, including financial and regulatory compliance reporting at non-U.S. subsidiaries of the former SmartForce PLC and our ability to process the financial closing cycle at certain subsidiaries.

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RISKS RELATED TO THE OPERATION OF OUR BUSINESS

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

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

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

SmartForce incurred substantial net losses prior to the Merger, including net losses of \$50.2 million in the six months ended June 30, 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 \$284 million for the fiscal year ended January 31, 2003 and \$113.3 million for the fiscal year ended January 31, 2004. We achieved profitability for the first time post-Merger in the first two quarters of the fiscal year ended January 31, 2005. However, we cannot guarantee that our combined business will sustain profitability in any future period.

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

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

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

- the size and timing of new/renewal agreements and upgrades;
- royalty rates;
- the announcement, introduction and acceptance of new products, product enhancements and technologies by us and our competitors;
- the mix of sales between our field sales force, our other direct sales channels and our telesales channels;
- general conditions in the U.S. or the international economy;
- the loss of significant customers;
- delays in availability of new products;
- product or service quality problems;
- seasonality -- due to the budget and purchasing cycles of our customers, we expect our revenue and operating results will generally be strongest in the second half of our fiscal year and weakest in the first half of our fiscal year;

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- 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

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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.

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

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

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.

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

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

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Many of our customer's users access our e-learning solutions over the Internet or through our customers' internal networks. Any factors that adversely affect Internet usage could disrupt the ability of those users to access our e-learning solutions, which would adversely affect customer satisfaction and therefore our business. For example, our ability to increase the effectiveness and scope of our services to customers is ultimately limited by the speed and reliability of both the Internet and our customers' internal networks. Consequently, the emergence and growth of the market for our products and services depends upon the improvements being made to the entire Internet as well as to our individual customers' networking infrastructures to alleviate overloading and congestion. If these improvements are not made, and the quality of networks degrades, the ability of our customers to use our products and services will be hindered and our revenues may suffer.

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

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

Since the Merger, we have recorded an aggregate of \$31.4 million in merger and exit costs and an aggregate of \$37.6 million of restructuring and other non-recurring charges. 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. 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

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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 could reduce the attractiveness of granting stock

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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 PROFITS AND LOSS OF MARKET SHARE.

The market for corporate education and training solutions is highly fragmented and competitive. We expect the market to become increasingly competitive due to the lack of significant barriers to entry. In addition to increased competition from new companies entering into the market, established companies are entering into the market through acquisitions of smaller companies, which directly compete with us, and this trend is expected to continue. We may also face competition from publishing companies 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 profits and loss of market share, any one of which would have a material adverse effect on our business. Many of our current and potential competitors have substantially greater financial, technical, sales, marketing and other resources, as well as greater name recognition, and we expect to face increasing price pressures from competitors as managers demand more value for their training budgets. Accordingly, we may be unable to provide e-learning solutions that compare favorably with new instructor-led techniques, other interactive training software or new e-learning solutions.

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

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operating results. Our expenses will not necessarily be incurred in the currency in which revenue is generated, and, as a result, we will be required from time to time to convert currencies to meet our obligations. These currency conversions are subject to exchange rate fluctuations, and changes to the value of the euro, pound sterling and other currencies relative to the U.S. dollar could adversely affect our business and results of operations.

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

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

Although we have taken steps to protect our proprietary rights, these steps may be inadequate. Existing patent, copyright, and trademark laws offer only limited protection. Moreover, the laws of other countries in which we market our products may afford little or no effective protection of our intellectual property. Additionally, unauthorized parties may copy aspects of our products, services or technology or obtain and use information that we regard as proprietary. Other parties may also breach protective contracts we have executed or will in the future execute. We may not become aware of, or have adequate remedies in the event of, a breach. Litigation may be necessary in the future to enforce or to determine the validity and scope of our intellectual

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property rights or to determine the validity and scope of the proprietary rights of others. Even if we were to prevail, such litigation could result in substantial costs and diversion of management and technical resources.

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

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

- difficulties or delays in developing and supporting non-English language versions of our products and services;
- political and economic conditions in various jurisdictions;
- difficulties in staffing and managing foreign subsidiary operations;
- longer sales cycles and account receivable payment cycles;
- multiple, conflicting and changing governmental laws and regulations;
- foreign currency exchange rate fluctuations;
- protectionist laws and business practices that may favor local competitors;
- difficulties in finding and managing local resellers;

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- 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 or more. Factors that contribute to our long sales cycle, include:

- our need to educate potential customers about the benefits of our products;
- competitive evaluations by customers;
- the customers' internal budgeting and approval processes;
- the fact that many customers view training products as discretionary spending, rather than purchases essential to their business; and

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

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

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

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

THE CONVICTION OF ARTHUR ANDERSEN LLP ON OBSTRUCTION OF JUSTICE CHARGES MAY

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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 fiscal year 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 3. - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of July 31, 2004, we did not use derivative financial instruments for speculative or trading purposes.

INTEREST RATE RISK

Our general investing policy is to limit the risk of principal loss and to ensure the safety of invested funds by limiting market and credit risk. We currently use a registered investment manager to place our investments in highly liquid money market accounts and government-backed securities. All highly liquid investments with original maturities of three months or less are considered to be cash equivalents. Interest income is sensitive to changes in the general level of U.S. interest rates. Based on the short-term nature of our investments, we have concluded that there is no significant market risk exposure.

FOREIGN CURRENCY RISK

Due to our multinational operations, our business is subject to fluctuations based upon changes in the exchange rates between the currencies in which we collect revenues or pay expenses and the U.S. dollar. Our expenses are not necessarily incurred in the currency in which revenue is generated, and, as a result, we are required from time to time to convert currencies to meet our obligations. These currency conversions are subject to exchange rate fluctuations, in particular changes to the value of the euro, Canadian dollar, Australian dollar, New Zealand dollar, Singapore dollar, and pound sterling relative to the U.S. dollar, which could adversely affect our business and the results of operations.

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ITEM 4. - 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 both the year-end and quarter-end financial closing process for the fiscal year ended January 31, 2003. External resources were engaged to assist management in both the year-end and quarter-end financial closing process and in identifying areas for improvement for the fiscal year ended January 31, 2003. In addition, in fiscal years ended January 31, 2003 and 2004, permanent resources and accounting process improvements have been added and implemented to improve the non-U.S. finance operations, the financial closing process, and the overall internal control environment. Our independent auditors have informed us that they believe we had no material weaknesses in internal controls at January 31, 2004. However, they have informed us of certain reportable conditions at that date, including financial and regulatory compliance reporting at non-U.S. subsidiaries of the former SmartForce PLC and our ability to process the financial closing cycle at certain subsidiaries.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer we evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of July 31, 2004. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that while we have implemented mitigating controls and process improvements with respect to our disclosure controls and procedures and that they are now operating effectively, we believe that continuous monitoring and improving of these disclosure controls and procedures will be required. Additionally, we have commenced a process of reviewing all of our material financial processes in an effort to assess our Sarbanes-Oxley 404 preparedness, which includes the establishment of an internal audit function.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f)) under the Exchange Act occurred during the quarter ended July 31, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II

ITEM 1. - LEGAL PROCEEDINGS

Not applicable.

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

Not applicable.

ITEM 3. - DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

PART II - ITEM 4 DISCLOSURE:

We held our 2004 annual general meeting of shareholders (the "AGM") on August 27, 2004. Under the terms of the deposit agreement, The Bank of New York is entitled to vote or cause to be voted on behalf of, and in accordance with the instructions received from, the ADS holders. Two individual shareholders, the proxy for the ordinary shareholders and a representative of AIB, the custodian for the ordinary shares representing the ADS's, were present for the vote. Voting was conducted on a show of hands in accordance with Irish law. There were no abstentions, broker non-votes or votes withheld with respect to any matter submitted to a vote of the ordinary shareholders at the AGM.

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

(1) Receipt and consideration of the consolidated financial statements for the fiscal year ended January 31, 2004 and the Report of the Directors and Auditors thereon.

	Votes "FOR"	"AGAINST"	"ABSTAIN"
Ordinary Shareholders	3	0	0
ADS Holders	105,620,888	48,666	52,421

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

	Votes "FOR"	"AGAINST"	"ABSTAIN"
Ordinary Shareholders	3	0	0
ADS Holders	103,917,497	1,788,682	15,796

(2) (B) Re-election of Ferdinand von Prondzynski, who retired by rotation, as a director.

	Votes "FOR"	"AGAINST"	"ABSTAIN"
Ordinary Shareholders	3	0	0
ADS Holders	103,970,857	1,732,833	18,285

(3) Election of William F. Meagher, who was appointed as a director in March 2003, as a director.

	Votes "FOR"	"AGAINST"	"ABSTAIN"
Ordinary Shareholders	3	0	0
ADS Holders	104,093,273	1,614,252	14,450

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(4) Authorization of the Audit Committee of the Board of Directors to fix the remuneration of our auditors and reporting accountants for the fiscal year ending January 31, 2005.

	Votes "FOR"	"AGAINST"	"ABSTAIN"
Ordinary Shareholders	3	0	0
ADS Holders	105,603,596	112,338	6,041

(5) Adoption of our 2004 Employee Share Purchase Plan.

	Votes "FOR"	"AGAINST"	"ABSTAIN"
Ordinary Shareholders	3	0	0
ADS Holders	104,073,800	1,607,414	40,761

The ordinary shareholders present at the AGM agreed not to put to a vote the resolution with respect to the approval of the terms of a share repurchase agreement proposed to be entered into between us and Credit Suisse First Boston, as an Extraordinary General Meeting will be convened on September 24, 2004 to consider a special resolution to approve the terms of a share purchase agreement to be entered into between us, several of our subsidiaries and Credit Suisse First Boston.

ITEM 5. - OTHER INFORMATION

Not applicable.

ITEM 6. - EXHIBITS

See the Exhibit Index attached hereto.

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SIGNATURE

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

SKILLSOFT PUBLIC LIMITED COMPANY

Date: September 9, 2004

By: /s/ Thomas J. McDonald

Thomas J. McDonald
Chief Financial Officer

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EXHIBIT INDEX

- 10.1 Lease agreement, dated June 9, 2004, by and between Hewlett-Packard Company and SkillSoft Corporation.
- 10.2 Loan and Security Agreement, dated July 23, 2004, by and between Silicon Valley Bank, SkillSoft Corporation, SmartCertify Direct Inc. and Books 247.com, Inc.
- 10.3 Form of Director Option Agreement for initial grants under the 2001 Director Option Plan.
- 10.4 Form of Director Option Agreement for subsequent grants under the 2001 Director Option Plan.
- 10.5 Form of Option Agreement under 2002 Share Option Plan.
- 31.1 Certification of the Company's CEO pursuant to Rule 13a-14 under the Securities Exchange Act of 1934.
- 31.2 Certification of the Company's CFO pursuant to Rule 13a-14 under the Securities Exchange Act of 1934.
- 32.1 Certification of the Company's CEO pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Company's CFO pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.