SYLVAN LEARNING SYSTEMS INC
Form 10-Q
May 15, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý	**Quarterly Report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934**
	for the quarter ended March 31, 2003 or
o	**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 0-22844

SYLVAN LEARNING SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Maryland	**52-1492296**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1001 Fleet Street, Baltimore, Maryland	**21202**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(410)843-8000**

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 ý. No o.

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

The registrant had 40,976,115 shares of Common Stock outstanding as of May 12, 2003.

SYLVAN LEARNING SYSTEMS, INC.

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SYLVAN LEARNING SYSTEMS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(Dollar and share amounts in thousands, except per share data)

	March 31, 2003 (Unaudited)	December 31, 2002 (Restated)
Assets		
Current assets:		
Cash and cash equivalents	$ 91,860	$ 98,618
Available-for-sale securities	23,726	22,546
Receivables:		
Accounts receivable	80,595	68,439
Notes receivable	14,315	11,270
Other receivables	6,274	7,566
	101,184	87,275
Allowance for doubtful accounts	(13,486)	(9,620)
	87,698	77,655
Inventory	4,702	3,955
Deferred income taxes	7,354	2,545
Prepaid expenses and other current assets	22,486	21,817
Current assets of discontinued operations	92,260	104,464
Total current assets	330,086	331,600
Notes receivable, less current portion	14,898	11,889
Property and equipment:		
Land	39,805	38,028
Buildings	162,314	157,834
Construction-in-progress	16,872	14,496
Furniture, computer equipment and software	96,750	93,748
Leasehold improvements	29,991	28,747
	345,732	332,853
Accumulated depreciation	(56,041)	(50,623)
	289,691	282,230
Intangible assets:		
Goodwill	194,526	193,301
Other intangible assets, net of accumulated amortization of $2,893 and $2,530 at March 31, 2003 and December 31, 2002, respectively	36,157	36,543
	230,683	229,844
Investments in and advances to affiliates	927	8,730
Other investments	4,778	12,375

Deferred income taxes		12,919		10,231
Deferred costs, net of accumulated amortization of $4,882 and $4,417 at March 31, 2003 and December 31, 2002, respectively		8,808		6,600
Other assets		19,703		16,875
Long-term assets of discontinued operations		55,000		55,000
Total assets	$	967,493	$	965,374

SYLVAN LEARNING SYSTEMS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets (continued)

(Dollar and share amounts in thousands, except per share data)

	March 31, 2003 (Unaudited)	December 31, 2002 (Restated)
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 26,016	$ 28,171
Accrued expenses	57,664	55,315
Income taxes payable	1,130	12,680
Current portion of long-term debt	12,099	11,194
Due to shareholders of acquired companies	8,859	8,802
Deferred revenue	92,343	76,773
Other current liabilities	4,071	1,672
Current liabilities of discontinued operations	36,370	30,648
Total current liabilities	238,552	225,255
Long-term debt, less current portion	151,915	153,542
Other long-term liabilities	26,546	26,636
Total liabilities	417,013	405,433
Minority interest	73,616	74,013
Stockholders equity:		
Preferred stock, par value $0.01 per share authorized 10,000 shares, no shares issued and outstanding as of March 31, 2003 and December 31, 2002		
Common stock, par value $0.01 per share authorized 90,000 shares, issued and outstanding shares of 40,958 as of March 31, 2003 and 40,331 as of December 31, 2002	410	403
Additional paid-in capital	263,818	257,926
Retained earnings	230,872	246,843
Accumulated other comprehensive loss	(18,236)	(19,244)
Total stockholders equity	476,864	485,928
Total liabilities and stockholders equity	$ 967,493	$ 965,374

See accompanying notes to consolidated financial statements.

SYLVAN LEARNING SYSTEMS, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(Dollar and share amounts in thousands, except per share data)

	Three months ended March 31, 2003	Three months ended March 31, 2002 (Restated)
	(Unaudited)	
Revenues		
Core operating segments	$ 108,286	$ 84,880
Sylvan Ventures	435	
Total revenues	108,721	84,880
Costs and expenses		
Direct costs:		
Core operating segments	102,347	79,684
Sylvan Ventures	1,469	
General and administrative expenses:		
Core operating segments	5,794	5,109
Sylvan Ventures	977	1,305
Total costs and expenses	110,587	86,098
Operating loss	(1,866)	(1,218)
Other income (expense)		
Investment and other income	206	1,514
Interest expense	(2,402)	(2,049)
Loss on Sylvan Ventures investments held for sale	(8,394)	
Equity in net income (loss) of affiliates:		
Sylvan Ventures	(7,502)	(1,810)
Other	66	(97)
	(7,436)	(1,907)
Minority interest in consolidated subsidiaries:		
Sylvan Ventures	487	396
Other	(1,749)	(1,343)
	(1,262)	(947)
Loss from continuing operations before income taxes and cumulative effect of change in accounting principle	(21,154)	(4,607)
Income tax benefit	8,012	2,691
Loss from continuing operations before cumulative effect of change in accounting principle	(13,142)	(1,916)
Income from discontinued operations, net of income tax expense of $1,655 in 2003 and $3,286 in 2002	2,388	1,500
Loss on disposal of discontinued operations, net of income tax benefit of $7,425 in 2003	(5,217)	
Loss before cumulative effect of change in accounting principle	(15,971)	(416)

Cumulative effect of change in accounting principle, net of income tax benefit of $7,700 in 2002				(78,634)
Net loss	$	(15,971)	$	(79,050)
Loss per common share, basic and diluted:				
Loss from continuing operations before cumulative effect of change in accounting principle	$	(0.33)	$	(0.05)
Net loss	$	(0.39)	$	(2.01)

See accompanying notes to consolidated financial statements.

SYLVAN LEARNING SYSTEMS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Amounts in thousands)

	Three months ended March 31, 2003	2002
	(Unaudited)	
Operating activities		
Net loss	$ (15,971)	$ (79,050)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	8,382	6,380
Amortization	711	426
Deferred income taxes	(2,422)	(344)
Loss on investments held for sale	8,394	
Equity in net loss of affiliates	7,436	1,907
Minority interest in income of consolidated subsidiaries	1,262	947
Loss on disposal of discontinued operations	5,217	
Cumulative effect of change in accounting principle		86,334
Other non-cash items	1,586	(246)
Changes in operating assets and liabilities:		
Receivables	(18,652)	(14,829)
Tuition loans, net	881	2,555
Inventory, prepaid expenses and other current assets	(3,002)	(5,625)
Accounts payables and accrued expenses	4,525	6,455
Income taxes payable	(4,189)	(8,995)
Deferred revenue and other current liabilities	17,029	17,514
Net cash provided by operating activities	11,187	13,429
Investing activities		
Purchase of available-for-sale securities	(9,519)	(1,912)
Proceeds from sale or maturity of available-for-sale securities	8,287	13,950
Investment in and advances to affiliates and other investments	(331)	(831)
Purchase of property and equipment	(9,414)	(13,487)
Cash paid for acquired businesses, net of cash received		(10,207)
Payment of contingent consideration for prior period acquisitions	(1,714)	
Expenditures for deferred contract costs	(1,158)	(890)
Increase in other assets	(3,374)	(4,336)
Net cash used in investing activities	(17,223)	(17,713)
Financing activities		
Proceeds from exercise of options and warrants	90	8,628
Proceeds from issuance of debt	564	12,991
Payments on debt	(2,626)	(1,280)
Cash received from minority members of Sylvan Ventures	829	7,588

Cash distributed to minority members of Sylvan Ventures				(12,000)
Change in other long-term liabilities		(58)		713
Net cash provided by (used in) financing activities		(1,201)		16,640
Effect of exchange rate changes on cash		234		(234)
Net increase (decrease) in cash and cash equivalents		(7,003)		12,122
Cash and cash equivalents at beginning of period		106,043		102,194
Cash and cash equivalents at end of period	$	99,040	$	114,316
Cash and cash equivalents classified as:				
Continuing operations		91,860		107,163
Discontinued operations		7,180		7,153
Cash and cash equivalents at end of period	$	99,040	$	114,316

See accompanying notes to consolidated financial statements.

Sylvan Learning Systems, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

Unaudited

(Dollar and share amounts in thousands, except per share amounts)

March 31, 2003

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 2003 are not necessarily indicative of the results that may be expected for the year ended December 31, 2003. The traditional semester programs in the education industry, with a summer break, result in large seasonality in the operating results of Sylvan Learning Systems, Inc. (the Company). The consolidated balance sheet at December 31, 2002 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the audited consolidated financial statements and footnotes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2002.

On March 10, 2003 the Company announced that it would sell the operations comprising its K-12 education business units (K-12 segment) and committed to a plan to sell certain investments in Sylvan Ventures that are not strategic to its remaining post-secondary education business (see Note 4 for further description). In connection with this announcement, the Company realigned its business segments. The Company s realigned segments include three separate business segments: a campus based university segment (Campus Based), an online university segment (Online), and Sylvan Ventures. The Campus Based segment owns or maintains controlling interests in six private universities located in Spain, Switzerland, Mexico, Chile and France and also includes the non-Spain operations of Wall Street Institute, a European-based franchiser and operator of learning centers that teach the English language in the post-secondary market. The Online segment provides professional development and graduate degree programs to teachers through Canter and Associates. Online also includes the operations of Walden E-Learning, Inc. (Walden) and National Technological University (NTU), which were previously reported as part of Sylvan Ventures. The Sylvan Ventures segment includes investments in certain education technology companies and consolidates the operations of EdVerify, Inc. (EdVerify) and Educational Satellite Services, Inc. (ESS), majority-owned subsidiaries. The Company plans to dispose of all remaining investments of the Sylvan Ventures segment, including EdVerify and ESS. Sylvan Ventures general and administrative expenses include the costs incurred to oversee its investments.

The accompanying consolidated balance sheets, statements of operations and related notes have been restated to reflect the K-12 segment as discontinued operations for all periods presented.

Certain amounts previously reported for 2002 have been reclassified to conform with the 2003 presentation.

Note 2 Accounting Policies

Stock Options Granted to Employees and Non-Employees

The Company records compensation expense for all stock-based compensation plans using the intrinsic value method and provides pro forma disclosures of net income (loss) and net earnings (loss) per common share as if the fair value method had been applied in measuring compensation expense. The Company records compensation expense for all stock options granted to non-employees in an amount equal to their estimated fair value at the earlier of the performance commitment date or the date at which performance is complete, determined using the Black-Scholes option valuation model. The compensation expense is recognized ratably over the vesting period.

Pro forma net income and earnings per share information has been determined as if the Company had accounted for its stock options using the fair value method. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because Company s stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options vesting periods. The Company s pro forma information is as follows for the quarters ended March 31:

		2003		**2002**
Net loss, as reported	$	(15,971)	$	(79,050)
Stock-based employee compensation expense included in net income as reported, net of tax		25		30
Stock-based employee compensation expense as if the fair value method had been applied, net of tax		(98)		(655)
Pro forma net loss	$	(16,044)	$	(79,675)
Loss per share, basic and diluted:				
As reported	$	(0.39)	$	(2.01)
Pro forma	$	(0.40)	$	(2.02)

Note 3 - New Accounting Standards

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which addresses the financial accounting and reporting for certain costs associated with exit or disposal activities. Statement No. 146 requires that these costs be recorded at their fair value when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management s commitment to an exit plan, which is generally before an actual liability has been incurred. The provisions of Statement No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect the adoption of the new standard to have a material impact on its consolidated financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others.* The Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. The Interpretation also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of Interpretation No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements in Interpretation No. 45 are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has made certain guarantees that may be subject to the liability recognition provisions of the Interpretation if modified. The Company adopted the disclosure requirements of the standard for its December 31, 2002 reporting period.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*. The objective of Interpretation No. 46 is to improve financial reporting by companies involved with variable interest entities. The Interpretation requires variable interest entities to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity s activities or is entitled to receive a majority of the entity s residual returns or both. The Company currently does not have any variable interest entities and, therefore, will apply the provisions of Interpretation No. 46 prospectively.

The EITF Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*, addresses situations which may involve the delivery or performance of multiple products, services, and/or rights to use assets, and for which performance may occur at different points in time or over different periods of time. The Issue also addresses whether the different revenue-generating activities, or deliverables, are sufficiently separable, and there exists sufficient evidence of their fair values to separately account for some or all of the deliverables. The issue applies to all contractual arrangements under which a vendor will perform multiple revenue-generating activities. Issue No. 00-21 is effective for all revenue arrangements entered into in fiscal periods beginning after June 15, 2003, with early adoption permitted. The Company will adopt this guidance prospectively for all revenue arrangements entered into after January 1, 2003. The Company does not believe that the impact of adoption will be material to reported operating results.

Note 4 Discontinued Operations

On March 10, 2003, the Company and Educate, Inc., a company newly formed by Apollo Management, L.P., (Apollo) executed an Asset Purchase Agreement that provided for the acquisition by Educate, Inc. of substantially all of the Company s K-12 education business units, including eSylvan, Inc. and Connections Academy, Inc., which are investments held by Sylvan Ventures (K-12 Disposal Group). The consideration for the sale of the assets comprising the K-12 Disposal Group will consist of the following at closing:

Cash of $112,000 to $117,000 plus an amount equal to the difference between $72,500 and the conversion value of the convertible debentures issued by the Company and surrendered by Apollo at closing, less any accrued and unpaid interest on the debentures, plus deferred payments of approximately $3.0 million;

A subordinated note in the amount of $55,000, bearing interest at 12% per annum and maturing in 2009;

The surrender of convertible debentures issued by the Company with a conversion value of up to $72,500;

The assumption of trade accounts payable of the K-12 business units, and other specified liabilities of the K-12 business units;

Apollo s 25% preferred interest in Sylvan Ventures.

Additionally, the proceeds received by the Company are subject to post-closing adjustments for specified changes in working capital from the date of the agreement to the closing date. The Company is also eligible for up to $10 million of additional consideration if certain operations of Connections Academy exceed specified levels of earnings any time prior to December 31, 2007. The transaction will result in the elimination of various consent and governance rights that had been held by Apollo. Apollo s representation on the Company s Board of Directors will be reduced from two board seats to one.

As a result of this expected disposal transaction, the Company estimates that it will record a yet to be determined gain from the disposition of its K-12 business units upon closing of the sale to Educate, Inc. (expected to be in the second quarter of 2003), representing the difference between the carrying value of the net assets sold (approximately $111 million at March 31, 2003) and net proceeds upon sale.

In the first quarter of 2003, the Company recorded a loss on disposal of discontinued operations of $5,217, net of income tax benefit of $7,425 related to the write-off of the net assets of the UK/France Disposal Group. The Company expects to sell these two operations for principally contingent amounts of future consideration by December 31, 2003.

The operations of the Company s disposal groups comprising its K-12 business units are classified as discontinued operations. Because the operations and cash flows of these components will be eliminated from the ongoing operations of the Company as a result of the disposal transactions, and because the Company will not have any significant continuing involvement in the held for sale operations after the disposal transactions, the results of operations of this component will be reported for all periods as a separate component of income, net of income taxes.

Summarized operating results from the discontinued operations included in the Company s statement of operations are as follows for the three months ended March 31:

	K-12		UK/France
	2003	**2002**	**2003**
Revenues	$ 60,850	$ 52,972	$ 204
Pretax income (loss) from discontinued operations	$ 4,808	$ 4,786	$ (766)

Assets and liabilities of the discontinued operations were as follows:

	K-12 Disposal Group		UK/France Disposal Group
	March 31, 2003	December 31, 2002	December 31, 2002
Current assets	$ 39,578	$ 41,109	$ 795
Property and equipment, net	25,187	26,326	896
Goodwill	74,997	71,705	9,035
Other assets	6,746	9,485	113
Current liabilities	(34,938)	(30,134)	
Long-term liabilities	(680)	(514)	
Net assets of discontinued operations	$ 110,890	$ 117,977	$ 10,839

The accompanying balance sheets at March 31, 2003 and December 31, 2002 classifies the assets and liabilities of the asset disposal groups based on the probable timing of sales proceeds.

Note 5 - Investments

Sylvan Ventures

On March 10, 2003 Sylvan acquired the remaining membership interests in Sylvan Ventures not owned by Sylvan or Apollo for consideration of 581 shares of Sylvan common stock, which is restricted from sale for three years. These membership interests were held by a group of investors, including certain executives of the Company. Additionally, all membership profit interests in Sylvan Ventures were eliminated. Upon completion of the sale of the K-12 business units, the Company will own all of the membership interests of Sylvan Ventures LLC. Contemporaneous with these transactions, the Company announced its intention to disband Sylvan Ventures and sell assets non-strategic to its post-secondary business, and recorded a loss on Sylvan Ventures assets held for sale of $8,394, primarily representing the book value of Sylvan Ventures cost basis investments in iLearning ($298) and ClubMom ($7,596). In addition, Sylvan Ventures wrote down the balance in its equity method investment in Chancery through a charge to equity in net loss of affiliates. Sylvan Ventures also recorded an operating loss of $221 related to the write-off of the net assets of the consolidated investment in EdVerify. These investments are being marketed to a single buyer and are expected to be sold by June 30, 2003 for principally contingent consideration.

The remaining investments of Sylvan Ventures consist of the consolidated investments of Walden and NTU, which will be managed and reported within the Online segment, and a $2,371 note receivable that will mature over the next two years.

Investments in and advances to affiliates consist principally of investments in common stock and preferred stock, as follows as of March 31, 2003 and December 31, 2002, respectively:

	March 31, 2003	Ownership Interest	December 31, 2002	Ownership Interest

Chancery Software Limited	$		42.0%	$	6,964	42%
iLearning, Inc.			2.5%		641	40%
Other		927			1,125	
Total	$	927		$	8,730	

Sylvan Ventures equity in net gains (losses) related to the investments in affiliates for the three months ended March 31, 2003 and 2002 was $865 (excluding the write-down of Chancery) and $1,810, respectively.

Each period in the tables below includes summarized financial data of those affiliates accounted for using the equity method in which Sylvan Ventures had an interest at the end of the period, and includes results of operations data of the affiliate for the entire quarter.

	March 31, 2003	December 31, 2002
Current assets	$ 7,087	$ 8,799
Other assets	1,236	3,280
Current liabilities	7,180	10,444
Long-term and other liabilities	3	2,478
Redeemable convertible preferred stock	38,520	37,368

	Three months ended March 31,	
	2003	2002
Net sales	$ 4,104	$ 5,339
Gross profit	3,052	3,018
Net loss	(1,163)	(4,868)

Note 6 - Goodwill and Other Intangible Assets

The following table summarizes the intangible assets that are subject to amortization as of March 31, 2003:

	Amortizing Intangible Assets
Gross carrying amount	$ 9,783
Accumulated amortization	(2,893)
Net carrying amount	$ 6,890

The estimated amortization expense for intangible assets for each of the five years subsequent to December 31, 2002 is as follows: 2003 - $1,901; 2004 - $1,741; 2005 - $1,298; 2006 - $1,067 and 2007 - $744.

Note 7 Income Taxes

The tax provisions for the three month periods ended March 31, 2003 and 2002 were based on the estimated effective tax rates applicable for the full years, after giving effect to significant items related specifically to the interim periods, including the reported results of Sylvan Ventures investments accounted for using the equity method. The Company s income tax provisions for all periods consist of federal, state, and foreign income taxes. The Company s effective tax rate from continuing operations was 37.9% for the three months ended March 31, 2003. Due to the volatility of Sylvan Ventures income and losses, the Company s consolidated effective tax rate may fluctuate from quarter to quarter. However, on a full year basis the Company estimates that the effective income tax rate for the Company excluding Sylvan Ventures, and for Sylvan Ventures, for the year ending December 31, 2003 will be 28.0% and 40.0%, respectively. Fluctuations in the magnitude and timing of the tax impact of Sylvan Ventures financial results may cause the Company s consolidated effective income tax rate to vary substantially from the statutory rate.

At March 31, 2003, undistributed earnings of non-U.S. subsidiaries totaled approximately $104,300. Deferred tax liabilities have not been recognized for these undistributed earnings because it is management s intention to reinvest such undistributed earnings outside of the United States. If all undistributed earnings were remitted to the United States, the amount of incremental U.S. federal income taxes, net of foreign tax credits, would be approximately $21,400.

Note 8 Stockholders Equity

The components of stockholders equity are as follows:

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
Balance at December 31, 2002	$ 403	$ 257,926	$ 246,843	$ (19,244)	$ 485,928
Options exercised for purchase of 7 shares of common stock, including income tax benefit of $17		106			106
Issuance of 40 shares of common stock in connection with the employee stock purchase plan		422			422
Issuance of 581 shares of restricted common stock in connection with acquisition of minority interest in Sylvan Ventures LLC	6	5,148			5,154
Other equity activity	1	216			217
Comprehensive loss:					
Net loss for the three months ended March 31, 2003			(15,971)		(15,971)
Foreign currency translation adjustment				990	990
Unrealized loss on available-for-sale securities				18	18
Total comprehensive loss					(14,963)
Balance at March 31, 2003	$ 410	$ 263,818	$ 230,872	$ (18,236)	$ 476,864

Expected Stock Option Modification in the Second Quarter of 2003

Certain employees of the Company s Campus Based segment have been granted options to acquire common stock of the holding company subsidiary comprising the Campus Based segment. In connection with the restructuring of the Company s operations resulting from the sale of the K-12 business units and non-strategic Sylvan Ventures assets, the Company has negotiated an agreement with certain key employees holding stock options to acquire common stock of the subsidiary that provides for the exchange of these stock options for stock options to acquire common stock of Sylvan, contingent upon the closing of the sale of the K-12 business units to Educate, Inc. The Company also expects to offer similar terms to other employees holding options to acquire common stock of the subsidiary. The result of the exchange of options will not increase the aggregate intrinsic value of the options or reduce the ratio of the exercise price per share of the options to the per share fair value of common stock on the date of exchange, as determined by independent members of the Board of Directors advised by independent valuation experts.

The exchange will be accounted for as a modification of granted stock options, resulting in a new measurement date for the exchanged stock options. The Company estimates that the modification will result in non-cash compensation expense of approximately $25 million. The change will be recorded primarily in the quarter the conversion is completed with the balance recorded over any remaining vesting period.

In connection with the sale of the K-12 Education business discussed more fully in Note 4, each unexpired and unexercised outstanding option to purchase shares of the Company s common stock held by employees who will be employed by Educate, Inc. will continue to vest for a period of twelve months following the closing of the transaction and will be exercisable for twenty-four months following the closing. This will be accounted for as a modification of granted stock options, resulting in a new measurement date. The modification will result in non-cash compensation expense in an amount equal to the intrinsic value of such options at the date of closing. This expense will be included in the Company s results from discontinued operations.

Note 9 - Comprehensive Loss

The components of comprehensive loss, net of related income taxes, are as follows:

	Three months ended March 31,			
		2003		2002
Net loss	$	(15,971)	$	(79,050)
Foreign currency translation adjustment		990		(4,208)
Unrealized gain (loss) on available-for-sale securities		18		(156)
Comprehensive loss	$	(14,963)	$	(83,414)

Note 10 Loss Per Share

The following table summarizes the computations of basic and diluted loss per common share:

	Three months ended March 31,			
		2003		2002
Numerator used in basic and diluted loss per common share:				
Loss from continuing operations, before cumulative effect of change in accounting principle	$	(13,142)	$	(1,916)
Income from discontinued operations, net of tax		2,388		1,500
Loss on disposal of discontinued operations, net of tax		(5,217)		
Cumulative effect of change in accounting principle, net of tax				(78,634)
Net loss	$	(15,971)	$	(79,050)
Denominator:				
Weighted average common shares outstanding		40,477		39,421
Net effect of dilutive stock options based on treasury stock method using average market price				
Effect of convertible debentures				
Weighted average common shares outstanding and additional dilution from common stock equivalents		40,477		39,421
Earning (loss) per common share, basic and diluted:				
Loss from continuing operations, before cumulative effect of change in accounting principle	$	(0.33)	$	(0.05)
Income from discontinued operations, net of tax		0.06		0.04
Loss on disposal of discontinued operations, net of tax		(0.12)		
Cumulative effect of change in accounting principle, net of tax				(2.00)
Net loss per common share, basic	$	(0.39)	$	(2.01)

Stock options and the convertible debentures were not dilutive for the three month periods ended March 31, 2003 and 2002 as the Company reported a net loss.

Note 11 - Contingencies

The Company is subject to legal actions arising in the ordinary course of its business. In management s opinion, the Company has adequate legal defenses and/or insurance coverage with respect to the eventuality of such actions and does not believe any settlement would materially affect the Company s financial position.

Guarantees

The Company has guaranteed the bank loans of certain K-12 business franchisees. These loans primarily represent the financing of programs and other purchased instructional materials. Of the $1,757 of available credit under these loans, the outstanding balance was $610 at March 31, 2003. This guarantee will be assumed by Educate, Inc. when the sale of the K-12 business division is final.

The Company has guaranteed a $2,000 bank line of credit of an affiliate. There were no borrowings outstanding as of March 31, 2003 and the line of credit expires on February 29, 2004. This guarantee will be assumed by Educate, Inc. when the sale of the K-12 business division is final.

The Company has guaranteed equipment leases of certain affiliates. As of March 31, 2003, the amount payable by the affiliates under these leases was $630. $544 of these equipment guarantees will be assumed by Educate, Inc. when the sale of the K-12 business division is final.

The Company has entered into an agreement with a third party to provide course materials. Payment is due upon sale of the course materials to franchisees. Under the terms of the agreement, the Company has guaranteed certain annual minimum payments of $264, to be paid quarterly. At March 31, 2003, the amount remaining to be paid under the agreement is $900.

Contingent Payments and Business Combinations

In the normal course of business, the Company is party to option agreements with franchisees that allow, under specified circumstances, the repurchase of operating franchises at predetermined multiples of operating results. These options may be at the Company s or the franchisee s discretion based upon the individual agreement and specific operating criteria. None of these option agreements would be individually material and operating results of the Company would not be materially impacted for the current period if the options were exercised.

The Company is self-insured for health care, workers compensation, and other insurable risks up to predetermined amounts above which third party insurance applies. The Company records estimates of its self-insured benefits liability at each balance sheet date. The Company is contingently liable to insurance carriers under certain of these policies and has provided a letter of credit in favor of the insurance carriers for approximately $1,300.

Note 12   Business Segment Information

The Company is a leading international provider of post-secondary educational services. On March 10, 2003, the Company announced that it would sell the operations comprising its K-12 education business units and committed to a plan to sell certain investments in Sylvan Ventures. Prior to March 2003, the Company was organized on the basis of educational services provided, including K-12 business services, online higher education, international universities, English language instruction   Spain, and Sylvan Ventures. As a result of the realigned business operations, the Company is now managing its operations through three separate business segments: a campus-based university segment, an online university segment and Sylvan Ventures. These segments are business units that offer distinct services and are managed separately as they have different customer bases and delivery channels. All historical segment information has been reclassified to conform to this presentation. The reportable segments are as follows:

	Three months ended March 31,	
	2003	2002
Operating revenues:		
Campus Based	$ 90,790	$ 72,235
Online	17,496	9,010
Sylvan Ventures	435	
Other		3,635
	$ 108,721	$ 84,880
Segment profit (loss):		
Campus Based	$ 8,404	$ 7,905
Online	(2,465)	(1,792)
Sylvan Ventures	(9,513)	(3,115)
Other		(917)
	$ (3,574)	$ 2,081

	Segment Assets			Goodwill	
	March 31, 2003		December 31, 2002	March 31, 2003	December 31, 2002
Campus Based	$	539,549			