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SYLVAN LEARNING SYSTEMS INC
Form 10-Q
May 11, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

- Quarterly Report pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934 for the quarter ended MARCH 31, 2001 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 0-22844

SYLVAN LEARNING SYSTEMS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

MARYLAND

(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

52-1492296

(I.R.S. EMPLOYER
IDENTIFICATION NO)

1001 FLEET STREET, BALTIMORE, MARYLAND

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

21202

(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 . No .

The registrant had 37,799,177 shares of Common Stock outstanding as of May 7, 2001.

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, 2001 ----- (Unaudited) |
|--|---|
| ASSETS | |
| Current assets: | |
| Cash and cash equivalents | \$ 66,306 |
| Available-for-sale securities | 123,673 |
| Receivables: | |
| Accounts receivable | 58,995 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 1,032 |
| Notes receivable from tuition financing | 8,283 |

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| | |
|---|-----------|
| Other notes receivable | 13,597 |
| Other receivables | 14,206 |
| | ----- |
| | 96,113 |
| Allowance for doubtful accounts | (6,735) |
| | ----- |
| | 89,378 |
| Inventory | 5,798 |
| Deferred income taxes | 3,960 |
| Prepaid expenses and other current assets | 19,983 |
| | ----- |
| Total current assets | 309,098 |
| Notes receivable from tuition financing, less current portion | 9,518 |
| Other notes receivable, less current portion | 4,839 |
| Property and equipment: | |
| Land and buildings | 90,235 |
| Furniture, computer equipment and software | 101,356 |
| Leasehold improvements | 27,448 |
| | ----- |
| | 219,039 |
| Accumulated depreciation | (46,387) |
| | ----- |
| | 172,652 |
| Intangible assets: | |
| Goodwill | 293,412 |
| Other | 4,757 |
| | ----- |
| | 298,169 |
| Accumulated amortization | (23,544) |
| | ----- |
| | 274,625 |
| Investments in and advances to affiliates | 81,021 |
| Other investments | 25,601 |
| Deferred costs, net of accumulated amortization of \$2,485 and \$1,969 at March 31, 2001 and December 31, 2000, respectively | 11,067 |
| Other assets | 15,126 |
| | ----- |
| Total assets | \$903,547 |
| | ===== |

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS.

SYLVAN LEARNING SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (CONTINUED)
(DOLLAR AND SHARE AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

MARCH 31,
2001

(Unaudited)

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LIABILITIES AND STOCKHOLDERS' EQUITY

| | |
|---|-----------|
| Current liabilities: | |
| Accounts payable | \$ 18,076 |
| Accrued expenses | 39,801 |
| Income taxes payable | 14,046 |
| Current portion of long-term debt | 10,979 |
| Due to shareholders of acquired companies | 27,050 |
| Deferred revenue | 39,986 |
| Other current liabilities | 21,161 |
| | ----- |
| Total current liabilities | 171,099 |
| Long-term debt, less current portion | 129,727 |
| Deferred income taxes | 4,724 |
| Other long-term liabilities | 9,435 |
| | ----- |
| Total liabilities | 314,985 |
| Minority interest | 51,148 |
| Stockholders' equity: | |
| Preferred stock, par value \$0.01 per share - - authorized 10,000 shares, no shares issued and outstanding as of March 31, 2001 and December 31, 2000 | - |
| Common stock, par value \$0.01 per share - - authorized 90,000 shares, issued and outstanding shares of 37,741 as of March 31, 2001 and 37,278 as of December 31, 2000 | 377 |
| Additional paid-in capital | 211,349 |
| Retained earnings | 348,648 |
| Accumulated other comprehensive loss | (22,960) |
| | ----- |
| Total stockholders' equity | 537,414 |
| | ----- |
| Total liabilities and stockholders' equity | \$903,547 |
| | ===== |

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS.

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SYLVAN LEARNING SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(DOLLAR AND SHARE AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)

| | THREE MONTHS ENDED MAR 2001 |
|-------------------|--------------------------------|
| | ----- (Unaudited) |
| REVENUES | \$120,446 |
| COST AND EXPENSES | |
| Direct costs | 108,074 |

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| | | |
|---|-------------|-------|
| Sylvan Ventures operating costs | 5,577 | |
| General and administrative expenses | 5,986 | |
| | | ----- |
| Total expenses | 119,637 | ----- |
| | | ----- |
| Operating income | 809 | |
| OTHER INCOME (EXPENSE) | | |
| Investment and other income | 3,327 | |
| Interest expense | (2,229) | |
| Sylvan Ventures investment losses | (400) | |
| Equity in net loss of affiliates: | | |
| Sylvan Ventures | (19,786) | |
| Other | (126) | |
| | | ----- |
| | (19,912) | ----- |
| Minority interest in consolidated subsidiaries: | | |
| Sylvan Ventures | 1,291 | |
| Other | (1,420) | |
| | | ----- |
| | (129) | ----- |
| | | ----- |
| Income (loss) from continuing operations before income taxes | (18,534) | |
| Income tax benefit (expense) | 6,950 | |
| | | ----- |
| Income (loss) from continuing operations | (11,584) | ----- |
| Loss from discontinued operations, net of income tax expense of \$163 | - | |
| Gain on disposal of discontinued operations, net of income tax expense of \$136,762 | - | |
| | | ----- |
| Net income (loss) | \$ (11,584) | ===== |
| | | ===== |
| Earnings (loss) per common share, basic: | | |
| Income (loss) from continuing operations | \$ (0.31) | |
| Net income (loss) | \$ (0.31) | |
| Earnings (loss) per common share, diluted: | | |
| Income (loss) from continuing operations | \$ (0.31) | |
| Net income (loss) | \$ (0.31) | |

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS.

SYLVAN LEARNING SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(AMOUNTS IN THOUSANDS)

THREE MONTHS ENDED
2001

(Unaudited)

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| | |
|--|-------------|
| OPERATING ACTIVITIES | |
| Net income (loss) | \$ (11,584) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | |
| Depreciation | 5,603 |
| Amortization | 3,703 |
| Gain on disposal of discontinued operations | - |
| Deferred income taxes | (41) |
| Loss on investments | 400 |
| Equity in net loss of affiliates | 19,912 |
| Minority interest in income of consolidated subsidiary | 129 |
| Other non-cash items | 657 |
| Changes in operating assets and liabilities: | |
| Receivables | 14,663 |
| Tuition loans, net | (2,533) |
| Inventory, prepaid and other current assets | (4,043) |
| Payables and accrued expenses | 97 |
| Income taxes payable | (102,738) |
| Deferred revenue and other current liabilities | (461) |
| Net cash provided by (used in) operating activities | (76,236) |
| | |
| INVESTING ACTIVITIES | |
| Purchase of available-for-sale securities | (23,494) |
| Proceeds from sale or maturity of available-for-sale securities | 103,098 |
| Investment in and advances to affiliates and other investments | (32,203) |
| Purchase of property and equipment | (13,301) |
| Proceeds from sale of Prometric, net of closing costs | - |
| Cash paid for acquired businesses, net of cash received | (2,630) |
| Payment of contingent consideration for prior period acquisitions | (13,145) |
| Expenditures for deferred costs | (4,395) |
| Decrease (increase) in other assets | (520) |
| Net cash provided by investing activities | 13,410 |
| | |
| FINANCING ACTIVITIES | |
| Proceeds from exercise of options and warrants | 3,806 |
| Proceeds from issuance of common stock | - |
| Repurchases of common stock | - |
| Proceeds from issuance of long-term debt | 747 |
| Payments on long-term debt | (7,452) |
| Cash received from members of Sylvan Ventures | 16,114 |
| Decrease in other long-term liabilities | 572 |
| Net cash provided by (used in) financing activities | 13,787 |
| Effect of subsidiary year-end change on cash and cash equivalents | - |
| Effect of exchange rate changes on cash | (1,145) |
| Net increase (decrease) in cash and cash equivalents | (50,184) |
| Cash and cash equivalents at beginning of period | 116,490 |
| Cash and cash equivalents at end of period | \$66,306 |

SEE ACCOMPANYING NOTES TO FINANCIAL STATEMENTS.

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SYLVAN LEARNING SYSTEMS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED
(DOLLAR AND SHARE AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

MARCH 31, 2001

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, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001. The traditional semester programs in the education industry, with a summer break, result in unusually large seasonality in the operating results of Sylvan Learning Systems, Inc. ("the Company"). The consolidated balance sheet at December 31, 2000 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, 2000.

Certain amounts previously reported for 2000 have been reclassified to conform with the 2001 presentation.

NOTE 2 - ADOPTION OF NEW ACCOUNTING STANDARD

In June 1998, the Financial Accounting Standards Board issued Statement No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES, which was adopted effective January 1, 2001. Because of the Company's minimal use of derivatives, the adoption of the new standard did not have any effect on the Company's consolidated financial position and results of operations.

NOTE 3 - DISCONTINUED OPERATIONS

On October 6, 2000, the Company sold its English Language immersion business, Aspect, ("Aspect") for \$19,794 in cash. The gain on the disposition recognized in the year ended December 31, 2000 was \$22,353, which includes an income tax benefit of \$3,047. The Company has estimated the domestic and foreign income taxes resulting from the sale based on the expected allocation of proceeds to subsidiaries that are parties to the transaction and the tax laws of the jurisdictions in which these subsidiaries operate, assuming that undistributed gains outside the United States will be reinvested outside the United States.

On March 3, 2000, the Company sold its computer-based testing division, Sylvan Prometric ("Prometric") for approximately \$775,000 in cash. The gain on the disposition recognized in the year ended December 31, 2000 was approximately \$288,454, net of income taxes of \$136,762. The final proceeds from the sale may change based on contractual provisions that provide for certain adjustments to the sale price, including an adjustment for changes in working capital of Prometric between November 30, 1999 and March 3, 2000. The Company and the buyer have not completed the process required to provide for a final settlement of the sale proceeds. However, management believes that any future adjustments will be immaterial to the Company's financial position and results of operations. The

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Company has estimated the domestic and foreign income taxes resulting from the sale based on the expected allocation of proceeds to subsidiaries that are a party to the transaction and the tax laws

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NOTE 3 - DISCONTINUED OPERATIONS (CONTINUED)

of the jurisdictions in which these subsidiaries operate, assuming that undistributed gains outside the United States will be reinvested outside the United States.

Summarized operating information of the Company's discontinued operations, including both Prometric and Aspect for the period owned in 2000, is as follows for the three months ended March 31, 2000:

| | |
|--------------------------|------------|
| Revenues | \$47,655 |
| | ----- |
| Loss before income taxes | (3,705) |
| Income tax expense | 163 |
| | ----- |
| Net loss | \$ (3,868) |
| | ===== |

Included in income from discontinued operations for the three month period ended March 31, 2000 is an allocation of corporate interest expense of \$678, based upon a percentage of the net equity investment in discontinued operations to the net equity of the Company including the discontinued operations.

NOTE 4 - INVESTMENTS IN AND ADVANCES TO AFFILIATES

FORMATION OF SYLVAN VENTURES

The Sylvan Ventures segment was established during the first quarter of 2000 to invest in and develop companies developing emerging technology solutions for the education and training marketplace ("portfolio companies"). On June 30, 2000, affiliates of Apollo Management L.P. ("Apollo") and certain members of Sylvan's management ("management investors") joined the Company to form Sylvan Ventures, LLC, with total committed funds of \$400,000. Of the \$400,000 commitment, the Company has committed \$285,000, including investments in portfolio companies valued at \$65,000; Apollo has committed \$100,000; and the management investors have committed \$15,000. On June 30, 2000, the Company transferred four investments in portfolio companies to Sylvan Ventures - eSylvan, Inc., Caliber Learning Network, Inc., OnlineLearning.net, and Zapme! corporation.

Upon formation, Sylvan Ventures issued common membership interests to Sylvan and the management investors and preferred membership interests to Apollo. Additionally, Sylvan Ventures authorized the granting of plan membership profit interests to members of management that entitle the recipients to receive an aggregate allocation of up to 20% of any cumulative net profits. As of March 31, 2001, plan membership profit interests have been granted to management for an aggregate allocation of approximately 15% of the cumulative net profits upon a profits interest event.

In 2000, the membership agreement provided for the allocation of net losses

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to the common and preferred members on a pro rata basis, subject to certain limitations. Beginning January 1, 2001, net losses are being allocated on a pro rata basis only to the common membership interest holders until their capital account balances have been reduced to zero, at which time any losses will be allocated to Apollo until its capital account balance has been reduced to zero. Thereafter, any losses will be allocated on a pro rata basis to all membership interest holders. Any profits earned after January 1, 2001 will first be allocated to Apollo until it has recovered its 2000 allocated losses and then to the common membership interest holders to recover previously allocated losses. After all previously allocated losses have been recovered through profit allocations, any additional net profits will be allocated on a pro rata basis to all interest holders, including the plan membership profit interest holders.

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NOTE 4 - INVESTMENTS IN AND ADVANCES TO AFFILIATES (CONTINUED)

CONSOLIDATED INVESTMENTS

eSylvan, Inc. ("eSylvan") is a start-up organization designed to distribute the Company's learning center tutoring product to students at home via computer. Sylvan Ventures owns 88% of eSylvan. eSylvan had not generated significant revenue through March 31, 2001, and its operating expenses have been included in the 2001 and 2000 consolidated statement of operations as a component of Sylvan Ventures' operating costs. Sylvan Ventures has committed additional funding of \$10,000 as of March 31, 2001 for eSylvan development and operating costs in 2001. During the quarter ended March 31, 2001 eSylvan issued common stock representing an 11% ownership interest to franchisees of Sylvan Learning Centers.

INVESTMENT IN AFFILIATES (EQUITY METHOD INVESTMENTS):

The Company's investment in and advances to affiliates consist of investments in and loans to companies in the initial or early stages of development. These companies are frequently illiquid or experiencing cash flow deficits from operations. Further, investments are generally unsecured and subordinated to the claims of other creditors. Accordingly, the Company's investments in and advances to affiliates are subject to a high degree of investment and credit risk. The Company has made estimates of the recoverability of loans and advances to its affiliates, and due to the inherent uncertainty of the operations of these affiliates, it is reasonably possible that these estimates may change in the near term.

Investments in and advances to affiliates consist principally of investments in common stock and preferred stock, as follows as of March 31, 2001 and December 31, 2000, respectively:

| | MARCH 31, 2001 | OWNERSHIP INTEREST | DECEMBER 31 2000 |
|--------------------------------|-------------------|-----------------------|---------------------|
| Walden E-Learning, Inc. | \$32,657 | 41% | |
| Chancery Software Limited | 13,248 | 42% | \$14 |
| Classwell Learning Group, Inc. | 10,879 | 42% | 13 |
| Caliber Learning Network, Inc. | 9,039 | 35% | 15 |
| HigherMarkets, Inc. | 4,880 | 31% | 6 |

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| | | | |
|-----------------|----------|-----|-------|
| ilearning, Inc. | 4,331 | 27% | 5 |
| Mindsurf, Inc. | 2,770 | 50% | 1 |
| Other | 3,217 | - | 2 |
| | ----- | | ----- |
| Total | \$81,021 | | \$57 |
| | ===== | | ===== |

Each period in the tables below includes summarized financial data of those affiliates in which Sylvan Ventures had an interest at the end of the respective period and includes results of operations data of such affiliates for the entire quarter.

| | MARCH 31, 2001 | DECEMBER 31, 2000 |
|--|----------------|-------------------|
| | ----- | ----- |
| Current assets | \$46,321 | \$44,4 |
| Other assets | 68,410 | 67,1 |
| Current liabilities | 40,175 | 37,9 |
| Long-term and other liabilities | 10,392 | 7,1 |
| Redeemable convertible preferred stock | 87,179 | 77,6 |

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NOTE 4 - INVESTMENTS IN AND ADVANCES TO AFFILIATES (CONTINUED)

| | THREE MONTHS ENDED MARCH 31, | |
|--------------|------------------------------|--------|
| | 2001 | 2000 |
| | ----- | ----- |
| Net sales | \$ 10,623 | \$ 5,0 |
| Gross profit | 6,753 | 2,9 |
| Net loss | (28,988) | (6,1 |

The Caliber Learning Network, Inc. ("Caliber") investment includes a note payable, secured by Caliber assets, to the Company for management services in the amounts of \$6,150 and \$7,150 as of March 31, 2001 and December 31, 2000, respectively. The Company has also guaranteed certain future non-cancelable lease obligations relating to Caliber totaling \$5,154. Caliber is currently seeking additional long-term financing to provide for its anticipated cash needs. There can be no assurance that such efforts by Caliber will be successful.

Sylvan Ventures has committed additional funding of \$21,150 to Mindsurf, Inc. ("Mindsurf") if specified performance targets are achieved.

The Company's allocable share of losses related to the investments in affiliates for the quarters ended March 31, 2001 and 2000 was \$19,912 and \$876, respectively. At March 31, 2001, the difference between the carrying amount of equity method investments and the amount of underlying equity in net assets of these investments was \$42,697. This amount is being amortized for each

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investment primarily over a three-year period as a component of the Company's allocable share of income or loss. For the quarter ended March 31, 2001, equity in net loss of affiliates includes \$2,805 of amortization.

NOTE 5 - DUE TO SHAREHOLDERS OF ACQUIRED COMPANIES

Due to shareholders of acquired companies consists of the following amounts payable in cash:

| | MARCH 31, 2001 |
|--|-------------------|
| | ----- |
| Amounts payable to former shareholders of Canter | \$ - |
| Amounts payable to former shareholders of Prometric | 3,050 |
| Amounts payable to former shareholders of WSI franchises | 12,000 |
| Amounts payable to former shareholders of UDLA | 12,000 |
| | ----- |
| | \$27,050 |
| | ===== |

In connection with the Company's acquisition of Canter, cash consideration of \$13,145 was paid in a final settlement with the former shareholders of Canter during the quarter ended March 31, 2001. The liability and additional goodwill were recorded at December 31, 2000.

NOTE 6 - INCOME TAXES

The tax provisions for the three month periods ended March 31, 2001 and 2000 were based on the estimated effective tax rates applicable for the full years, after giving effect to significant unusual items related specifically to the interim periods. 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 37.5% for the three months ended March 31, 2001. The Company estimates that its effective income tax rate from continuing operations for the year ended December 31, 2001 will be 37.5%.

The Company's effective tax rate from continuing operations in 2000 was significantly affected by the inability to utilize tax benefits from certain investment losses of Sylvan Ventures, the impact of minority interests and timing of recognition of corporate level tax benefits from subsidiary losses. Because of these factors, the 2000 effective tax rate varied substantially from the statutory rate.

NOTE 7 - STOCKHOLDERS' EQUITY

The components of stockholders' equity are as follows:

| COMMON | ADDITIONAL PAID-IN | RETAINED | ACCUMU OTH COMPRE |
|--------|-----------------------|----------|-------------------------|
|--------|-----------------------|----------|-------------------------|

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| | STOCK | CAPITAL | EARNINGS | INCOME |
|--|-------|-----------|-----------|--------|
| | ----- | ----- | ----- | ----- |
| Balance at December 31, 2000 | \$373 | \$205,343 | \$360,232 | |
| Options exercised for purchase of 456 shares of common stock, including income tax benefit of \$2,078 | 4 | 5,880 | | |
| Other equity activity | | 126 | | |
| Comprehensive income (loss): | | | | |
| Net loss for the three months ended March 31, 2001 | | | (11,584) | |
| Unrealized gain on available- for-sale securities | | | | |
| Foreign currency translation adjustment | | | | |
| Total comprehensive loss | | | | |
| Balance at March 31, 2001 | \$377 | \$211,349 | \$348,648 | |
| | ===== | ===== | ===== | ===== |

NOTE 8 - COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss), net of related tax, are as follows:

| | THREE MONTHS ENDED MARCH 31, 2001 | MARCH 31, 2000 |
|---|--------------------------------------|-------------------|
| | ----- | ----- |
| Net income (loss) | \$ (11,584) | \$2 |
| Foreign currency translation adjustment | (10,298) | |
| Unrealized gain (loss) on available-for-sale securities | 23 | |
| Comprehensive income (loss) | \$ (21,859) | \$2 |
| | ===== | ===== |

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NOTE 9 - EARNINGS (LOSS) PER SHARE

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

| | THREE MONTHS ENDED MARCH 2001 | MARCH 2000 |
|---|----------------------------------|---------------|
| | ----- | ----- |
| Numerator used in basic and diluted earnings (loss) per common share: | | |
| Income (loss) from continuing operations | \$ (11,584) | \$ |

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| | | |
|---|-------------|-------|
| Loss from discontinued operations, net of tax | - | |
| Gain on disposal of discontinued operations, net of tax | - | 2 |
| | ----- | ----- |
| Net income (loss) | \$ (11,584) | \$2 |
| | ===== | ===== |
| Denominator: | | |
| Weighted average common shares outstanding | 37,441 | |
| 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 | 37,441 | |
| | ===== | ===== |
| Earnings (loss) per common share, basic: | | |
| Income (loss) from continuing operations | \$ (0.31) | |
| Loss from discontinued operations, net of tax | - | |
| Gain on disposal of discontinued operations, net of tax | - | |
| | ----- | ----- |
| Net income (loss) | \$ (0.31) | |
| | ===== | ===== |
| Earnings (loss) per common share, diluted: | | |
| Income (loss) from continuing operations | \$ (0.31) | |
| Loss from discontinued operations, net of tax | - | |
| Gain on disposal of discontinued operations, net of tax | - | |
| | ----- | ----- |
| Net income (loss) | \$ (0.31) | |
| | ===== | ===== |

Stock options and the convertible debentures were not dilutive for the quarter ended March 31, 2001 as the Company reported a net loss from continuing operations.

NOTE 10 - CONTINGENCIES

On November 18, 1996, ACT, Inc. filed suit against the Company alleging that the Company violated federal antitrust laws and committed various state law torts in connection with the operations of its computer-based testing operations and in obtaining a testing services contract from the NASD. The Company believes the grounds of the lawsuit are without merit and is defending the lawsuit vigorously. Management is unable to predict the ultimate outcome of the lawsuit, but believes that the ultimate resolution of the matter will not have a material effect on the Company's consolidated financial position.

On November 18, 1998, James Jinsoo and Christine Choi filed suit against the Company seeking damages and rescission under the Development Agreement they had entered into for Korea in 1995 and which had been terminated by the Company due to their default under the Development Agreement. The dispute will be decided by arbitration pursuant to the terms of the Agreement. The Company believes the grounds of the lawsuit are without merit and is defending the lawsuit vigorously. Management is unable to predict the ultimate outcome of the lawsuit but believes that the ultimate resolution of the matter will not have a material effect on the Company's consolidated financial position.

The Company is subject to other 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.

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NOTE 11 - BUSINESS SEGMENT INFORMATION

| | THREE MONTHS ENDED MARCH 31, 2001 | MARCH 31, 2001 | DECEMBER 31, 2000 |
|-------------------------------------|--------------------------------------|-------------------|----------------------|
| | ----- | ----- | ----- |
| Operating revenues: | | | |
| Sylvan Learning Centers | \$ 27,842 | \$ 90,169 | \$ 84,895 |
| Sylvan Education Solutions | 26,770 | 109,429 | 120,756 |
| Sylvan English Language Instruction | 13,017 | 128,414 | 135,857 |
| Sylvan International Universities | 52,817 | 239,762 | 239,166 |
| Sylvan Ventures | - | 94,303 | 82,006 |
| | ----- | ----- | ----- |
| | \$120,446 | \$662,077 | \$662,680 |
| | ===== | ===== | ===== |
| Segment profit (loss): | | | |
| Sylvan Learning Centers | \$ 5,690 | | \$ 5,002 |
| Sylvan Education Solutions | 1,675 | | 1,867 |
| Sylvan English Language Instruction | 688 | | 1,558 |
| Sylvan International Universities | 4,319 | | 2,685 |
| Sylvan Ventures | (25,763) | | (1,662) |
| | ----- | | ----- |
| | \$ (13,391) | | \$ 9,450 |
| | ===== | | ===== |
| Segment assets: | | | |
| Sylvan Learning Centers | | \$ 90,169 | \$ 84,895 |
| Sylvan Education Solutions | | 109,429 | 120,756 |
| Sylvan English Language Instruction | | 128,414 | 135,857 |
| Sylvan International Universities | | 239,762 | 239,166 |
| Sylvan Ventures | | 94,303 | 82,006 |
| | | ----- | ----- |
| | | \$662,077 | \$662,680 |
| | | ===== | ===== |

Segment profit (loss) is calculated as net operating profit (loss) for operating segments. Segment profit for Sylvan Ventures is calculated as the sum of the operating costs, net investment gain (loss) and equity in net loss of affiliates. There are no significant intercompany sales or transfers. The following table reconciles the reported information on segment profit (loss) to income (loss) from continuing operations before income taxes reported in the consolidated statements of operations:

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| | THREE MONTHS ENDED MARCH 31 2001 | 2000 |
|--|-------------------------------------|-------|
| | ----- | ----- |
| Total profit (loss) for reportable segments | \$ (13,391) | \$ |
| Corporate general and administrative expense | (5,986) | |
| Other income (expense) and minority interest, net | 843 | |
| | ----- | ----- |
| Income (loss) from continuing operations before income taxes | \$ (18,534) | \$ |
| | ===== | ===== |

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

OVERVIEW

Sylvan Learning Systems, Inc. ("the Company" or "Sylvan") generates revenues from four business segments: Sylvan Learning Centers, which earns primarily franchise royalties, franchise sales fees and Company-owned Learning Center revenues; Sylvan Education Solutions, which earns revenues from providing supplemental remedial education services to public and non-public schools as well as providing teacher training services; Sylvan English Language Instruction, which earns primarily franchise royalties, company-owned center revenue and franchise sales fees; and Sylvan International Universities, which earns tuition and dormitory fees paid by the students of Universidad Europea de Madrid CEES ("UEM"), Swiss Hotel Association Hotel Management School Les Roches ("Les Roches"), Universidad del Valle de Mexico ("UVM") and Universidad de Las Americas ("UDLA"). A fifth segment, Sylvan Ventures, invests in and develops companies to bring technology solutions to the education and training marketplace. Sylvan Ventures has not generated revenues since its inception in 2000, but costs have been incurred to oversee and develop the investments.

The following table sets forth the percentage relationships of operating revenues and direct costs for each division, as well as certain income statement line items expressed as a percentage of total revenues for the periods indicated:

| | THREE MONTHS END 2001 |
|-------------------------------------|--------------------------|
| | ----- |
| Revenues: | |
| Sylvan Learning Centers | 23% |
| Sylvan Education Solutions | 22% |
| Sylvan English Language Instruction | 11% |
| Sylvan International Universities | 44% |
| | ----- |
| Total revenues | 100% |
| Direct costs: | |
| Sylvan Learning Centers | 18% |
| Sylvan Education Solutions | 21% |
| Sylvan English Language Instruction | 10% |
| Sylvan International Universities | 40% |

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| | |
|---|-------|
| Total direct costs | 89% |
| General and administrative expenses | 5% |
| Sylvan Ventures operating costs | 5% |
| | |
| Operating income | 1% |
| Non-operating expense (including equity in net loss of Ventures affiliates) | 16% |
| | |
| Income (loss) from continuing operations | (15%) |
| | |
| Income tax benefit (expense) | 5% |
| | |
| Income (loss) from continuing operations | (10%) |

RESULTS OF OPERATIONS

Sylvan is a leading international provider of educational services to families and schools. The Company provides lifelong educational services through five separate business segments. The Sylvan Learning Centers segment designs and delivers individualized tutorial programs to school age children through franchised and Company-owned Learning Centers. This segment also includes the operations of Schulerhilfe, a major provider of tutoring services in Germany. The Sylvan Education Solutions segment principally provides educational programs to students of public and non-public school districts through contracts funded by Title 1 and state-based programs. This segment also

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provides professional development and graduate degree programs to teachers through the Canter Group. The Sylvan English Language Instruction segment consists of the operations of Wall Street Institute, Kft., ("WSI"), a European-based franchiser and operator of learning centers that teach the English language to professionals. Sylvan International Universities segment owns or maintains controlling interests in four private, for-profit universities located in Spain, Switzerland, Mexico and Chile. The Company's newest segment, Sylvan Ventures, invests in and develops companies that are creating emerging technology solutions for the education marketplace.

Consistent with the stated goal of focusing resources and management's efforts on the core business of educational services, and in order to fund expansion of technology applications in educational and training services, the Company consummated the sale of Prometric, a computer-based testing business and Aspect Language Schools, B.V. ("Aspect"), an English Language immersion business in 2000. Unless specifically noted, all discussion of financial results excludes the results Prometric and Aspect except as disclosed as discontinued operations.

COMPARISON OF RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2001 TO RESULTS FROM THE THREE MONTHS ENDED MARCH 31, 2000.

REVENUES. Total revenues from continuing operations increased by \$44.9 million, or 59%, to \$120.4 million in 2001 from \$75.5 million in 2000. Included in the total revenues from continuing operations in 2001 were \$36.7 million of revenues from Les Roches, UVM and UDLA, which were acquired in the third and fourth quarters of 2000. Total revenues from continuing operations increased 11%,

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excluding the increase due to the Les Roches, UVM and UDLA acquisitions.

SYLVAN LEARNING CENTERS revenue increased by \$5.2 million, or 23%, to \$27.8 million for the quarter ended March 31, 2001, compared to \$22.7 million in the same period in 2000. Revenues from Company-owned learning centers increased \$1.7 million, or 15%, to \$12.8 million during the first quarter of 2001. Same center revenues increased 7%, or \$0.8 million, with the remaining revenue increase of \$0.9 million generated from five Company-owned centers acquired from franchise owners and a net of one new center opened during the past year. In May of 2000, the Company acquired Ivy West, an SAT preparation company based in California. The acquisition of Ivy West resulted in additional revenue of \$1.9 million for the three months ended March 31, 2001. Franchise sales increased by \$0.3 million primarily due to increased territory sales in the U.S. and Canada. Franchise royalties increased by \$0.9 million, or 17%, in the first quarter of 2001 as a result of a net increase of forty-nine new Learning Centers opened after March 31, 2000, and a 12% increase in same center revenue. International revenues, primarily Schulerhilfe, remained constant at \$4.0 million in the first quarter of 2001 and 2000. Operating revenue for Sylvan Learning Centers represents 23% of total revenues from continuing operations of the Company for the three month period ended March 31, 2001.

SYLVAN EDUCATION SOLUTIONS revenue increased by \$0.8 million, or 3%, to \$26.8 million for the quarter ended March 31, 2001, compared to the same period in 2000. Career Starters (formerly known as "Sylvan At Work") revenue increased \$1.0 million over the same period in 2000 as a result of new contracts signed since March 31, 2000. Canter revenue decreased \$0.2 million to \$5.2 million for the quarter ended March 31, 2001 from \$5.4 million in the same period in 2000, primarily as a result of timing differences of shipments of materials to students between periods. Operating revenue for Sylvan Education Solutions represents 22% of total revenues from continuing operations of the Company for the three month period ended March 31, 2001.

SYLVAN ENGLISH LANGUAGE INSTRUCTION revenue increased \$0.6 million, or 5%, to \$13.0 million for the quarter ended March 31, 2001, compared to the same period in 2000. This increase was almost entirely the result of increased tuition revenues from Company-owned centers along with improved sales volumes in existing franchised centers. Operating revenue for Sylvan English Language Instruction segment represents

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11% of total revenues from continuing operations of the Company for the three month period ended March 21, 2001.

SYLVAN INTERNATIONAL UNIVERSITIES revenue for the first quarter of 2001 increased \$38.3 million, or 264%, to \$52.8 million, compared to the same period in 2000. International Universities revenue increased \$36.7 million due to the acquisitions of controlling interests of Les Roches, UVM and UDLA, which occurred in the third and fourth quarters of 2000 and are, therefore, not included in revenue for the quarter ended March 31, 2000. Seasonality of university semesters significantly impacts these operating revenues as evidenced by the semester break at UDLA in the first quarter which results in limited class schedules for the summer break during the first two months of the first quarter. Operating revenue for Sylvan International Universities represents 44% of total revenues from continuing operations of the Company for the three month period ended March 31, 2001.

DIRECT COSTS. Total direct costs of revenues excluding Sylvan Ventures increased 68% to \$108.1 million in 2001 from \$64.4 million in 2000. Included in direct

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costs in the first quarter of 2001 were \$33.9 million of costs of Les Roches, UVM and UDLA, which were acquired in the third and fourth quarters of 2000. Total direct costs increased \$9.7 million, or 15%, excluding the costs related to Les Roches, UVM and UDLA. Direct costs as a percentage of total revenues increased to 90% in 2001 from 85% in 2000. This increase in direct costs as a percentage of revenues is primarily due to the expenses related to the expansion of the International Universities and the impact of seasonality in acquired universities.

SYLVAN LEARNING CENTERS expenses increased \$4.5 million to \$22.2 million, or 80% of Learning Centers revenue for 2001, compared to \$17.7 million, or 78% of Learning Centers revenue for the same period in 2000. Approximately \$1.7 million of the increase in the first quarter of 2001 relates to expenses incurred in Company-owned learning centers due to the acquisition of franchised learning centers and variable costs associated with higher revenues at existing Company-owned centers. The acquisition of Ivy West resulted in \$1.6 million of increased cost during the three months ended March 31, 2001. The remaining cost increase for the quarter relates to additional franchise support costs. Despite this increase, franchise support costs actually decreased as a percentage of franchise royalty revenue to 55% compared to 58% for the first quarter of 2000.

SYLVAN EDUCATION SOLUTIONS expenses increased by \$1.0 million to \$25.1 million, or 94% of Sylvan Education Solutions revenue for the quarter ended March 31, 2001, compared to \$24.1 million or 93% of Sylvan Education Solutions revenue for the same period in 2000. The increase in expenses as a percentage of revenue for the quarter ended March 31, 2001 is primarily due to investments made in Canter personnel and technology systems to provide the necessary infrastructure to support Canter's expected future growth.

SYLVAN ENGLISH LANGUAGE INSTRUCTION expenses increased by \$1.4 million to \$12.3 million or 95% of Sylvan English Language Instruction revenues for the three month period ended March 31, 2001, compared to \$10.9 million or 88% of Sylvan English Language Instruction revenues for the same period in 2000. The increase in expenses as a percentage of revenue for the three months ended March 31, 2001 is primarily the result of increasing overhead costs related to the future internal expansion of the international network of centers.

SYLVAN INTERNATIONAL UNIVERSITIES expenses increased by \$36.7 million to \$48.4 million, or 92% of Sylvan International Universities revenue for the three month period ended March 31, 2001, compared to \$11.1 million or 81% of Sylvan International Universities revenue for the same period in 2000. This increase is primarily due to the acquisition of controlling interests of Les Roches, UVM and UDLA in the third and fourth quarters of 2000, as well as an increase in headquarter expenses to support the expansion of the university network. Closure of UDLA for the summer break in January and February was the primary reason for the division's decreased operating margins in comparison to the first quarter of 2000.

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OTHER EXPENSES. General and administrative expenses increased by \$1.2 million during the three month period ended March 31, 2001, compared to the same period in 2000. The increase was primarily due to performance-based bonus recognition and moving costs incurred in 2001. General and administrative expenses decreased to 5% of total revenues for the three month period ended March 31, 2001, compared to 6% of revenues for the same period in 2000.

Sylvan Ventures operating costs increased by \$4.2 million to \$5.6

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million for the three months ended March 31, 2001, compared to \$1.4 million for the same period in 2000. eSylvan, a subsidiary of Sylvan Ventures, incurred \$3.6 million of expenses related to the development of its Internet-based tutoring operations. Sylvan Ventures incurred management expenses of \$2.0 million in connection with research, evaluation and management of its portfolio companies.

Sylvan Ventures equity in net losses of affiliates increased by \$19.5 million to \$19.8 million for the first quarter of 2001, compared to \$0.3 million for the same period in 2000. These losses relate to Sylvan Ventures' share of operating losses generated by the early stage enterprises in the investment portfolio and the amortization of the difference between the initial carrying amount of equity method investments and the underlying equity in net assets of these investments at the time of purchase. Sylvan Ventures investment losses of \$0.4 million consisted of impairment charges related to portfolio investments. Minority interests' share of Sylvan Ventures losses totaled \$1.3 million for the first quarter of 2001.

Other non-operating items remained constant at \$0.4 million for the quarter ended March 31, 2001, compared to the same period in 2000. The increase in interest and other income and decrease in equity in net loss of other affiliates of \$0.4 million and \$0.5 million, respectively, were partially offset by an increase in other minority interest of \$0.7 million.

The Company's effective tax rate from continuing operations was 37.5% for the three month period ended March 31, 2001. The reported effective income tax rate from continuing operations differs from the U.S. federal statutory tax rate due to the impact of state income taxes, minority interests, foreign income taxed at lower rates and the inability to utilize tax benefits from certain investment losses of Sylvan Ventures. The Company anticipates that its effective income tax rate from continuing operations for the year ending December 31, 2001 will be 37.5%.

The Company's effective tax rate from continuing operations in 2000 was significantly affected by the inability to utilize tax benefits from certain investment losses of Sylvan Ventures, the impact of minority interests and timing of recognition of corporate level tax benefits from subsidiary losses. Because of these factors, the 2000 effective tax rate varied substantially from the statutory rate.

INCOME (LOSS) FROM CONTINUING OPERATIONS. Income from continuing operations decreased by \$15.0 million, to a loss of \$11.6 million for the three months ended March 31, 2001. The decrease is primarily the result of additional Sylvan Ventures related costs and investment losses totaling \$14.5 million in the quarter ended March 31, 2001.

LIQUIDITY AND CAPITAL RESOURCES

Cash used by operations was \$76.2 million for the three month period ended March 31, 2001, a decrease of \$92.3 million as compared to the three months ended March 31, 2000. The reported net loss of \$11.6 million was offset by significant non-cash items such as depreciation and amortization charges of \$9.3 million and equity in net loss of affiliates, primarily due to Sylvan Ventures, of \$19.9 million. Working capital related decreases in liquidity of \$95.0 million consisted primarily of income tax payments of \$95.0 million, primarily resulting from the sale of Prometric in the first quarter of 2000, which were not payable until 2001.

Cash provided by investing activities was \$13.4 million in the three

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month period ended March 31, 2001 compared to cash provided by investing activities of \$659.3 million in 2000. The 2001 investment activity was primarily the result of proceeds from the net sale of available-for-sale securities (\$79.6 million) partially offset by increases in investments in and advances to affiliates primarily related to Sylvan Ventures (\$32.2 million), purchases of property and equipment (\$13.3 million) and the payment of contingent consideration for a prior acquisition (\$13.1 million). The significant investing proceeds received in 2000 related primarily to the sale of the Prometric division (\$712.2 million). At March 31, 2001, the Company has accrued obligations payable in cash of \$27.1 million related to contingent consideration for certain prior acquisitions. The amounts are expected to be paid later in 2001.

Cash provided by financing activities was \$13.8 million in the three month period ended March 31, 2001 compared to cash used by financing activities of \$136.7 million in 2000. The 2001 financing activity related primarily to cash received from the minority interest members of Sylvan Ventures (\$16.1 million) and proceeds from the exercise of options (\$3.8 million) partially offset by net payments of long-term debt (\$6.7 million). Cash used by financing activities of \$136.7 million in 2000 related primarily to the repayment of the Company's borrowings under its revolving credit facility (\$127.6 million) and the repurchase of shares of its common stock (\$9.9 million).

The Company anticipates that cash flow from operations, available cash and existing credit facilities, will be sufficient to meet its operating requirements, including the expansion of its existing business, fund International University acquisitions, pay contingent consideration and fund Sylvan Ventures investments and operating costs. Sylvan Ventures has outstanding commitments to provide certain additional funding totaling \$21.2 million to certain portfolio companies. The Company continues to examine opportunities in the educational services industry for potential synergistic acquisitions.

EURO CONVERSION

On January 1, 1999, certain countries of the European Union established fixed conversion rates between their existing currencies and one common currency, the Euro. The Euro is now traded on currency exchanges and may be used in business transactions. The Company encountered no difficulties related to the initial adoption of the Euro in 1999. Beginning in January 2002, new euro-denominated currencies will be issued and the existing currencies will be withdrawn from circulation. The Company is currently evaluating the systems and business issues raised by the euro conversion. These issues include the need to adapt computer and other business systems and equipment and the competitive impact of cross-border transparency. At present, management does not believe the Euro conversion will have a material impact on the Company's financial condition or results of operations.

CONTINGENT MATTERS

In connection with the Company's acquisition of Les Roches, variable amounts of contingent consideration are payable to the seller if specified levels of earnings are achieved in 2001 and 2002. The Company will record the contingent consideration when the contingencies are resolved and the additional consideration is payable.

In connection with the Company's acquisition of UDLA, variable amounts of contingent consideration are payable to the seller in 2006 and 2007 if specified levels of earnings are achieved in 2004, 2005 and 2006. The Company will record the contingent consideration when the contingencies are resolved and the additional consideration is payable.

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The Company has entered into agreements with certain franchisees of Sylvan Learning Centers and Wall Street Institute that allow the franchisees to require that the Company purchase the centers back at a predetermined multiple of operating results if specified operating results thresholds are achieved. When the

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Company can assess the likelihood of a put being exercised and the amount of the related commitment to purchase the center, such obligation is disclosed.

EFFECTS OF INFLATION

Inflation has not had a material effect on Sylvan's revenues and income from continuing operations in the past three years. Inflation is not expected to have a material effect in the foreseeable future.

SEASONALITY IN RESULTS OF OPERATIONS

The Company experiences seasonality in results of operations primarily as a result of changes in the level of student enrollments and the timing of semester cycles, particularly in the International Universities segment. Timing of semester breaks at the International Universities results in the most favorable operating performance being achieved in the second and fourth quarters of the year. Other factors that impact the seasonality of operating results include: timing of contracts funded under Title I, timing of franchise license fees and the timing of Sylvan Ventures' development costs. Revenues and profits in any period will not necessarily be indicative of results in subsequent periods.

ALL STATEMENTS CONTAINED HEREIN THAT ARE NOT HISTORICAL FACTS, INCLUDING BUT NOT LIMITED TO, STATEMENTS REGARDING THE COMPANY'S CONTINGENT PAYMENT OBLIGATIONS RELATING TO ACQUISITIONS, FUTURE CAPITAL REQUIREMENTS, POTENTIAL ACQUISITIONS, AND THE COMPANY'S FUTURE DEVELOPMENT PLANS ARE BASED ON CURRENT EXPECTATIONS. THESE STATEMENTS ARE FORWARD LOOKING IN NATURE AND INVOLVE A NUMBER OF RISKS AND UNCERTAINTIES. POLITICAL, ECONOMIC, CURRENCY, TAX, REGULATORY, TECHNOLOGICAL, COMPETITIVE AND OTHER FACTORS DESCRIBED IN THE COMPANY'S REPORTS FILED FROM TIME TO TIME WITH THE COMMISSION COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THE FORWARD-LOOKING STATEMENTS. THE COMPANY CAUTIONS READERS NOT TO PLACE UNDUE RELIANCE ON ANY SUCH FORWARD LOOKING STATEMENTS, WHICH STATEMENTS ARE MADE PURSUANT TO THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND, AS SUCH, SPEAK ONLY AS OF THE DATE MADE.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK

Market risk is the risk of loss to future earnings, to fair values or to future cash flows that may result from the changes in the price of financial instruments. The Company is exposed to financial market risks, including changes in foreign currency exchange rates, interest rates and investment values. The Company occasionally uses derivative financial instruments to protect against adverse currency movements related to significant foreign acquisitions. Exposure to market risks related to operating activities is managed through the Company's regular operating and financing activities.

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FOREIGN CURRENCY RISK

The Company derives approximately 58% of its revenues from continuing operations from customers outside the United States. This business is transacted through a network of international subsidiaries, generally in the local currency that is considered the functional currency of that foreign subsidiary. Expenses are also incurred in the foreign currencies to match revenues earned and minimize the Company's exchange rate exposure to operating margins. A hypothetical 10% adverse change in average annual foreign currency exchange rates would reduce net income and cash flows for the quarter ended March 31, 2001 by \$0.8 million. The Company generally views its investment in the majority of its foreign subsidiaries as long-term. The effects of a change in foreign currency exchange rates on the Company's net investment in foreign subsidiaries are reflected in other comprehensive income. A 10% depreciation in functional currencies relative to the U.S. dollar would result in a decrease in consolidated stockholders' equity at March 31, 2001 of approximately \$15.5 million.

INTEREST RATE RISK

The Company holds its cash and cash equivalents in high quality short-term fixed income securities. Consequently, the fair value of the Company's cash and cash equivalents would not be significantly impacted by either a 100 basis point increase or decrease in interest rates due to the short-term nature of the Company's portfolio. The Company's long-term revolving credit facility bears interest at variable rates, and the fair value of this instrument is not significantly affected by changes in market interest rates. The Company's convertible debentures bear interest at 5%, which presently approximates the market rate and therefore the fair value approximates the recorded value of this liability. A 100 basis point decrease in interest rates would impact net interest income and interest expense by reducing pretax income for the quarter ended March 31, 2001 by \$0.4 million.

INVESTMENT RISK

The Company's investment portfolio contains debt securities that mature within one year. A hypothetical 10% adverse change in the fair value of the debt securities would not materially adversely effect earnings or cash flows because of the Company's ability to hold the debt securities until maturity.

In addition to the debt securities, the Company also has an investment portfolio that consists of direct investment positions in education technology companies through Sylvan Ventures as well as short-term investments in available-for-sale debt and equity securities. The Company's investment portfolio is exposed to risks arising from changes in these investment values.

The Company's investment portfolio includes a number of holdings of non-publicly traded companies in the educational services industry. The Company accounts for these investments using either the cost method (cost less impairment, if any) or the equity method of accounting. Equity method investments are specifically excluded from the scope of this disclosure. Non-public investments where the Company owns less than a 20% interest are subject to fluctuations in market value, but their current illiquidity reduces the exposure to

pure market risk while resulting in risk that the Company may not be able to liquidate these investments in a timely manner.

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The Company is exposed to equity price risks on equity securities included in the portfolio of investments entered into for the promotion of business and strategic objectives. These investments are generally small capitalization stocks in the Internet segment of the educational services industry. The Company typically does not attempt to reduce or eliminate its market exposure on these securities. A 10% adverse change in equity prices would not materially impact the fair value of the Company's marketable securities and comprehensive income.

All the potential impacts noted above are based on sensitivity analysis performed on the Company's financial position at March 31, 2001. Actual results may differ materially.

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PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

The Company did not file any reports on Form 8-K during the three month period ended March 31, 2001.

SIGNATURES

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

Sylvan Learning Systems, Inc.

Date: May 11, 2001

/s/ Sean Creamer

Sean Creamer, Vice President Corporate Finance

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