The Advisory Board Company

Annual Report to Shareholders

Fiscal Year 2004

The Advisory Board Company in Brief

The Advisory Board Company provides best practices research and analysis to the health care industry, focusing on business strategy, operations, and general management issues. The company's research services are offered through discrete annual programs to a membership of more than 2,300 hospitals, health systems, pharmaceutical and biotech companies, health care insurers, and medical device companies.

Our business model is predicated on the view that there are economies of intellect in health care, compelling intellectual advantages to large numbers of health systems, corporations, and clinicians collaborating to identify ideas with potential to shape the industry. By providing a standardized set of services in each of our programs, we are able to spread our largely fixed program cost structure across our membership base of participating companies. This economic model allows us to provide our members with access to industry best practices at a fraction of the cost of a customized analysis performed by a major consulting firm.

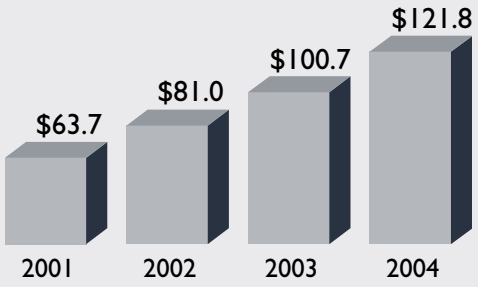
For a fixed annual fee, members of each of our programs have access to an integrated set of services designed to provide valuable, timely information derived from lessons learned from the industry's most progressive participants. These services can include:

- Best practice research studies
- Executive education seminars
- Customized research briefs
- Web-based access to content databases and decision-support tools

We strive to provide our members with an unparalleled level of service. Our hope is that our members conclude that they do not work with any other organization so dedicated to intelligent service and that therefore there is little question as to their long-term commitment to working with us.

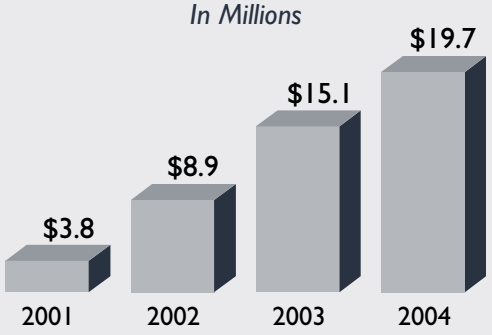
Annual Revenues for Fiscal Years Ending March 31

In Millions

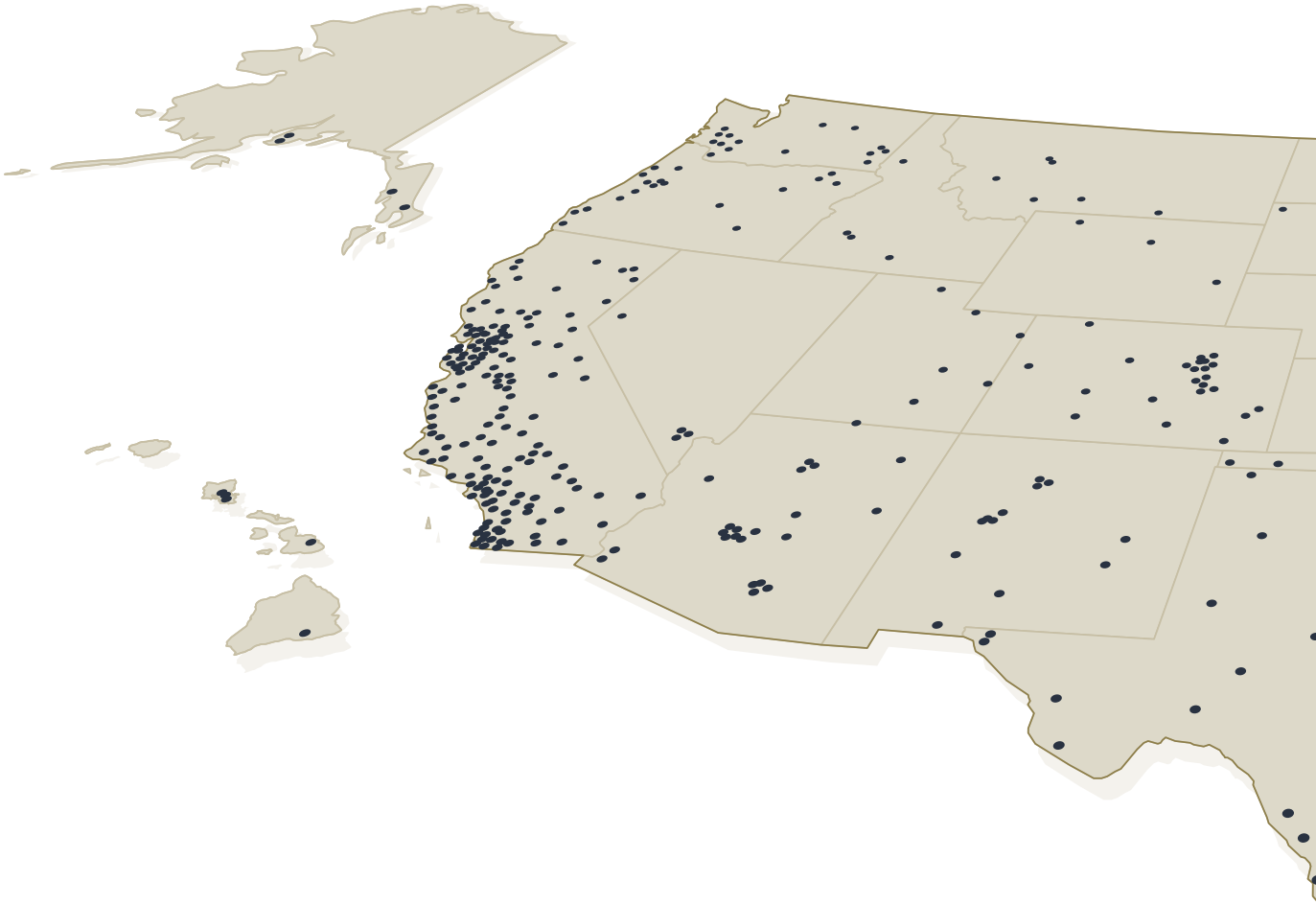


Pro Forma Net Income* for Fiscal Years Ending March 31

In Millions



* Pro forma presentations are not presented in accordance with Generally Accepted Accounting Principles (GAAP). See page 6 for a reconciliation of GAAP to pro forma results.



Representative Advi

Academic Medical Centers

Beth Israel Medical Center
Brigham and Women's Hospital
Duke University Medical Center
Hospital of the University of Pennsylvania
Indiana University Medical Center
Johns Hopkins Health System
Loma Linda University Medical Center
Loyola University Health System
Massachusetts General Hospital
Montefiore Medical Center
The Mount Sinai Medical Center
MUSC Medical Center
New York University Medical Center
North Carolina Baptist Hospitals
Northwestern Memorial Hospital
The Ohio State University Medical Center
Stanford Hospitals and Clinics
UCLA Medical Center
UCSD Healthcare
University of Alabama Hospital
University of Chicago Hospitals
University of Michigan Medical Center
University of Wisconsin Hospital
Yale-New Haven Hospital

Teaching Hospitals

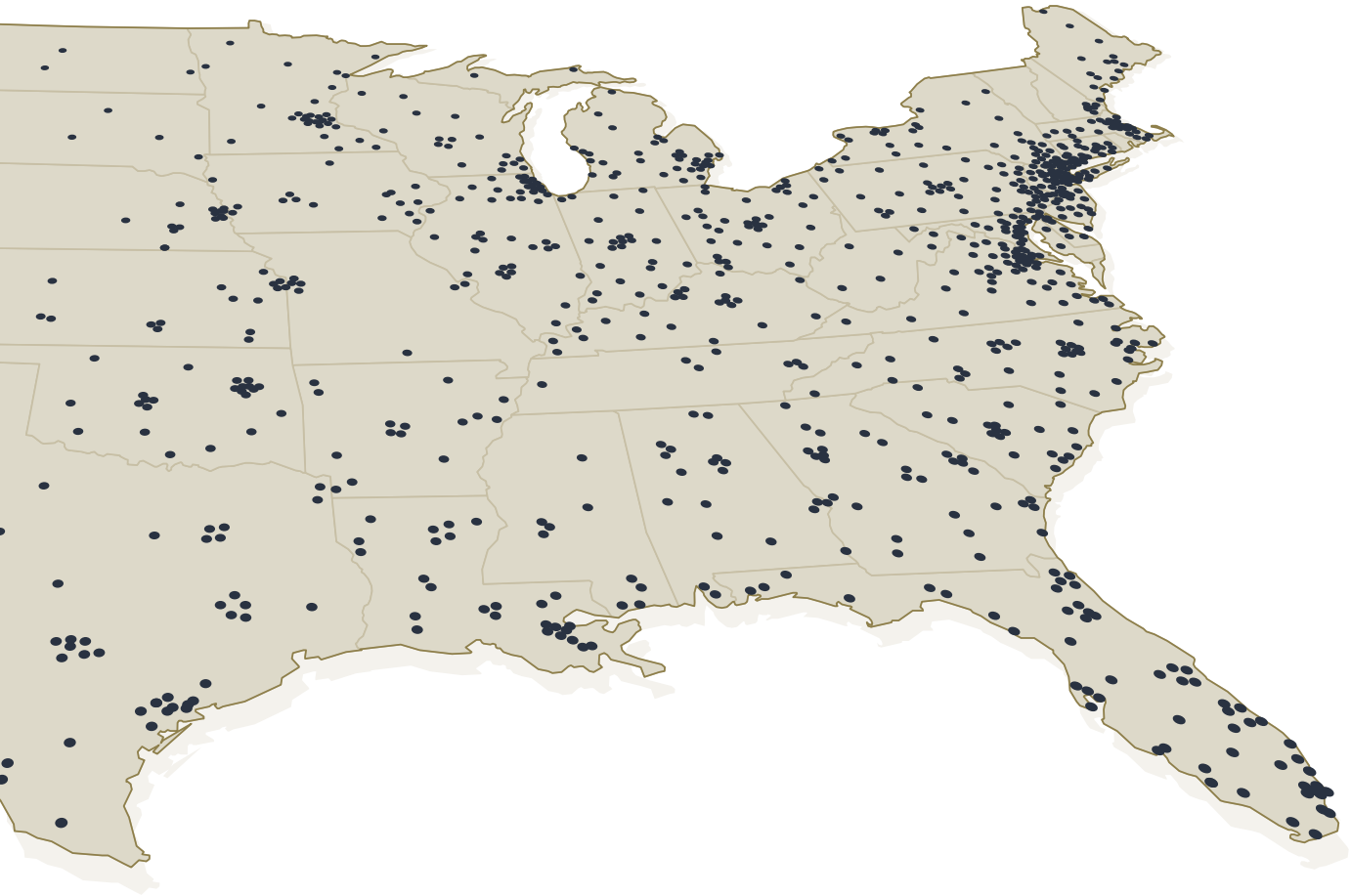
Bayview Medical Center
Detroit Medical Center
Detroit Receiving Hospital
Grace Hospital
Grady Memorial Hospital
Harborview Medical Center
Harper Hospital
Harris County Hospital District
Hurley Medical Center
Lenox Hill Hospital
Long Beach Memorial Medical Center
MacNeal Hospital
Overlook Hospital
Parkland Memorial Hospital
Pitt County Memorial Hospital
Queen's Medical Center
St. Luke's Episcopal Hospital
St. Luke's-Roosevelt Hospital Center
Saint Mary's Hospital
Saint Vincent's Hospital and Medical Center
Scott and White Memorial Hospital
Sinai Hospital of Baltimore
William Beaumont Hospital

Major Health Systems

Adventist Health System
Ascension Health
Atlantic Health System
Aurora Health Care
Baptist Health System
Baylor Health System
BJC Health System
Bon Secours Health System
Carilion Health System
Catholic Healthcare Partners
Catholic Healthcare West
Catholic Health Initiatives
Cedars-Sinai Health System
Clarian Health Partners
Cleveland Clinic Health System
Community Health Systems
Fairview Hospital and Health System
HCA
HealthEast Care System
Henry Ford Health System
Inova Health System
Legacy Health System
North Shore-Long Island Jewish Health System
OSF Healthcare System
Providence Health System
Robert Wood Johnson Health System
Scripps Health
Sharp HealthCare
Sutter Health
Tenet Health System
Texas Health Resources
Triad Hospitals, Inc.
Trinity Health
Veterans Integrated Health Networks
Wheaton Franciscan Services

Clinics and Specialty Hospitals

Barbara Ann Karmanos Cancer Institute
Children's Healthcare of Atlanta
Children's Hospital—Boston
Children's Hospital of Los Angeles
Children's Medical Center of Dallas
Children's National Medical Center
Cleveland Clinic Foundation
Dana-Farber Cancer Institute
H. Lee Moffitt Cancer Center
Hospital for Joint Diseases Institute
Hospital for Special Surgery
Kaiser Foundation Hospital
Mayo Foundation
Memorial Sloan-Kettering Cancer Center
National Institutes of Health
New York Eye and Ear Infirmary



sory Board Members

Ochsner Clinic Foundation
Roswell Park Cancer Institute
University of Texas M.D. Anderson Cancer Center
Woman's Hospital Foundation

Community Hospitals

Bronx-Lebanon Hospital Center
Cape Cod Hospital
Cape Fear Valley Medical Center
Charleston Area Medical Center
Danbury Hospital
DCH Regional Medical Center
Eastern Maine Medical Center
Gratiot Community Hospital
Heartland Regional Medical Center
Hoag Memorial Hospital
Ingham Regional Medical Center
Lenox Hill Hospital
Lutheran Hospital
Maimonides Medical Center
Maine Medical Center
Medical Center of Central Georgia
Mississippi Baptist Medical Center
Mount Clemens General Hospital
Northside Hospital
Norwalk Hospital
Our Lady of Lourdes Medical Center
Our Lady of the Lake Regional Medical Center
Reading Hospital and Medical Center
Resurrection Medical Center
Saint Francis Hospital
St. Luke's Regional Medical Center
Tucson Medical Center
Valley Baptist Medical Center
Washoe Medical Center

Insurers and Managed Care

Aetna
Anthem, Inc.
Blue Shield of California
Blue Cross and Blue Shield of Florida
Blue Cross and Blue Shield of Montana
Blue Cross and Blue Shield of Northeastern Pennsylvania
Blue Cross Blue Shield of Tennessee
Excellus Blue Cross Blue Shield
First Health
Harvard Pilgrim Health Care
HIP
Horizon Blue Cross Blue Shield of New Jersey
Mid Atlantic Medical Services, Inc.
Triple-S Management
WellChoice, Inc.

Pharmaceutical and Biotechnology

Abiomed, Inc.
Amgen, Inc.
Aventis Pharmaceuticals
Bayer Pharmaceutical
Becton Dickinson Health Care Systems
Berlex Laboratories, Inc.
Biosite Diagnostics, Inc.
Bristol-Myers Squibb
Eli Lilly and Company
Johnson & Johnson Health Care Systems
The Medicines Company
Merck & Company
Novartis Pharmaceuticals Corporation
Ortho Biotech
Pfizer, Inc.
Philips Medical Systems North America Inc.
Quest Diagnostics Incorporated
Roche Laboratories
Schering-Plough
Scios Inc.
WellChoice, Inc.
Wyeth Pharmaceuticals

Health Care Corporations

ALARIS Medical, Inc.
American Healthways, Inc.
Boston Scientific Corporation
California HealthCare Foundation
Cardinal Health, Inc.
Eclipsys Corporation
Elekta Oncology Systems, Inc.
Espirito Santo Saude
Fresenius Medical Care Extracorporeal Alliance
GE Medical Systems
Guidant Corporation
Hammes Company
Hill-Rom
Hitachi Medical Systems America, Inc.
IBM Corporation
IDX Systems Corporation
Jose de Mello Saude
Kaiser Permanente
McKesson
MedAmerica, Inc.
MedCath, Inc.
Medtronic, Inc.
Siemens Medical Solutions, USA
Varian Medical Systems
Xerox

To Our Shareholders:

I am pleased to report that fiscal year 2004 was another strong year for The Advisory Board Company. Our best practice research consistently provided tremendous strategic and operational insights for our member organizations, as evidenced by our institutional renewal rate of 87 percent and our revenue growth of 21 percent over this past year. Given the underlying challenges in the health care sector and the larger economy across the year, our performance stands as a testament to the value of our research in helping member executives address their most pressing business issues. As a result of our relevant and timely research, strong product portfolio, and unique business model, we continue to meet our stated objective of building a scalable growth company with unparalleled products and services.

Serving the Health Care Industry—Growth and Innovation Driving Opportunity

There has never been a more exciting time to serve the health care industry through the identification and dissemination of proven best practices. Health care is a $1.7 trillion industry that is experiencing a period of dynamic change and innovation. It is a fragmented environment in need of strategic insights and innovative ideas. Furthermore, the aging of the population continues to spur the sector's fast growth, resulting in a need for new care models, an increased demand for capital, and a dearth of adequately trained skilled labor.

Amidst these trends, technological and operational advances in the sector continue apace. In our research this year, our staff has profiled a wide array of the latest clinical and management developments, including:

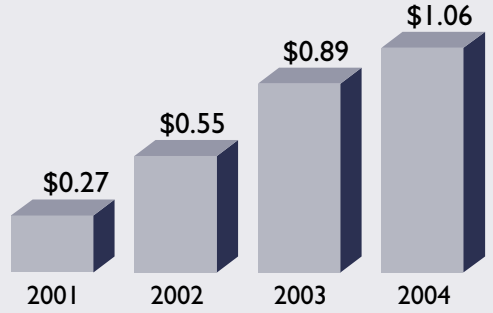
- Virtual colonoscopy and combined PET/CT scans, which are revolutionizing cancer screening and diagnosis
- New care models which provide increased clinical efficiency and enhanced workforce productivity
- Innovative tactics for directly addressing the increasing bad debt issues faced by many institutions during more challenging economic times
- Groundbreaking technologies, such as Computerized Physician Order Entry, that are enhancing patient safety and reducing medical errors

In this environment of fast growth, new technologies, and elevated uncertainty, health care executives are increasingly in need of analytical support, strategic insight, and a holistic view of the greater health care landscape. With a growing base of more than 2,300 member institutions, our success in this environment confirms that the Advisory Board stands as a trusted partner to provide health care executives this intellectual ballast. Our more than fifteen years of experience in this terrain, defined research methodology, and knowledge base of more than 30,000 management practices, uniquely position us to guide health care organizations through times of change.

Consistent Growth and Strong Financial Results

Across this year we have continued to focus on delivering consistent growth and strong financial results. Accordingly, revenues grew 21 percent to $121.8 million in fiscal 2004 from $100.7 million in fiscal 2003. Net income increased to $18.7 million in fiscal 2004 from $14.4 million in fiscal 2003, with earnings of $1.00 per diluted share versus $0.85 in the prior year. In addition, pro forma net income increased to $19.7 million in fiscal 2004 from $15.1 million in fiscal 2003, with

Pro Forma Earnings per Diluted Share*
for Fiscal Years Ending March 31



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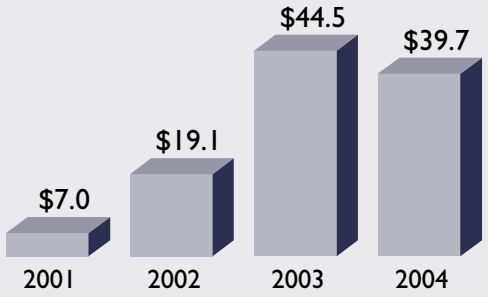
Cash Flow from Operations
for Fiscal Years Ending March 31

In Millions



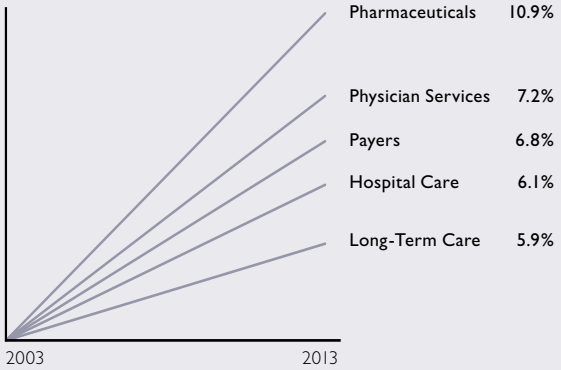
pro forma earnings of $1.06 per diluted share versus $0.89 in the prior year. (See page 6 for a reconciliation of GAAP to pro forma results.)

As in the past, our growth was driven by four primary sources: new program launches, cross-selling programs to existing members, the addition of new member institutions, and price increases. Our new program launches in information technology management, physician leadership development, and revenue cycle performance did particularly well, receiving strong member attachment. As always, each of these was developed with the input of industry thought leaders from such organizations as Brigham and Women's Hospital, Stanford Hospital and Clinics, Cedars-Sinai Medical Center, Baylor Healthcare System, and the University of Michigan Health System, which served as charter members, guiding the programs' research agendas and service offerings.

For 2005, we will continue to target between three and four new program launches, leveraging our strong industry reputation and our new product pipeline of more than 25 concepts in development. In addition, our 2005 strategy calls for capitalizing on our cross-sell opportunity (currently estimated at over $1.1 billion) by growing our relationships with existing members. Because we are in constant contact with our member executives through member meetings, research interviews, and on-line fax polls, we are able to consistently align our agendas, services, and new launches with the most important issues facing the industry. Our recent performance has demonstrated that even in a more challenging business environment, our research provides substantial value to organizations that are facing increasingly complex business problems. Our continued growth is driven by the strength of our value proposition, whereby a member needs to implement only one of the dozens of best practices we profile each year in order to receive a substantial return on their membership investment.

Serving a $1.7 Trillion Health Care Industry

*Annual Growth in Spending**



- Health care is a $1.7 trillion market, growing across all major segments we serve.
- Sources of growth include price increases, new program launches, the addition of new member institutions, and cross-selling current programs to existing members.
- Our three new programs launched this year focused on information technology management, physician leadership development, and revenue cycle performance.

* Source: Centers for Medicare and Medicaid Services; *Journal of Health Affairs*, authored by members of Centers for Medicare and Medicaid Services, Office of the Actuary.

The Force of Membership: Uniquely Positioned to Deliver Cutting-Edge Research

Ultimately our success as a research organization is based on our ability to identify proven best practices across a wide range of topic areas. With a membership of more than 2,300 of the largest and most progressive health care organizations, the Advisory Board is uniquely positioned to provide cutting-edge research to the industry. As of the end of fiscal 2004, we counted among our members not only the top 17 hospitals as ranked by *U.S. News and World Report* (including The Cleveland Clinic, Duke University Medical Center, Johns Hopkins Hospital, Massachusetts General Hospital, and UCLA Medical Center) but also leading pharmaceutical and biotech companies, health care insurers, and medical device companies such as Johnson & Johnson, Philips, Aetna, Medtronic, Merck, and Wyeth Pharmaceuticals.

The advantage of this membership network is twofold. First, through fax polls, Advisory.com, and executive roundtables, our members drive our research agenda, ensuring that we focus on the most urgent issues facing health care organizations today. Second, because these members rely upon and are actively involved in our research, they offer us unparalleled access to the best practices in health care strategy and operations across the country. Our resulting productivity is high: In fiscal year 2004 we published 53 new studies on mission-critical issues for our members and researched more than 1,200 strategic and operational best practices to build our proprietary library of management practices to more than 30,000.

Beyond sheer volume, we are able to leverage our industry-wide network and ever-gathering intellectual capital to tackle health care's largest and most vexing questions in our research. For example, this year in our health system strategy program for CEOs we have undertaken a research initiative intended to help hospitals move away from reactive growth, and develop a more strategic approach to issues of investment and service line development. At the macro level this work provides insight into the major forces affecting future growth, such as anticipated reimbursement policy changes, demographic shifts, and new technology introduction. As a part of this initiative, we have produced a series of best practice research reports on issues relating to outpatient strategy and emerging service line trends that includes briefs on the future of orthopedics, oncology, diagnostic imaging, cardiac surgery, and cardiac imaging. This research has been very well received by our membership, and, as a result, we have begun work on the next series which will cover vascular services, neurosciences, general surgery, and pediatrics.

We are grateful to have the industry support and access that allows us to undertake such cutting-edge research with confidence. Through our relentless focus on providing our members actionable solutions and tangible impact, we seek to uphold our members' trust and consistently deliver superior value.

Driving Tangible Impact for Our Members

Cutting-edge research is exciting, but in order for it to be useful to our membership it must also offer concrete, actionable insights to positively impact their businesses. The fact that we provide a comprehensive solution to our members' most significant problems is ultimately what provides high returns on their membership investment.

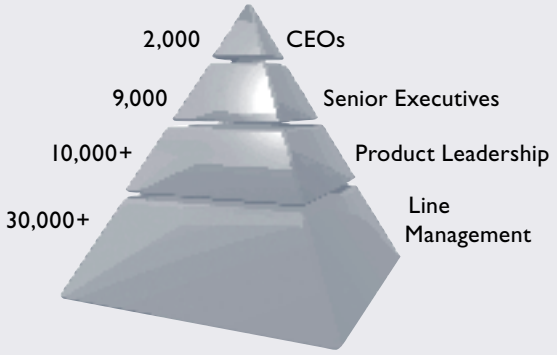
For example, one significant area of concern for our membership this year has been the workforce shortage in health care. As a result of new regulations mandating patient ratios and the lack of qualified personnel for key positions, health care providers are facing a staffing crisis, record vacancy levels, and undue economic hardship driven by increased salaries, overtime costs, and agency labor. Across our programs this year, we have provided members tools to face these workforce planning and management challenges by enhancing the recruitment and retention of key personnel as well as achieving productivity improvements. Several examples of the tangible economic impact our members are deriving from these tools include:

- A 300-bed urban hospital in the mid-Atlantic used our materials to run a 100-day recruitment campaign—a focused effort to install best recruiting practices in a truncated timeline. Through this campaign, the member was able to hire more than 130 employees for difficult-to-fill positions across the hundred-day period, generating millions of dollars in economic benefit.
- A 600-bed hospital in the West worked with us to install best practices focused on training nurse managers to successfully drive retention of existing staff. The hospital was able to cut its RN turnover rate from 24 percent to 11 percent—reducing agency costs by more than $3 million.
- A 350-bed hospital in the South put in place staff-led productivity changes as a result of their membership with us and generated productivity improvements yielding more than $1 million of savings in departments across the hospital.

These are but a few of the many tangible economic improvements our members have received as a result of their Advisory Board memberships. We believe these tangible returns drive member satisfaction, ultimately creating both a high renewal rate and the opportunity to expand our member relationships over time.

The Force of Membership

Executive Access Drives Cutting-Edge Research



- Across our membership, we are privileged to have relationships at all levels of the organization, from CEOs and senior executives through line management.
- Members generate program agendas through constant input into our research process.
- Members also serve as an important source of best practice solutions by providing access to case studies and operational plans.

Providing Comprehensive Decision Support

As we continue to enhance our value proposition, we have realized that delivery channel innovation is key to ensure that our research provides on-demand decision support for individuals at all levels of our member organizations, from senior executives all the way down to line management. In pursuit of this goal, our on-line services and capabilities have become a critical access point for our members, allowing them real-time access to our knowledge base and decision support tools through password-protected websites for each of our research programs. With more than 50,000 executives receiving our daily and weekly briefings and over 18 million content-based member touches through our on-line offerings yearly, these tools are having a dramatic impact on our ability to reach more individuals at our member institutions and on the value our members derive from our programs.

The on-line channel is critical not only because it allows us to penetrate more deeply into our member organizations, but also because it allows us to introduce a different-in-kind set of tools as part of our service offering to our members. For example, this year in our marketing strategy program we developed an on-line tool that allows our members to build an outpatient surgery dashboard to analyze their own volume and profitability metrics by service line. By uploading their institution's outpatient data into the tool, members receive the service line insights needed to make critical strategic decisions. This tool—along with others launched this year, including an on-line margin audit toolkit in our health system strategy

program for CEOs—received enormously positive reviews from members who praised the tools' specificity, relevance, and analytical sophistication.

We are pleased that as a result of these new offerings, our members are receiving substantially greater value from their Advisory Board memberships year over year. Our on-line tools help us guide member decisions at all levels of the organization, providing on-demand access to our tools and research to a broad member constituency.

Building an Organization to Support Growth

In our quest to build a scalable growth company, it is critically important that we invest in our underlying organization. Fortunately, we begin from a strong position. First, our standardized approach to the research and our emphasis on quality control provide a scalable intellectual enterprise that consistently delivers a relevant, actionable, and valuable product to our members. In addition, our dedicated staff of nearly 600 employees represents top talent from the best graduate and undergraduate programs, consulting firms and health care institutions. With career research staff retention rates in the high 80s, we have in place a leadership team that is committed to producing excellent research and serving our members to the highest standard.

Innovative Delivery Channels

On-Line Reach and Capability

Margin Diagnostic Tool **Outpatient Surgery Dashboard**

- On-line services and capabilities have become a critical access point, allowing members real-time access to our knowledge base and decision support tools.
- Each year, more than 50,000 member executives receive our on-line briefings, and we have more than 18 million content-based member touches through our proprietary websites.
- By reaching a broader base of members and providing such new services as institution-specific audit tools, analyses, and dashboards, our on-line channel innovations are enabling us to enhance member value.

Moreover, we continue to invest in our organization to ensure that these advantages are preserved and enhanced. We've had great success in recruiting and retaining top talent and are vigilant about maintaining a culture based on our core values: a culture of meritocracy, a dedication to the force of ideas, the delivery of superior value to our members, and a spirit of generosity in our daily interactions. We remain focused on ongoing staff development and have recently launched an internal fellowship initiative aimed at accelerating the development of star talent. With the entire senior executive team dedicated to the fellowship's two-year curriculum and formal mentoring program, we are ensuring that we are building our leadership bench for the future. Already, the fellowship has been successful in elevating the performance of the participants and is a strong retention lever for those most likely to be future leaders of the firm. This is one of many initiatives under way to ensure we have the human capital to continue our track record of successful growth and high member impact.

Closing Thoughts

I have the daily privilege of working with a group of 600 talented and committed individuals who are dedicated to serving our members to the highest standard. Our employees take a great deal of pride in our accomplishments of the past year and are incredibly excited about both our prospects for continued growth and the increasing opportunity we have to positively impact the health care industry. On their behalf and mine, thank you for your continued interest and support.

Frank Williams
Chief Executive Officer

Executive Officers, Clockwise from Upper Left:

Richard A. Schwartz, *General Manager, Research*
David L. Felsenthal, *Chief Financial Officer, Secretary, and Treasurer*
Scott A. Schirmeier, *General Manager, Sales and Marketing*
Frank J. Williams, *Chief Executive Officer and Director*
Scott M. Fassbach, *Chief Research Officer*

Selected Financial Data

The Advisory Board Company and Subsidiaries

The following table sets forth selected financial and operating data. The selected financial data presented below as of March 31, 2000 and 2001, and for the two fiscal years in the period ended March 31, 2001, have been derived from our financial statements which have been audited by Arthur Andersen LLP, independent public accountants. The selected financial data presented below as of March 31, 2002, 2003 and 2004 and for the three fiscal years in the period ended March 31, 2004, have been derived from our financial statements which have been audited by Ernst & Young LLP, independent auditors. You should read the selected financial data presented below in conjunction with our financial statements, the notes to our financial statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this Annual Report.

	Fiscal Year Ended March 31,				
(In thousands except per share amounts)	2000	2001	2002	2003	2004
Statement of Operations Data:					
Revenues	$ 58,535	$63,727	$ 80,970	$100,714	$121,847
Costs and expenses:					
Cost of services (excluding special compensation and stock option related expenses of $1,766, $1,821, $645, $615 and $560) [1] [2]	27,441	33,644	37,142	41,598	50,167
Member relations and marketing (excluding special compensation and stock option related expenses of $836, $679, $0, $133 and $256) [1] [2]	8,741	12,588	16,100	19,842	24,599
General and administrative (excluding special compensation and stock option related expenses of $408, $344, $837, $399 and $857) [1] [2] [3]	8,524	9,768	10,659	12,507	15,445
Depreciation and loss on disposal of fixed assets	1,762	1,539	2,030	1,827	1,415
Special compensation and stock option related expenses [1] [2]	3,010	2,844	1,482	1,147	1,673
Affiliate company charge [4]	4,097	4,505	2,676	—	—
Total costs and expenses	53,575	64,888	70,089	76,921	93,299
Income (loss) from operations	4,960	(1,161)	10,881	23,793	28,548
Interest income	592	471	453	1,038	2,911
Income (loss) before (provision) benefit for income taxes	5,552	(690)	11,334	24,831	31,459
(Provision) benefit for income taxes [5]	(559)	68	(1,358)	(10,392)	(12,739)
Net income (loss)	$ 4,993	$ (622)	$ 9,976	$ 14,439	$ 18,720
Earnings (loss) per share:					
Net income (loss) per share—basic	$ 0.36	$ (0.04)	$ 0.73	$ 1.10	$ 1.19
Net income (loss) per share—diluted	$ 0.34	$ (0.04)	$ 0.62	$ 0.85	$ 1.00
Basic weighted average number of shares outstanding	13,977	13,977	13,748	13,139	15,745
Diluted weighted average number of shares outstanding	14,725	13,977	16,089	16,996	18,680

	March 31,				
(In thousands)	2000	2001	2002	2003	2004
Balance Sheet Data:					
Cash and cash equivalents and marketable securities	$ 5,433	$20,853	$ 23,959	$ 90,407	$139,809
Working capital (deficit)	(13,662)	(6,793)	(20,374)	(18,110)	(6,293)
Total assets	29,195	44,009	48,506	117,923	203,999
Deferred revenues	29,592	39,270	51,538	63,653	72,410
Total stockholders' (deficit) equity	(10,229)	(1,531)	(16,587)	41,495	115,623

	March 31,				
	2000	2001	2002	2003	2004
Other Operating Data:					
Membership programs offered	6	12	15	18	21
Total members	1,988	2,086	2,170	2,297	2,347
Member renewal rate [6]	86%	86%	88%	89%	87%
Contract value (in thousands) [7]	$58,122	$69,873	$86,108	$106,745	$124,929
Contract value per member [8]	$29,236	$33,496	$39,681	$ 46,472	$ 53,229

	March 31,				
	2000	2001	2002	2003	2004
Reconciliation of GAAP to Pro Forma Results [9]					
Income (loss) from operations	$ 4,960	$ (1,161)	$10,881	$ 23,793	$ 28,548
Special compensation and stock option related expense	3,010	2,844	1,482	1,147	1,673
Affiliate company charge	4,097	4,505	2,676	—	—
Pro forma income from operations	12,067	6,188	15,039	24,940	30,221
Interest income	592	471	453	1,038	2,911
Pro forms income before provision for income taxes	12,659	6,659	15,492	25,978	33,132
Pro forma provision for income taxes	(5,380)	(2,830)	(6,584)	(10,877)	(13,418)
Pro forma net income	$ 7,279	$ 3,829	$ 8,908	$ 5,101	$ 9,714
Pro forma earnings per share					
Basic	$ 0.52	$ 0.27	$ 0.65	$ 1.15	$ 1.25
Diluted	$ 0.50	$ 0.27	$ 0.55	$ 0.89	$ 1.06

(1) As a private company, we entered into special equity-based compensation arrangements with key employees. These arrangements were predominantly the repurchase of stock options and a special bonus paid to optionholders. Since our initial public offering, we have not entered, and we do not anticipate that in the future we will enter, into any special compensation arrangements.

(2) We recognized approximately $781,000 and $1,673,000 in compensation expense reflecting additional Federal Insurance Corporation Act taxes as a result of the taxable income that the employees recognized upon the exercise of common stock options in fiscal 2003 and fiscal 2004, respectively.

(3) General and administrative expenses prior to fiscal 2003 include certain amounts paid to DGB Enterprises, Inc., a corporation owned by our former principal stockholder, for management services. See Note 9 to our financial statements for more information regarding these charges. Since our initial public offering, we provide these management services internally at a cost similar to the amounts paid to DGB Enterprises in the past.

(4) Charges from DGB Enterprises, Inc. for strategic direction and oversight. See Note 9 to our financial statements for more information regarding these charges. As of October 1, 2001, our newly constituted Board of Directors began to provide strategic direction and oversight services and, consequently, we no longer pay the affiliate company charge.

(5) In conjunction with our initial public offering, our S corporation election terminated and we are now subject to U.S. federal and state income taxes at prevailing corporate rates.

(6) The percentage of member institutions at the beginning of a fiscal year that hold one or more memberships in any of our programs at the beginning of the next fiscal year, adjusted to reflect mergers, acquisitions or different affiliations of members that result in changes of control over individual institutions.

(7) The aggregate annualized revenue attributed to all agreements in effect at a given point in time, without regard to the initial term or remaining duration of any such agreement.

(8) Total contract value divided by the number of members.

(9) A reconciliation of GAAP to pro forma results is presented to provide comparisons with prior periods in a manner we believe would be consistent if we had been a public company prior to fiscal 2002. Pro forma results exclude special compensation and stock option related expense and affiliate company charge, and include income taxes at our effective tax rates.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The Advisory Board Company and Subsidiaries

OVERVIEW

We provide best practices research and analysis across the health care industry. Best practices research identifies and analyzes specific management initiatives, processes and strategies that have been determined to produce the best results in solving common business problems or challenges. Members of each program are typically charged a fixed annual fee and have access to an integrated set of services, including best practices research studies, executive education seminars, customized research briefs and web-based access to the program's content database and decision support tools.

Our revenues grew 21.0% in fiscal 2004 over fiscal 2003, and grew 24.4% in fiscal 2003 over fiscal 2002. We increased our contract value by 17.0% at March 31, 2004 over March 31, 2003, and by 24.0% at March 31, 2003 over March 31, 2002. We define contract value as the aggregate annualized revenue attributed to all membership agreements in effect at a given point in time, without regard to the initial term or remaining duration of any such agreement.

Memberships in each of our fourteen best practices research programs are renewable at the end of their one-year membership contracts. Our remaining programs provide best practices installation support. These 12-month program memberships help participants accelerate the adoption of best practices profiled in our research studies, and are therefore not individually renewable. Renewable programs generated more than 80% of our revenues in fiscal 2004, with the balance of our revenues generated by programs providing installation support.

Costs associated with a new program initially increase more rapidly than revenues following introduction of the program because revenues associated with the new program are recognized ratably over the membership year while costs are expensed as incurred. Because we offer a standardized set of services, however, our program cost structure is relatively fixed and the incremental cost to serve an additional member is low. In fiscal 2004, our income from operations was $28.5 million, compared to $23.8 million in fiscal 2003.

Our operating costs and expenses consist of cost of services, member relations and marketing, general and administrative expenses and depreciation. Cost of services represents the costs associated with the production and delivery of our products and services. Member relations and marketing expenses include the costs of acquiring new members and renewing existing members. General and administrative expenses include the costs of human resources and recruiting, finance and accounting, management information systems, facilities management, new program development and other administrative functions.

We completed our initial public offering in November 2001. As a private company, we entered into the following arrangements which were discontinued in connection with our initial public offering. Accordingly, we believe the effect of these items on our historical financial statements are not indicative of future results.

- We entered into special equity-based compensation arrangements with key employees. These arrangements were predominantly the repurchase of stock options and a special bonus paid to optionholders in the absence of a public market for our stock. Since our initial public offering, we have not entered, and do not anticipate that in the future we will enter into any special compensation arrangements, although we incurred charges of $366,000 in fiscal 2003 with respect to arrangements entered into prior to our initial public offering.
- We paid the affiliate company charge to DGB Enterprises, Inc., a corporation created by our former principal stockholder in 1997 to manage his various business interests, for strategic direction and oversight. As of October 1, 2001, our newly constituted Board of Directors began to provide this strategic direction and oversight and, consequently, we no longer pay the affiliate company charge.

Prior to our initial public offering, we were treated as an S corporation for federal income tax purposes. As an S corporation, our taxable income or loss flowed through to, and was reportable by, our stockholders. Accordingly, we did not make any provision for federal income taxes in our financial statements for periods ending prior to the closing of our initial public offering. In conjunction with our initial public offering, our S corporation status terminated and we became subject to federal income taxes at prevailing corporate rates. The impact of this change resulted in a benefit for income taxes of $1.6 million during the three months ended December 31, 2001.

RESULTS OF OPERATIONS

The following table shows statement of income data expressed as a percentage of revenues for the periods indicated.

	Fiscal Year Ended March 31,		
	2002	2003	2004
Revenues	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of services (excluding special compensation and stock option related expenses of 0.8%, 0.6% and 0.4%)	45.9	41.3	41.2
Member relations and marketing (excluding special compensation and stock option related expenses of 0.0%, 0.1% and 0.2%)	19.9	19.7	20.2
General and administrative (excluding special compensation and stock option related expenses of 1.0%, 0.5% and 0.7%)	13.2	12.4	12.7
Depreciation and loss on disposal of fixed assets	2.5	1.8	1.2
Special compensation and stock option related expenses	1.8	1.2	1.3
Affiliate company charge	3.3	—	—
Total costs and expenses	86.6	76.4	76.6
Income from operations	13.4	23.6	23.4
Interest income	0.6	1.0	2.4
Income before provision for income taxes	14.0	24.6	25.8
Provision for income taxes	(1.7)	(10.3)	(10.4)
Net income	12.3%	14.3%	15.4%

FISCAL YEARS ENDED MARCH 31, 2002, 2003 AND 2004

Revenues

Total revenues increased 24.4% from $81.0 million in fiscal 2002 to $100.7 million in fiscal 2003, and increased 21.0% to $121.8 million in fiscal 2004. The increase in revenues was primarily due to the introduction and expansion of new programs, cross-selling existing programs to existing members, and, to a lesser degree, sales to new member organizations and price increases. We offered 15 membership programs as of March 31, 2002, 18 as of March 31, 2003 and 21 as of March 31, 2004. Our contract value increased 24.0% from $86.1 million at March 31, 2002 to $106.7 million at March 31, 2003, and increased 17.0% to $124.9 million at March 31, 2004. We define contract value as the aggregate annualized revenue attributed to all membership agreements in effect at a given point in time, without regard to the initial term or remaining duration of any such agreement.

Cost of services

Cost of services increased 12.0% from $37.1 million, or 45.9% of revenues, in fiscal 2002, to $41.6 million, or 41.3% of revenues, in fiscal 2003 and increased 20.6% to $50.2 million, or 41.2% of revenues in fiscal 2004. Costs associated with a new program initially increase more rapidly than revenues following introduction of the program because revenues associated with the new program are recognized ratably over the membership year while costs are expensed as incurred. Because we offer a standardized set of services, our program cost structure is relatively fixed and the incremental cost to serve an additional member is low. Consequently, while cost of services increased since fiscal 2002, it has decreased as a percentage of revenues.

Member relations and marketing

Member relations and marketing expense increased 23.2% from $16.1 million or 19.9% of revenues in fiscal 2002 to $19.8 million, or 19.7% of revenues, in fiscal 2003, and increased 24.0% to $24.6 million, or 20.2% of revenues, in fiscal 2004. The increase in member relations and marketing expense was primarily due to an increase in sales staff and related costs associated with the introduction of new programs, as well as an increase in member relations personnel and related costs to serve the expanding membership base.

General and administrative

General and administrative expense increased from $10.7 million, or 13.2% of revenues, in fiscal 2002 to $12.5 million, or 12.4% of revenues, in fiscal 2003, and increased to $15.4 million, or 12.7% of revenues, in fiscal 2004 with the development of new programs and the expansion of several administrative functions. The decrease as a percent of revenues in fiscal 2003 reflects the leveraging of resources across our larger revenue base. The increase in fiscal 2004 reflects increased investment in recruiting and hiring efforts in the member relations and new product development areas. General and administrative expense includes approximately $1.2 million, $0.7 million and $1.0 million in fiscal 2002, 2003 and 2004, respectively, of net charges from DGB Enterprises, Inc. for expenses related to management services, shared space and facilities and certain administrative functions. We believe these charges approximate the expense which would have been incurred had we provided the equivalent services internally. See Note 9 to our financial statements for a detailed description of the administrative services agreement with DGB Enterprises, Inc.

Depreciation

Depreciation expense decreased from $2.0 million, or 2.5% of revenues in fiscal 2002, to $1.8 million, or 1.8% of revenues in fiscal 2003, and decreased to $1.4 million, or 1.2% of revenues in fiscal 2004. The decrease in fiscal 2003 was due to lower capital expenditures in fiscal 2002 and fiscal 2003 as compared to prior years. In fiscal 2004, we incurred construction costs in connection with our move to our new headquarters facility and depreciation expense may increase in future periods as a result.

Special compensation and stock option related expenses

Special compensation and stock option related expenses decreased from $1.5 million in fiscal 2002 to $1.1 million in fiscal 2003, and increased to $1.7 million in fiscal 2004. Since our initial public offering, we have not entered into, and we do not anticipate that we will enter in the future, any special compensation arrangements. See Note 11 to our financial statements for a detailed description of these arrangements. In fiscal 2003 and 2004, we recognized approximately $781,000 and $1.7 million in compensation expense reflecting additional Federal Insurance Corporation Act (FICA) taxes as a result of the taxable income that employees recognized upon the exercise of common stock options.

Affiliate company charge

Affiliate company charge was $2.7 million in fiscal 2002 and as of October 1, 2001, we no longer pay the affiliate company charge. See Note 9 to our financial statements for more information regarding this charge.

Interest income

Interest income increased $2.9 million in fiscal 2004, from $1.0 million in fiscal 2003 and $453,000 in fiscal 2002. The growth was principally from income associated with the increased levels of cash, cash equivalents and marketable securities. Cash, cash equivalents and marketable securities increased as a result of cash flows from operating activities and cash flows from financing activities as further discussed in the liquidity and capital resources section below.

Provision for income taxes

We recorded a provision for income taxes of $12.7 million, $10.4 million and $7.1 million in fiscal 2004, 2003 and 2002, respectively. Our effective income tax rate decreased to 40.5% as of January 1, 2003 from 42.5% primarily due to an increase in the amount of tax-exempt interest income earned on our portfolio of cash and cash equivalents and marketable securities and, to a lesser extent, changes in states where income was generated.

We will amend our 2003 Washington, D.C. income tax return to file as a Qualified High Technology Company. If approved, our Washington, D.C. income tax rate would be reduced to 0.0% and we would incur a noncash charge to earnings of approximately $5.8 million, representing the impact on our existing deferred tax asset of lowering the Washington, D.C. income tax rate. For further information please see Note 7 to our consolidated financial statements included elsewhere in this Annual Report.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows from operating activities

Program memberships are generally payable by members at the beginning of the contract term. The combination of revenue growth and advance payment of memberships typically results in operating activities generating net positive cash flows on an annual basis. Net cash flows provided by operating activities were $19.9 million in fiscal 2002, $44.5 million in fiscal 2003 and $39.7 million in fiscal 2004. We had approximately $139.8 million in cash and cash equivalents and marketable securities at March 31, 2004. We expect that these funds and expected net positive cash flows from operations will satisfy working capital, financing activities and capital expenditure requirements for at least the next 12 months.

Cash flows from investing activities

Net cash flows used in investing activities during fiscal 2002 were $0.9 million, consisting of purchases of property and equipment. Net cash flows used in investing activities in fiscal 2003 were $57.0 million, consisting of purchases of marketable securities of $56.5 million and purchases of property and equipment of $0.5 million. We used net cash flows in investing activities in fiscal 2004 of $46.5 million, consisting of purchases of marketable securities of $54.7 million offset by $13.4 million in proceeds on the redemption of marketable securities and purchases of property and equipment of $5.2 million, which includes approximately $4.6 million of expenditures relating to our new headquarters facility discussed below.

Cash flows from financing activities

In fiscal 2002, we distributed $15.9 million to our pre-IPO stockholders, consisting of $13.0 million of cash and $2.9 million of offering costs and other cash distributions we paid in conjunction with our initial public offering. We generated $21.8 million and $14.9 million in cash from financing activities in fiscal 2003 and 2004, respectively, of which $21.5 million and $26.8 million, respectively, was from the receipt of cash for the exercise of stock options in conjunction with sales of our common stock by our employees. Also in fiscal 2003 and 2004, we received approximately $351,000 and $331,000, respectively, in proceeds from the issuance of common stock under our employee stock purchase plan. In January 2004, our Board of Directors authorized a share repurchase of up to $50 million of our common stock, and as of March 31, 2004, we had repurchased 349,320 shares of our common stock at a total cost of approximately $12.2 million.

The lease on our former headquarters facility expired May 31, 2004. As of June 1, 2004, our headquarters are located in approximately 106,000 square feet of office space in Washington, D.C.. The facilities accommodate research, marketing and sales, information technology, administration, graphic services and operations personnel. We lease our office facilities, and the lease expires in June 2019. The terms of the lease on the new facility contain provisions for rental escalation and we are required to pay our portion of executory costs such as taxes and insurance. We are also obligated to take additional expansion space in the building pursuant to the lease. We believe that our facilities are adequate for our current needs and that additional facilities are available for lease to meet any future needs.

We have entered into a $3.2 million letter of credit agreement with a commercial bank which expires October 5, 2004, to provide a security deposit for our new office lease. We pledged certain assets as collateral under the letter of credit agreement. To date, no amounts have been drawn on this agreement.

The following summarizes certain of our contractual obligations at March 31, 2004 and the effect such obligations are expected to have on our liquidity and cash flows in future periods. These arrangements are more fully described in Notes 9 and 12 to the consolidated financial statements.

	Payments Due by Period				
(In thousands)	Total	<1 Year	1–3 Years	4–5 Years	>5 Years
Non-cancelable operating leases	$50,517	$3,131	$8,603	$7,622	$31,161
Facilities services contract	1,499	545	954	—	—
Total	$52,016	$3,676	$9,557	$7,622	$31,161

At March 31, 2003 and 2004, we have no off-balance sheet financing or other arrangements with unconsolidated entities or financial partnerships (such as entities often referred to as structured finance or special purpose entities) established for purposes of facilitating off-balance sheet financing or other debt arrangements or for other contractually narrow or limited purposes.

SHARE REPURCHASE

In January 2004, we announced that our Board of Directors authorized a share repurchase of up to $50 million of our common stock. Repurchases will be made from time to time in open market and privately negotiated transactions subject to market conditions. No minimum number of shares has been fixed. We will fund our share repurchases with cash on hand and cash generated from operations.

EXERCISE OF CERTAIN OPTIONS

Options granted to certain of our optionholders under our 1997 and 2001 stock-based incentive compensation plans were exercised to acquire shares sold at various times in fiscal 2003 and fiscal 2004. Upon the exercise of these options we received a total of approximately $21.5 million in fiscal 2003 and $26.8 million in fiscal 2004 in cash in payment of option exercise prices.

We recognized approximately $781,000 and $1.7 million in compensation expense reflecting additional Federal Insurance Corporation Act taxes as a result of the taxable income that employees recognized upon the exercise of non-qualified common stock options in fiscal 2003 and 2004, respectively. We also incurred additional compensation expense for tax reporting purposes, but not for financial reporting purposes, that increased our deferred tax asset to reflect allowable tax deductions that will be realized in the determination of our income tax liability and therefore reduce our future income tax payments. In connection with these transactions, our deferred tax asset increased by approximately $20.9 million and $40.0 million in fiscal 2003 and 2004, respectively. Although our provision for income taxes in the consolidated statements of income did not change since the tax benefit associated with the option exercises is recorded directly into stockholders' equity, our actual cash payments will be reduced as we utilize our deferred tax asset. As a result of the receipt of cash for the exercise of options, the incurrence of additional compensation expense and the recognition of a deferred tax asset, our stockholders' equity increased by approximately $40.6 million and $65.1 million in fiscal 2003 and 2004, respectively, in connection with the exercise of stock options.

SIGNIFICANT RELATED PARTY TRANSACTIONS

Transactions with DGB Enterprises, Inc.

Our founder, David G. Bradley owns a controlling interest in certain entities that operate in different industries from us. In 1997, our founder created DGB Enterprises, Inc. to manage his various business interests including his ownership in us. To achieve operating efficiencies, DGB Enterprises, Inc. consolidated certain management and administrative functions for these entities, and assumed the primary lease on office space used by these entities and shared with us. We entered into the following transactions with DGB Enterprises and these other interests as follows:

Management Services DGB Enterprises, Inc. provided us with direct senior management services, which resulted in an allocation in the three months ended June 30, 2001 in the amount of $96,000, for compensation and related charges for our acting Chief Executive Officer. The Chief Executive Officer services charge was phased out in June 2001 when we hired a permanent Chief Executive Officer. We believe these charges approximate the costs which would have been incurred had we operated on a stand-alone basis.

Administrative Services From January 2000 to June 2001, the majority of our administrative functions, including recruiting, human resources, facilities and telecommunications, were provided under an administrative services agreement by DGB Enterprises, Inc., which provided similar services to all entities under our founder's control. In July 2001, we entered into a new administrative services agreement whereby we assumed internal management of substantially all these administrative functions while DGB Enterprises, Inc. continued to provide us with services related to the facilities associated with our shared leased space. Under the new agreement we provide DGB Enterprises, Inc., and related entities owned or controlled by our founder, with a variety of administrative services including services related to information technology and support, payroll and accounting and recruiting. This new agreement has a two-year term. Fees for the services provided under all these agreements are based on direct costs per transaction, square footage, headcount or a fixed cost per month that approximates the cost for each entity to internally provide or externally source these services. We believe these net charges approximate the costs which would have been incurred had we operated on a stand-alone basis. We incurred net charges under all these arrangements in the amount of $1.1 million, $0.7 million and $1.0 million for fiscal 2002, 2003 and 2004, respectively.

Affiliate Company Charge DGB Enterprises, Inc. assessed a fee for strategic direction and oversight services to us and to each of the entities controlled by our founder. The charge was calculated as a percentage of revenue. As of October 1, 2001, our newly constituted Board of Directors began to provide these services and the affiliate company charge, which amounted to $2.7 million in fiscal 2002, was eliminated.

Lease and Sublease Agreements In fiscal 2000 we assigned our office lease to DGB Enterprises, Inc., transferred leasehold improvements related to our office space to DGB Enterprises, Inc. and subsequently entered into a sublease agreement with them on terms consistent

with the original agreement. The lease agreement runs through May 2004. We incurred rent expense under this arrangement of $3.2 million, $3.4 million, and $3.6 million for fiscal 2002, 2003 and 2004, respectively.

Transactions with The Corporate Executive Board Company

In October 1997, the Company spun-off The Corporate Executive Board Company, a division that provided best practices research and analysis focusing on corporate strategy, operations and general management issues for non-health care companies.

We have a noncompetition agreement with The Corporate Executive Board Company which generally prohibits The Corporate Executive Board Company from selling any membership-based products and services to health care providers. Additionally, The Corporate Executive Board Company is prohibited from selling such products and services to other types of health care organizations unless the products and services are of a general business nature and are principally sold to companies and institutions not in the health care industry. This agreement ends on January 1, 2007. After that date, The Corporate Executive Board Company may sell membership-based products and services in direct competition with us, which may have a material adverse effect on our revenues.

In conjunction with the spin-off of The Corporate Executive Board Company and in order to assist in its transition to an independent corporation, we and The Corporate Executive Board Company entered into a royalty free license agreement, an administrative services agreement, a vendor contracts agreement and sublease agreement. Under these arrangements, we provided services of approximately $110,000 in fiscal 2002, and each of these arrangements has expired or been terminated.

Transactions with our Officers, Directors and Stockholders

Prior to our initial public offering, we made loans to Jeffrey D. Zients, our Chairman of the Board, and Michael A. D'Amato, one of our directors. In connection with our initial public offering in November 2001, we made cash and noncash distributions of $15.9 million, including these loans, to our then existing stockholders. We also distributed approximately $13.0 million in cash to our founder in May and June 2001. In addition, in April 2001 we funded a loan to Scott A. Schirmeier, our General Manager, Sales and Marketing, which was repaid with interest in December 2001.

In May 2001, we entered into a stock option agreement with our founder pursuant to which we had an option to purchase 4,564,061 shares of our common stock at $7.13 per share. This option was intended to provide us with shares to be issued upon the exercise of outstanding employee stock options so that our stockholders would not experience dilution because of the issuance of new shares upon such exercise. Our founder terminated this option immediately prior to our initial public offering by transferring shares of our common stock to us in an amount equal to the excess of the fair value of the stock over the exercise price of the option.

For more information on all of these transactions, see Note 9 to our consolidated financial statements.

SUMMARY OF CRITICAL ACCOUNTING POLICIES

We have identified the following policies as critical to our business operations and the understanding of our results of operations. This listing is not a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. However, certain of our accounting policies are particularly important to the presentation of our financial position and results of operations and may require the application of significant judgment by our management; as a result they are subject to an inherent degree of uncertainty. In applying those policies, our management uses its judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical experience, our observance of trends in the industry, information provided by our members and information available from other outside sources, as appropriate. For a more detailed discussion on the application of these and other accounting policies, see Note 2 to our consolidated financial statements. Our critical accounting policies include:

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue recognition

Revenues from renewable research memberships and best practices installation support memberships are recognized over the term of the related subscription agreement, which is generally 12 months. Fees are generally billable, and the full amount of program agreement fees receivable and related deferred revenue are recorded, when a letter agreement is signed by the member. Certain fees are billed on an installment basis. Members may request a refund of their fees, which is provided on a pro rata basis relative to the length of the service period. As of March 31, 2002, 2003 and 2004, approximately $1.0 million, $0.3 million and $1.3 million, respectively, of deferred revenues were to be recognized beyond the following 12 months.

Cash equivalents and marketable securities

Included in cash equivalents are marketable securities that mature within three months of purchase. Investments with maturities of more than three months are classified as marketable securities. As of March 31, 2003 and 2004, the Company's marketable securities consisted of U.S. government agency obligations and Washington, D.C. and other state tax-exempt notes and bonds. The Company's marketable securities, which are classified as available-for-sale, are carried at fair market value based on quoted market prices. The net unrealized gains and losses on available-for-sale marketable securities are excluded from net income and are included within accumulated elements of comprehensive income. The specific identification method is used to compute the realized gains and losses on the sale of marketable securities. Current marketable securities have maturity dates within twelve months of the balance sheet date. The Company may not hold its marketable securities to maturity and may elect to sell the securities at any time.

Allowance for uncollectible revenue

Our ability to collect outstanding receivables from our members has an effect on our operating performance and cash flows. This effect is mitigated because memberships, which are predominantly annual contracts, are generally payable by members at the beginning of the contract term. We record an allowance for uncollectible revenue as a reduction of revenue based on our ongoing monitoring of our members' credit and the aging of receivables.

Deferred incentive compensation

Direct incentive compensation related to the negotiation of new and renewal memberships is deferred and amortized on a straight line basis over the term of the related memberships.

Deferred tax asset recoverability

For tax purposes, we have deferred income tax assets consisting primarily of net operating loss carryforwards for regular federal and state income tax purposes generated from the exercise of common stock options. In estimating future tax consequences, Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS No. 109) generally considers all expected future events in the determination and evaluation of deferred tax assets and liabilities. We believe that our future taxable income will be sufficient for the full realization of the deferred income taxes. However, SFAS No. 109 does not consider the effect of future changes in existing tax laws or rates in the determination and evaluation of deferred tax assets and liabilities until the new tax laws or rates are enacted. We have established our deferred income tax assets and liabilities using currently enacted tax law and rates. We will recognize an adjustment for the impact of new tax laws or rates on the existing deferred tax assets and liabilities when and if new tax laws or rates are enacted.

Washington, D.C. income tax incentives

The Office of Tax and Revenue of the Government of the District of Columbia (the "Office of Tax and Revenue") has adopted regulations in accordance with the New E-Conomy Transformation Act of 2000 (the "Act") that modify the income and franchise tax, sales and use tax, and personal property tax regulations, effective April 2001. Specifically, the regulations provide certain credits, exemptions and other benefits to a Qualified High Technology Company ("QHTC").

We have performed an analysis to support our position that we meet the definition of a QHTC under the provisions of the Act. Accordingly, we will amend our 2003 Washington, D.C. income tax return and certain sales and use tax returns, to file as a QHTC. As a QHTC, our Washington, D.C. income tax rate will be 0.0% and we will be eligible for certain Washington, D.C. income tax credits. In addition, we will be entitled to relief from certain sales and use taxes. While we believe we qualify as a QHTC, we have not recognized the impact of this election within the financial statements for the fiscal year ended March 31, 2004 because of uncertainties inherent in the regulations, as adopted.

For financial reporting purposes, we have valued our deferred income tax assets and liabilities using Washington, D.C.'s currently enacted income tax rate of 9.975%. Additionally, we have continued to provide for income, sales and use taxes as if we were not a QHTC. However, if we had received a determination that we qualified for QHTC status, we would have recorded a charge to earnings of approximately $5.8 million, representing the effects on our existing deferred tax assets of reducing the Washington, D.C. income tax rate to 0.0%, net of any income tax credits discussed above. If we determine it is more likely than not that the Office of Tax and Revenue will accept our election as a QHTC, we will record the applicable charge. Additionally, we would recognize the refund of any previously paid or provided sales and use taxes at that time.

Recovery of long-lived assets

Long-lived assets and identifiable assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be addressed. Impairment is identified by comparing the carrying value to the estimated undiscounted future cash flows expected to result from the use of the assets and their eventual dispositions. Impairment is measured and recorded on the basis of fair value determined using discounted cash flows. We consider expected cash flows and estimated future operating results, trends and other available information in assessing whether the carrying value of assets is impaired. We believe no such impairment existed as of March 31, 2004 or 2003.

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued Financial Accounting Standards Board Interpretation No. 46 ("FIN 46"), *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51.* This interpretation of ARB No. 51, *Consolidated Financial Statements,* requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. We adopted FIN 46 as of March 31, 2004. The adoption had no impact on our consolidated financial statements.

In November 2002, the Emerging Issues Task Force ("EITF") reached a consensus on EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables,* ("Issue 00-21"). Issue 00-21 provides guidance for determining the unit(s) of accounting in arrangements that include multiple products, services, and/or rights to use assets. The adoption of Issue 00-21 had no impact on the Company's financial statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to interest rate risk primarily through our portfolio of cash, cash equivalents and marketable securities, which is designed for safety of principal and liquidity. Cash and cash equivalents include investments in highly liquid U.S. Treasury obligations with maturities of less than three months. At March 31, 2004, our marketable securities consist of $16.0 million in tax-exempt notes and bonds issued by the District of Columbia, $3.0 million in tax-exempt notes and bonds issued by other states, and $79.4 million in U.S. government agency securities. The average maturity on all our marketable securities as of March 31, 2004 was approximately 4.9 years. We perform periodic evaluations of the relative credit ratings related to the cash, cash equivalents and marketable securities. This portfolio is subject to inherent interest rate risk as investments mature and are reinvested at current market interest rates. We currently do not use derivative financial instruments to adjust our portfolio risk or income profile. Due to the nature of our investments we have not prepared quantitative disclosure for interest rate sensitivity in accordance with Item 305 of Regulation S-K as we believe the effect of interest rate fluctuations would not be material.

Report of Independent Registered Public Accounting Firm

TO THE STOCKHOLDERS OF THE ADVISORY BOARD COMPANY:

We have audited the accompanying consolidated balance sheets of The Advisory Board Company and subsidiaries as of March 31, 2003 and 2004, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended March 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Advisory Board Company and subsidiaries as of March 31, 2003 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2004, in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

Baltimore, Maryland
April 28, 2004

Consolidated Balance Sheets

The Advisory Board Company and Subsidiaries

(In thousands, except share amounts)	March 31, 2003	March 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 33,301	$ 41,389
Marketable securities	—	3,737
Membership fees receivable, net	9,234	14,338
Prepaid expenses and other current assets	1,600	3,121
Deferred income taxes	11,532	17,123
Deferred incentive compensation	2,259	2,375
Total current assets	57,926	82,083
Property and equipment, net	2,891	6,701
Deferred income taxes, net of current portion	—	20,532
Marketable securities	57,106	94,683
Total assets	$117,923	$203,999
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Deferred revenues	$ 63,653	$ 72,410
Accounts payable and accrued liabilities	5,484	8,262
Accrued incentive compensation	6,899	7,704
Total current liabilities	76,036	88,376
Long-term liabilities:		
Deferred income taxes	392	—
Total liabilities	76,428	88,376
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.01 par value; 5,000,000 shares authorized, zero issued and outstanding	—	—
Common stock, $0.01 par value; 90,000,000 shares authorized, 14,779,567 and 18,323,526 shares issued at March 31, 2003 and 2004, respectively, and 14,779,567 and 17,974,206 shares outstanding at March 31, 2003 and 2004, respectively	148	183
Additional paid-in capital	21,821	88,885
Retained earnings	18,974	37,694
Accumulated elements of other comprehensive income	552	1,031
Treasury stock, zero and 349,320 shares at March 31, 2003 and 2004, respectively	—	(12,170)
Total stockholders' equity	41,495	115,623
Total liabilities and stockholders' equity	$117,923	$203,999

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

Consolidated Statements of Income

The Advisory Board Company and Subsidiaries

(In thousands, except per share amounts)	Year Ended March 31, 2002	2003	2004
Revenues	$80,970	$100,714	$121,847
Costs and expenses:			
Cost of services (excluding special compensation and stock option related expenses of $645, $615 and $560)	37,142	41,598	50,167
Member relations and marketing (excluding special compensation and stock option related expenses of $0, $133 and $256)	16,100	19,842	24,599
General and administrative (excluding special compensation and stock option related expenses of $837, $399 and $857)	10,659	12,507	15,445
Depreciation and loss on disposal of fixed assets	2,030	1,827	1,415
Special compensation and stock option related expenses	1,482	1,147	1,673
Affiliate company charge	2,676	—	—
Total costs and expenses	70,089	76,921	93,299
Income from operations	10,881	23,793	28,548
Interest income	453	1,038	2,911
Income before provision for income taxes	11,334	24,831	31,459
Provision for income taxes	(1,358)	(10,392)	(12,739)
Net income	$ 9,976	$ 14,439	$ 18,720
Earnings per share:			
Historical net income per share—basic	$ 0.73	$ 1.10	$ 1.19
Historical net income per share—diluted	$ 0.62	$ 0.85	$ 1.00
Basic weighted average number of shares outstanding	13,748	13,139	15,745
Diluted weighted average number of shares outstanding	16,089	16,996	18,680
Pro forma statements of income data (unaudited):			
Income before provision for income taxes, as reported	$11,334		
Pro forma income tax provision	(4,817)		
Pro forma net income	$ 6,517		
Pro forma net income per share—basic	$ 0.47		
Pro forma net income per share—diluted	$ 0.41		

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

Consolidated Statements of Stockholders' Equity

The Advisory Board Company and Subsidiaries

(In thousands, except share amounts)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deferred Compensation	Promissory Notes Receivable	(Accumulated Deficit) Retained Earnings	Accumulated Elements of Other Comprehensive Income	Treasury Stock	Total	Annual Comprehensive Income
Balance at March 31, 2001	13,977,200	$140	$ 10,817	$ (700)	$ —	$(11,788)	$ —	$ —	$ (1,531)	
Cash distributions to stockholder	—	—	—	—	—	(12,971)	—	—	(12,971)	$ —
Deferred compensation pursuant to stock option repurchase agreements	—	—	—	(1,050)	—	—	—	—	(1,050)	—
Amortization of deferred compensation	—	—	—	1,384	—	—	—	—	1,384	—
Exercise of stock options	1,023,872	10	3,544	—	—	—	—	—	3,554	—
Issuance of promissory notes receivable	—	—	—	—	(3,346)	—	—	—	(3,346)	—
Interest earned on promissory notes	—	—	—	—	(100)	—	—	—	(100)	—
Net income—pre-termination of S corporation status	—	—	—	—	—	5,441	—	—	5,441	5,441
Noncash distributions to stockholders in connection with initial public offering	—	—	—	—	3,446	(13,027)	—	—	(9,581)	—
Payment of offering costs and other distributions	—	—	—	—	—	(2,922)	—	—	(2,922)	—
Termination of S corporation status	—	—	(35,267)	—	—	35,267	—	—	—	—
Receipt of shares from stockholder pursuant to stock option agreement	(2,851,337)	(29)	29	—	—	—	—	—	—	—
Net income—post-termination of S corporation status	—	—	—	—	—	4,535	—	—	—	4,535
Balance at March 31, 2002	12,149,735	121	(20,877)	(366)	—	4,535	—	—	(16,587)	$ 9,976
Amortization of deferred compensation	—	—	—	366	—	—	—	—	366	$ —
Exercise of stock options	2,616,382	26	21,427	—	—	—	—	—	21,453	—
Tax benefit on exercise of options	—	—	20,921	—	—	—	—	—	20,921	—
Issuance of common stock under employee stock purchase plan	13,450	1	350	—	—	—	—	—	351	—
Unrealized gains on available-for-sale marketable securities, net of income taxes	—	—	—	—	—	—	552	—	552	552
Net income	—	—	—	—	—	14,439	—	—	14,439	14,439
Balance at March 31, 2003	14,779,567	148	21,821	—	—	18,974	552	—	41,495	$14,991
Exercise of stock options	3,533,296	35	26,737	—	—	—	—	—	26,772	$ —
Tax benefit on exercise of options	—	—	39,996	—	—	—	—	—	39,996	—
Issuance of common stock under employee stock purchase plan	10,663	—	331	—	—	—	—	—	331	—
Purchase of treasury stock	(349,320)	—	—	—	—	—	—	(12,170)	(12,170)	—
Net unrealized gains on available-for-sale marketable securities, net of income taxes	—	—	—	—	—	—	479	—	479	479
Net income	—	—	—	—	—	18,720	—	—	18,720	18,720
Balance at March 31, 2004	17,974,206	$183	$ 88,885	$ —	$ —	$ 37,694	$1,031	$(12,170)	$115,623	$19,199

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

Consolidated Statements of Cash Flows

The Advisory Board Company and Subsidiaries

(In thousands)	Year Ended March 31, 2002	2003	2004
Cash flows from operating activities:			
Net income	$ 9,976	$ 14,439	$ 18,720
Adjustments to reconcile net income to net cash flows provided by operating activities:			
Depreciation	1,929	1,722	1,415
Loss on disposal of fixed assets	101	105	—
Special compensation arrangements	(37)	(363)	—
Deferred income taxes and tax benefits resulting from the exercise of common stock options	(2,305)	6,140	12,644
Amortization of marketable securities premiums	—	352	755
Changes in operating assets and liabilities:			
Membership fees receivable	(2,269)	4,865	(5,104)
Prepaid expenses and other current assets	(286)	(657)	(1,521)
Deferred incentive compensation	(691)	(365)	(116)
Payable to/receivable from affiliates	(6,479)	—	—
Deferred revenues	12,268	12,115	8,757
Accounts payable and accrued liabilities	4,478	4,955	3,356
Accrued incentive compensation	3,178	1,240	805
Net cash flows provided by operating activities	19,863	44,548	39,711
Cash flows from investing activities:			
Purchases of property and equipment	(864)	(531)	(5,225)
Redemption of marketable securities	—	—	13,350
Purchases of marketable securities	—	(56,515)	(54,661)
Net cash flows used in investing activities	(864)	(57,046)	(46,536)
Cash flows from financing activities:			
Proceeds on issuance of stock from exercise of options	—	21,453	26,772
Reimbursement of offering costs	—	992	149
Payment of offering costs and other distributions	(2,922)	(956)	(169)
Issuance of common stock under employee stock purchase plan	—	351	331
Purchase of treasury shares	—	—	(12,170)
Distributions to stockholder	(12,971)	—	—
Net cash flows (used in) provided by financing activities	(15,893)	21,840	14,913
Net increase in cash and cash equivalents	3,106	9,342	8,088
Cash and cash equivalents, beginning of year	20,853	23,959	33,301
Cash and cash equivalents, end of year	$ 23,959	$ 33,301	$ 41,389
Supplemental disclosure of cash flow information:			
Noncash distributions to stockholders	$ 13,027	$ —	$ —
Cash paid during the year for income taxes	$ 270	$ 1,000	$ —

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

Notes to Consolidated Financial Statements

The Advisory Board Company and Subsidiaries

1. BUSINESS DESCRIPTION

The Advisory Board Company (the Company) provides best practices research and analysis to the health care industry, focusing on business strategy, operations and general management issues. Best practices research and analysis identifies, analyzes and describes specific management initiatives, processes and strategies that produce the best results in solving common business problems or challenges.

2. STOCK SPLITS, REINCORPORATION AND INITIAL PUBLIC OFFERING

On October 26, 2001, the Company completed a 16.84-for-1 stock split of its Class A voting shares and Class B nonvoting shares. In addition, all the Class A and Class B shares were converted to shares of Common Stock. All share and per share amounts have been retroactively adjusted to give effect to this action. In August 2002 the Company retired its Class A Voting Common Stock and Class B Nonvoting Common Stock.

To change its state of incorporation, the Company was merged into a newly formed Delaware corporation on August 13, 2001. No effect was given to this reincorporation for accounting purposes. The new corporation is authorized to issue 125,000,000 shares of stock consisting of:

- 20,000 shares of Class A Voting Common Stock, par value $0.01 per share;
- 29,980,000 shares Class B Nonvoting Common Stock, par value $0.01 per share;
- 90,000,000 shares of Common Stock, par value $0.01 per share; and
- 5,000,000 shares of Preferred Stock, par value $0.01 per share.

In November 2001, the Company completed its initial public offering in which the Company's founder and former principal stockholder sold 5,750,000 shares of the Company's common stock. The Company did not receive any proceeds from this offering.

3. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Advisory Board Services, Inc. (ABSI) and Advisory Board Investments, Inc. (ABII), both of which were formed during the year ended March 31, 2003. ABSI holds the Company's trademarks and service marks, and ABII holds certain of the Company's marketable securities. All significant intercompany transactions have been eliminated.

Cash equivalents and marketable securities

Included in cash equivalents are marketable securities that mature within three months of purchase. Investments with maturities of more than three months are classified as marketable securities. As of March 31, 2003 and 2004, the Company's marketable securities consisted of U.S. government agency obligations and Washington, D.C. and other state tax-exempt notes and bonds. The Company's marketable securities, which are classified as available-for-sale, are carried at fair market value based on quoted market prices. The net unrealized gains and losses on available-for-sale marketable securities are excluded from net income and are included within accumulated elements of other comprehensive income. The specific identification method is used to compute the realized gains and losses on the sale of marketable securities. Current marketable securities have maturity dates within twelve months of the balance sheet date. The Company may not hold its marketable securities to maturity and may elect to sell the securities at any time.

Property and equipment

Property and equipment consists of leasehold improvements, furniture, fixtures, equipment, and capitalized internal software development costs. Property and equipment is stated at cost, less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, ranging from three to fifteen years. Internal software development costs are accounted for in accordance with AICPA Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* and web development costs are accounted for in accordance with EITF 00-2, *Accounting for Web Site Development Costs.* Capitalized internal software development costs and capitalized web development costs are amortized using the straight-line method over the estimated useful lives of the assets, which range from three to five years. Maintenance and repairs are charged to expense as incurred.

Recovery of long-lived assets

Long-lived assets and identifiable assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be addressed. Impairment is identified by comparing the carrying value to the estimated undiscounted future cash flows expected to result from the use of the assets and their eventual dispositions. Impairment is measured and recorded on the basis of fair value. The Company considers expected cash flows and estimated future operating results, trends, and other available information in assessing whether the carrying value of assets is impaired. The Company believes that no such impairment existed as of March 31, 2003 and 2004.

Revenue recognition

Revenues from renewable research memberships and best practices installation support memberships are recognized over the term of the related subscription agreement, which is generally 12 months. Fees are generally billable, and the full amount of program agreement fees receivable and related deferred revenue are recorded, when a letter agreement is signed by the member. Certain fees are billed on an installment basis. Members may request a refund of their fees, which is provided on a pro rata basis relative to the length of the service period. As of March 31, 2002, 2003 and 2004, approximately $1.0 million, $0.3 million and $1.3 million, respectively, of deferred revenues were to be recognized beyond the following 12 months.

Allowance for uncollectible revenue

The Company's ability to collect outstanding receivables from its members has an effect on the Company's operating performance and cash flows. This effect is mitigated because memberships, which are predominantly annual contracts, are generally payable by members at the beginning of the contract term. The Company records an allowance for uncollectible revenue as a reduction of revenue based on its ongoing monitoring of members' credit and the aging of receivables.

Deferred incentive compensation

Direct incentive compensation related to the negotiation of new and renewal memberships is deferred and amortized over the term of the related memberships.

Earnings per share

Basic earnings per share is computed by dividing net income by the number of weighted average common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the number of weighted average common shares and common share equivalents outstanding during the period. Common share equivalents consist of common shares issuable upon the exercise of outstanding common stock options. The number of weighted average common share equivalents outstanding is determined in accordance with the treasury stock method, using the Company's prevailing tax rates. A reconciliation of basic to diluted weighted average common shares outstanding is as follows (in thousands):

	Year Ended March 31,		
	2002	2003	2004
Basic weighted average common shares outstanding	13,748	13,139	15,745
Weighted average common share equivalents outstanding	2,341	3,857	2,935
Diluted weighted average common shares outstanding	16,089	16,996	18,680

Concentrations of risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, marketable securities and membership fees receivable. The Company maintains cash and cash equivalents and marketable securities with financial institutions. Marketable securities consist of U.S. government agency obligations and municipal obligations, primarily from the District of Columbia. The Company performs periodic evaluations of the relative credit ratings related to the cash, cash equivalents and marketable securities. The credit risk with respect to membership fees receivable is generally diversified due to the large number of entities comprising the Company's membership base, and the Company establishes allowances for potential credit losses.

The Company generates revenues from customers located outside the United States. For each of the years ended March 31, 2002, 2003 and 2004, the Company generated approximately 1% of revenues from customers outside the United States. No one customer accounted for more than 2% of revenues for any period presented.

Income taxes

Deferred income taxes are determined on the asset and liability method. Under this method, temporary differences arise as a result of the difference between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or the entire deferred tax asset will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax law and tax rates on the date of the enactment of the change.

Fair value of financial instruments

The fair value of current assets and current liabilities approximates their carrying value due to their short maturity.

Segment reporting

Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information* requires a business enterprise, based upon a management approach, to disclose financial and descriptive information about its operating segments. Operating segments are components of an enterprise about which separate financial information is available and regularly evaluated by the chief operating decision maker of an enterprise. Under this definition, the Company operated as a single segment for all periods presented.

Research and development costs

Costs related to the research and development of new company programs are expensed when incurred.

Stock-based compensation

The Company has several stock-based compensation plans, which are described more fully in Note 11. The Company accounts for those plans using the intrinsic value method of expense recognition and measurement prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and related Interpretations (collectively, APB No. 25). In accordance with Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), as amended by Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure* (SFAS No. 148), the pro forma stock-based compensation cost, net income and basic and diluted earnings per share is computed as if the fair value based method of expense recognition and measurement prescribed by SFAS No. 123 had been applied to all options.

The fair values of options granted from the date of the Spin-Off, were estimated at the date of grant for each period using the Black-Scholes option pricing model with the following weighted average assumptions:

	Year Ended March 31,		
	2002	2003	2004
Risk free interest rate	5.2%	3.91%	2.63%
Dividend yield	—	—	—
Weighted average expected lives of options	6.5 years	7.5 years	5 years
Expected volatility	94%	48%	40%
Weighted average fair values of options granted	$10.72	$19.01	$13.62

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that 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 characteristics that are significantly different from those of traded options. 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 rights.

For purposes of pro forma disclosures, the estimated fair value of options is amortized to expense over the estimated service period. If the Company had used the fair value accounting provisions of SFAS No. 123, pro forma net income (loss) for each period would have been as follows (in thousands, except per share information):

	Year Ended March 31,		
	2002	2003	2004
Net income, as reported	$ 9,976	$14,439	$18,720
Deduct: Total stock-based compensation expense determined under fair value based methods for all awards, net of related tax effects	(5,989)	(7,753)	(8,843)
Pro forma net income	$ 3,987	$ 6,686	$ 9,877
Pro forma net income per share:			
Basic—as reported	$ 0.73	$ 1.10	$ 1.19
Diluted—as reported	$ 0.62	$ 0.85	$ 1.00
Basic—pro forma	$ 0.29	$ 0.51	$ 0.63
Diluted—pro forma	$ 0.25	$ 0.41	$ 0.54

The pro forma results may not necessarily be indicative of future results.

Use of estimates in preparation of consolidated financial statements

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent accounting pronouncements

In January 2003, the FASB issued Financial Accounting Standards Board Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51.* This interpretation of ARB No. 51, *Consolidated Financial Statements,* requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The Company adopted FIN 46 as of March 31, 2004. The adoption had no impact on the Company's consolidated financial statements.

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables,* (Issue 00-21). Issue 00-21 provides guidance for determining the unit(s) of accounting in arrangements that include multiple products, services, and/or rights to use assets. The adoption of Issue 00-21 had no impact on the Company's consolidated financial statements.

4. MARKETABLE SECURITIES

The aggregate value, amortized cost, gross unrealized gains and gross unrealized losses on available-for-sale marketable securities are as follows (in thousands):

	As of March 31, 2004			
	Market Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
U.S. government agency obligations	$79,412	$78,329	$1,245	$(162)
Washington, D.C. tax exempt obligations	15,989	15,469	520	—
Tax exempt obligations of other states	3,019	2,921	98	—
	$98,420	$96,719	$1,863	$(162)

	As of March 31, 2003			
	Market Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
U.S. government agency obligations	$37,861	$37,371	$ 494	$ (4)
Washington, D.C. tax exempt obligations	16,215	15,819	396	—
Tax exempt obligations of other states	3,030	2,973	57	—
	$57,106	$56,163	$ 947	$ (4)

The following table summarizes marketable securities maturities (in thousands):

	As of March 31, 2004	
	Fair Market Value	Amortized Cost
Matures in less than 1 year	$ 3,737	$ 3,729
Matures after 1 year through 5 years	40,465	39,649
Matures after 5 years through 10 years	54,218	53,341
	$98,420	$96,719

The average maturity on all marketable securities held by the Company as of March 31, 2004 was approximately 4.9 years.

5. MEMBERSHIP FEES RECEIVABLE

Membership fees receivable consist of the following (in thousands):

	As of March 31,	
	2003	2004
Billed fees receivable	$ 7,161	$ 9,718
Unbilled fees receivable	3,723	6,270
	10,884	15,988
Allowance for uncollectible revenue	(1,650)	(1,650)
Membership fees receivable, net	$ 9,234	$14,338

Billed fees receivable represent invoiced membership fees. Unbilled fees receivable represent fees due to be billed to members who have elected to pay on an installment basis.

6. PROPERTY AND EQUIPMENT

Property and equipment consists of the following (in thousands):

	As of March 31,	
	2003	2004
Leasehold improvements, furniture, fixtures and equipment	$ 8,225	$ 13,426
Software and web development costs	4,036	4,060
	12,261	17,486
Accumulated depreciation	(9,370)	(10,785)
Property and equipment, net	$ 2,891	$ 6,701

7. INCOME TAXES

The Company is a calendar year taxpayer and, prior to November 2001, was treated as an S corporation for federal income tax purposes, whereby taxable income or losses flowed through to, and were reportable by, the individual stockholders. Accordingly, prior to November 2001, no provision was made for federal income taxes in the consolidated financial statements. The District of Columbia, as well as several states, however, assess a corporate level tax even on S corporations. In conjunction with an initial public offering in November 2001, the Company became subject to federal income taxes at prevailing corporate rates. At the date of conversion to a taxable corporation, the Company recorded a net deferred tax asset of $1.6 million, representing the difference between the book and income tax bases of recorded tax assets and liabilities. The Company presents unaudited pro forma information for the year ended March 31, 2002, which reflects results of operations the Company would have reported if it had been subject to federal income taxes for the entire year. The Company had no income taxes payable as of March 31, 2003 and 2004.

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

	Year Ended March 31,		
	2002	2003	2004
Current	$(3,663)	$(10,155)	$(13,357)
Deferred	2,305	(237)	618
Provision for income taxes	$(1,358)	$(10,392)	$(12,739)

Deferred income taxes are provided for temporary differences between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. The tax effect of these temporary differences is presented below (in thousands):

	As of March 31,	
	2003	2004
Deferred income tax assets:		
Net operating loss carryforward	$ 8,345	$34,522
Compensation accrued for financial reporting purposes	3,337	3,750
Reserve for uncollectible revenue	684	684
Long-term membership contracts	103	354
Deferred income tax liabilities:		
Unrealized gains on available-for-sale securities	(392)	(670)
Deferred incentive compensation	(937)	(985)
Net deferred income tax assets	$11,140	$37,655

The provision for income taxes differs from the amount of income taxes determined by applying the applicable income tax statutory rates to income before provision for income taxes as follows:

	Year Ended March 31,		
	2002	2003	2004
Statutory U.S. federal income tax rate	34.0%	35.0%	35.0%
State income tax, net of U.S. federal income tax benefit	6.6	6.5	6.5
Termination of S corporation status	(14.9)	—	—
Phase-in rate differential	(16.3)	—	—
Other permanent differences, net	2.6	0.4	(1.0)
Effective tax rate	12.0%	41.9%	40.5%

The Company has deferred income tax assets, consisting primarily of net operating loss (NOL) carryforwards for regular Federal and state income tax purposes generated from the exercise of common stock options. In estimating future tax consequences, Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS No. 109) generally considers all expected future events in the determination and evaluation of deferred tax assets and liabilities. The Company believes that its future taxable income will be sufficient for the full realization of its deferred income tax assets. However, SFAS No. 109 does not consider the effect of future changes in existing laws or rates in the determination and evaluation of deferred tax assets and liabilities until the new tax laws or rates are enacted. The Company has established its deferred income tax assets and liabilities using currently enacted tax laws and rates. The Company will recognize into income an adjustment for the impact of new tax laws or rates on the existing deferred tax assets and liabilities when new tax laws or rates are enacted.

The Company has net operating losses in the amount of approximately $83.2 million at March 31, 2004. The net operating losses expire between 2022 and 2024. The Company utilized tax benefits from the exercise of stock options that were recorded in the consolidated statement of equity that offsets the current tax provision that was recorded in the consolidated statement of income which resulted in no current tax liability for the year ended March 31, 2004.

Washington, D.C. income tax incentives

The Office of Tax and Revenue of the Government of the District of Columbia (the Office of Tax and Revenue) has adopted regulations in accordance with the New E-Conomy Transformation Act of 2000 (the Act) that modify the income and franchise tax, sales and use tax, and personal property tax regulations, effective April 2001. Specifically, the regulations provide certain credits, exemptions and other benefits to a Qualified High Technology Company (QHTC).

The Company has performed an analysis to support its position that it meets the definition of a QHTC under the provisions of the Act. Accordingly, the Company will amend its 2003 Washington, D.C. income tax return and certain sales and use tax returns, to file as a QHTC. As a QHTC, the Company's Washington, D.C. income tax rate will be 0.0% for five years and the Company will be eligible for certain Washington, D.C. income tax credits. In addition the Company will be entitled to relief from certain sales and use taxes. While the Company believes it qualifies as a QHTC, the Company has not recognized the impact of this election within the consolidated financial statements, because of uncertainties inherent in the regulations, as adopted.

For financial reporting purposes, the Company has valued its deferred income tax assets and liabilities using Washington, D.C.'s currently enacted income tax rate of 9.975%. Additionally, the Company has continued to provide for income, sales and use taxes as if the Company were not a QHTC. However, if the Company had received a determination that it qualified for QHTC status as of March 31, 2004, it would have recorded a noncash charge to earnings up to approximately $5.8 million, representing the effects on its existing deferred tax assets of reducing the Washington, D.C. income tax rate to 0.0%, net of any income tax credits discussed above. If the Company determines it is more likely than not that the Office of Tax and Revenue will accept the Company's election as a QHTC, the Company will record the applicable charge. Additionally, the Company would recognize the refund of any previously paid or provided sales and use taxes at that time.

8. COMPREHENSIVE INCOME

Comprehensive income is defined as net income plus the net-of-tax impact of foreign currency translation adjustments, minimum pension liability adjustments, and net unrealized gains and losses on certain investments in marketable securities. Comprehensive income for the years ended March 31, 2002, 2003 and 2004 was $10.0 million, $15.0 million and $19.2 million, respectively. The accumulated elements of other comprehensive income, net of tax, included within stockholders' equity on the consolidated balance sheets are comprised solely of the changes in net unrealized gains and losses on marketable securities.

9. TRANSACTIONS WITH AFFILIATES

Background

The Company had or currently has certain transactions with affiliated entities, including the sharing of certain administrative functions and charges incurred for strategic direction and oversight prior to the Company's initial public offering in November 2001. These transactions are summarized below:

Transactions with entities controlled by the former principal stockholder

Administrative Services From January 2000 to June 30, 2001, the majority of the Company's administrative functions, including recruiting, career management, facilities and telecommunications, were provided by DGB Enterprises, Inc. (DGB Enterprises), an entity which managed our former principal stockholder's various business interests including his ownership interest in the Company. The Company and DGB Enterprises entered into an administrative services agreement which provided for fees for these services based on direct costs per transaction, square footage, headcount or a fixed cost per month that approximated the cost for each entity to internally provide or externally source these services.

As of July 1, 2001, the Company and DGB Enterprises entered into a new Administrative Services Agreement (New ASA), whereby the Company assumed internal management of substantially all these administrative functions while DGB Enterprises continued to provide services related to the facilities associated with the shared leased space (see Lease and Sublease Agreements below). Under the New ASA, the Company provides certain services to DGB Enterprises and other affiliated entities for fees based on direct costs per transaction, square footage, headcount or a fixed cost per month that approximates the cost for each entity to internally provide or externally source these services. The New ASA expired in June 2003, however the Company and DGB Enterprises have continued the arrangements on a month-to-month basis. These net charges, which management believes approximate the expenses which would have been incurred had the Company operated on a stand-alone basis, are included in the Company's general and administrative expenses.

The Company performs and receives certain services from other affiliated entities. These net charges are included in Transactions with Other Related Entities in the accompanying Receivable from Affiliates table.

Lease and Sublease Agreements On July 1, 1999, the Company assigned its headquarters lease for office space to DGB Enterprises and subsequently entered into a Sublease Agreement with DGB Enterprises whereby the Company leased the space it occupies on terms consistent with the original lease agreement through April 2004, which was extended to May 31, 2004.

Other Transactions In November 2001, in conjunction with its initial public offering, the Company made cash and noncash distributions to its stockholders of $15.9 million. In May and June 2001, the Company distributed approximately $13.0 million to its former principal stockholder.

Transactions with The Corporate Executive Board Company

In October 1997, the Company spun-off (the Spin-Off) The Corporate Executive Board Company (CEB), a division of the Company that provided best practices research and analysis focusing on corporate strategy, operations and general management issues for non-health care companies.

The Company has a noncompetition agreement with CEB that extends through January 1, 2007, which generally prohibits CEB from selling programs to health care providers. This agreement also prohibits CEB from selling programs to other types of health care organizations unless the programs address issues of a general business nature and are principally sold to companies and institutions not in the health care industry. This noncompetition agreement generally prohibits the Company from selling its programs to organizations principally engaged in businesses other than health care.

Also in conjunction with the Spin-Off, and in order to assist in its transition to an independent corporation, the Company and CEB entered into a royalty free license agreement, an administrative services agreement (ASA), a vendor contracts agreement (VCA) and sublease agreement. Each of these arrangements has expired or been terminated.

Affiliate company charge

DGB Enterprises assessed a fee for strategic direction and oversight services to each of the entities controlled by the Company's former principal stockholder, including the Company. This charge was eliminated in October 2001.

Receivable from affiliates

The transactions discussed above are as follows (in thousands):

	Year Ended March 31,		
	2002	2003	2004
Balance at beginning of year	$ 1,889	$ —	$ —
Transactions with CEB:			
ASA charges	16	—	—
VCA charges	94	—	—
Transactions with DGB:			
Management services	(96)	—	—
ASA charges, net	(1,077)	(748)	(1,043)
Sublease charge	(3,246)	(3,412)	(3,557)
Affiliate company charge	(2,676)	—	—
Distributions in connection with initial public offering	(8,368)	—	—
Transactions with other related entities:			
ASA charges, net	(11)	(46)	(46)
	(15,364)	(4,206)	(4,646)
Net cash transfers from the Company	13,475	4,206	4,646
Balance at end of year	$ —	$ —	$ —

10. PUBLIC OFFERINGS OF COMMON STOCK

Options granted to certain of the Company's option holders under the Company's 1997 and 2001 stock-based incentive compensation plans were exercised to acquire shares sold in public offerings at various times in fiscal 2003 and fiscal 2004. Upon the exercise of these options the Company received a total of approximately $21.5 million and $26.8 million in fiscal 2003 and 2004, respectively, in cash in payment of option exercise prices.

The Company recognized approximately $781,000 and $1.7 million in compensation expense reflecting additional Federal Insurance Corporation Act taxes as a result of the taxable income that employees recognized upon the exercise of non-qualified common stock options in fiscal 2003 and 2004, respectively. The Company also incurred additional compensation expense for tax reporting purposes, but not for financial reporting purposes, that increased the deferred tax asset to reflect allowable tax deductions that will be realized in the determination of the Company's income tax liability and therefore reduce its future income tax payments. In connection with these transactions, the Company's deferred tax asset increased by approximately $20.9 million and $40.0 million in fiscal 2003 and 2004, respectively. Although the provision for income taxes for financial reporting purposes did not change, the Company's actual cash payments will be reduced as the deferred tax asset is utilized. As a result of the receipt of cash for the exercise of options, the incurrence of additional compensation expense and the recognition of a deferred tax asset, the Company's stockholders' equity increased by approximately $40.6 million and $65.1 million in fiscal 2003 and 2004, respectively, in connection with the exercise of stock options.

11. STOCK OPTION PLANS, SPECIAL COMPENSATION ARRANGEMENTS AND OTHER EMPLOYEE BENEFIT PLANS

Stock-based incentive compensation plans

The 1997 Stock-Based Incentive Compensation Plan (1997 Plan) provided for the issuance of options to purchase up to 10,104,000 shares of Class B nonvoting common stock. In connection with the Company's initial public offering, the stock options granted pursuant to the 1997 Plan generally became exercisable in equal portions on each of the first three anniversaries of the initial public offering. The New Options generally expire five years after the initial public offering.

On June 1, 2001, the Company adopted the 2001 Stock-Based Incentive Compensation Plan (2001 Plan). The 2001 Plan is designed to provide for the grant of stock options that qualify as incentive stock options as well as stock options that do not qualify as incentive stock options under Section 422 of the Internal Revenue Code. Stock options granted pursuant to the 2001 Plan may only be granted to the Company's officers, independent contractors, employees and prospective employees. The aggregate number of shares of the Company's common stock issuable under the 2001 Plan may not exceed 2,357,600 shares. To date, all options granted under the 2001 Plan have been granted to employees.

On June 1, 2001, the Company adopted the Directors' Stock Plan (Directors' Plan). Any person who is, or is elected to be, a member of the Company's board of directors or the board of directors of a subsidiary of the Company is eligible for the award of stock options and/or stock grants under the Directors' Plan. The Directors' Plan is intended to operate in a manner that exempts grants of stock from Section 16(b) of the Securities Exchange Act of 1934. The maximum number of shares of the Company's common stock that can be issued under the Directors' Plan is 842,000.

The Company's former principal stockholder issued options to acquire 2,778,600 shares of the Company's common stock owned by him. These options were cancelled during fiscal 2002. In accordance with APB Opinion No. 25, the Company has accounted for these options as if the Company issued the options directly.

Stock Option Repurchase Agreements

During fiscal 2001, the Company entered into an agreement to repurchase certain stock options at a fixed price. In August 2001, the Company entered into two additional Stock Option Repurchase Agreements (collectively, the Stock Option Repurchase Agreements). Compensation expense is recognized under these Stock Option Repurchase Agreements over the relevant required employment periods. Total compensation expense was $1.4 million, $0.4 million and zero in fiscal 2002, 2003 and 2004, respectively.

Option to purchase stock from the former principal stockholder

The Company had an option to purchase 4,564,061 shares of common stock from the former principal stockholder at $7.13 per share, pursuant to a stock option agreement dated May 1, 2001. This option was intended to provide shares to be issued upon the exercise of outstanding employee stock options so that the Company's stockholders would not experience dilution because of the issuance of new shares upon such exercise. Upon completion of the IPO, the former principal stockholder terminated the option by issuing to the Company 2,851,337 shares, representing the excess of the fair value of the stock over the exercise price of the option. The Company then immediately cancelled these shares and they are no longer considered issued and outstanding.

Transactions under stock option plans

The following table summarizes the changes in common stock options for all of the common stock option plans described above.

	Number of Options	Exercise Price Per Share	Weighted Average Exercise Price
Outstanding at March 31, 2001	12,273,026	$ 2.91–13.06	$ 7.13
Options granted	1,647,016	7.13–19.00	14.11
Options exercised	(1,023,872)	2.91– 7.13	3.27
Options cancelled	(3,096,254)	7.13–19.00	8.06
Outstanding at March 31, 2002	9,799,916	2.91–19.00	8.42
Options granted	638,416	29.28–36.12	30.44
Options exercised	(2,616,382)	5.94–19.00	8.20
Options cancelled	(67,180)	7.13–29.77	14.65
Outstanding at March 31, 2003	7,754,770	2.91–36.12	10.26
Options granted	896,000	34.44–47.49	35.15
Options exercised	(3,533,296)	2.91–29.28	7.55
Options cancelled	(141,045)	7.13–29.28	18.60
Outstanding at March 31, 2004	4,976,429	$ 7.13–47.49	$16.34

Exercise prices for options outstanding at March 31, 2004, are as follows:

Range of Exercise Prices	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life—Years	Number Exercisable	Weighted Average Exercise Price
$ 7.13–10.09	2,821,343	$ 7.16	3.2	432,696	$ 7.30
10.10–11.88	93,519	11.19	3.7	9,039	11.88
19.00–23.75	609,151	19.00	7.6	136,318	19.00
28.49–33.24	508,000	30.28	8.8	76,250	29.67
33.25–37.99	922,416	34.80	9.8	42,416	33.63
42.74–47.49	22,000	47.46	9.5	—	—
$ 7.13–47.49	4,976,429	$16.34	5.6	696,719	$13.70

On May 31, 2001, certain employees of the Company exercised options to purchase 1,023,872 shares of Class B nonvoting common stock at a weighted average exercise price of $3.27 per share. The Company advanced funds to the employees equal to the aggregate exercise price of the options, in exchange for full recourse 6.5% promissory notes from the employees.

Benefit Plan

The Company sponsors a defined contribution 401(k) plan (the Plan) for all employees who have reached the age of twenty-one. The Company provides contributions equal to 50% of an employee's contribution up to a maximum of 4% of base salary. Contributions to the Plan for the years ended March 31, 2002, 2003 and 2004 were approximately $438,000, $499,000 and $573,000, respectively.

Employee Stock Purchase Plan

On October 25, 2001, the Company established an employee stock purchase plan (the ESPP). Under the ESPP, employees may authorize payroll deductions not to exceed 15% of their salary to purchase shares of the Company's common stock quarterly at 85% of the lesser of the share price on the first or last day of the quarter. The ESPP is authorized to issue up to 842,000 shares of the Company's common stock. Employees began contributing to the ESPP on April 1, 2002, and for the years ended March 31, 2003 and 2004, the Company issued 13,450 and 10,663 shares of common stock under the ESPP, respectively.

12. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company assigned its office lease to DGB Enterprises as of July 1, 1999, and subsequently entered into a sublease agreement (the Sublease) with DGB Enterprises, which expires in May 2004. The Company remains jointly and severally liable for all obligations under the original lease.

In October 2003, the Company entered into a new lease for its headquarters space (New Lease) which takes effect June 1, 2004 and has a 15-year term. The terms of the New Lease contain provisions for rental escalation and the Company is required to pay its portion of executory costs such as taxes and insurance. The Company is also obligated to take additional expansion space in the building pursuant to the lease. The Company's future minimum lease payments under the Sublease and New Lease, including expansion space but excluding rental escalation and executory costs, are as follows (in thousands):

Year Ending March 31,	
2005	$ 3,131
2006	2,958
2007	2,278
2008	3,367
2009	3,839
Thereafter	34,944
Total	$50,517

Rent expense during the years ended March 31, 2002, 2003 and 2004 was approximately $3.4 million, $3.6 million and $3.7 million, respectively.

The Company entered into a $3.2 million letter of credit agreement with a commercial bank which expires October 5, 2004, to provide a security deposit for the New Lease. Certain assets have been pledged as collateral under the letter of credit agreement. To date, no amounts have been drawn on this agreement.

Litigation

From time to time, the Company is subject to ordinary routine litigation incidental to its normal business operations. The Company is not a party to, and its property is not subject to, any material legal proceedings.

Other

The Company has outsourced certain office functions to a vendor under a five-year services contract that includes minimum commitments of approximately $45,000 per month through December 2006.

13. QUARTERLY FINANCIAL DATA (UNAUDITED)

Unaudited summarized financial data by quarter for the years ended March 31, 2003 and 2004 is as follows (in thousands, except per share amounts):

	Fiscal 2003 Quarter Ended			
	June 30	September 30	December 31	March 31
Revenues	$22,929	$24,488	$25,865	$27,432
Cost of services	9,609	10,708	10,726	10,555
Income from operations	5,243	5,466	5,414	7,670
Income before income taxes	5,379	5,650	5,683	8,119
Net income	3,090	3,249	3,269	4,831
Earnings per share:				
Basic	$ 0.25	$ 0.27	$ 0.24	$ 0.33
Diluted	$ 0.19	$ 0.20	$ 0.19	$ 0.27

	Fiscal 2004 Quarter Ended			
	June 30	September 30	December 31	March 31
Revenues	$28,449	$29,951	$31,262	$32,185
Cost of services	11,617	12,291	13,167	13,092
Income from operations	6,863	7,218	6,958	7,509
Income before income taxes	7,444	7,898	7,739	8,378
Net income	4,430	4,700	4,605	4,985
Earnings per share:				
Basic	$ 0.29	$ 0.30	$ 0.29	$ 0.30
Diluted	$ 0.24	$ 0.25	$ 0.25	$ 0.26

Executive Officers and Directors

Jeffrey D. Zients
Chairman of the Board

Frank J. Williams
Chief Executive Officer and Director

Marc N. Casper*†‡
Director

Michael A. D'Amato
Director

Kelt Kindick*†‡
Director

Joseph E. Laird, Jr.†‡
Director

LeAnne M. Zumwalt*‡
Director

Scott M. Fassbach
Chief Research Officer

David L. Felsenthal
Chief Financial Officer, Secretary, and Treasurer

Scott A. Schirmeier
General Manager, Sales and Marketing

Richard A. Schwartz
General Manager, Research

* Member of the Audit Committee of the Board of Directors
† Member of the Compensation Committee of the Board of Directors
‡ Member of the Governance Committee of the Board of Directors

Corporate Information

Form 10-K/Investor Contact
A copy of the Company's Annual Report on Form 10-K for the fiscal year ending March 31, 2004 (without exhibits) is available from the Company at no charge. Requests for the Annual Report on Form 10-K and other investor contacts should be directed to David L. Felsenthal, Chief Financial Officer, Secretary and Treasurer, at the Company's corporate office.

Common Stock Dividend Information
The common stock of The Advisory Board Company has been traded on the Nasdaq National Market under the symbol ABCO since the initial public offering on November 12, 2001. As of September 2004, there were approximately 5,800 holders of the common stock, including eight stockholders of record. The Company has not declared or paid any cash dividend on the common stock since the closing of its initial public offering, and it does not anticipate declaring or paying cash dividends in the foreseeable future. The timing and amount of future cash dividends, if any, would be determined by the Company's Board of Directors and would depend upon the Company's earnings, financial condition, and cash requirements.

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Equity Services Group
1525 West WT Harris Boulevard, 3C3
Charlotte, NC 28262
800-829-8432

Independent Public Accountants
Ernst & Young LLP
621 East Pratt Street
Baltimore, MD 21202

The following table sets forth, for the periods indicated, the high and low closing prices per share of our common stock as reported on the Nasdaq Stock Market.

	High	Low
Fiscal year ending March 31, 2003		
First Quarter	$43.34	$31.76
Second Quarter	$37.46	$26.37
Third Quarter	$35.04	$25.31
Fourth Quarter	$35.02	$28.85
Fiscal year ending March 31, 2004		
First Quarter	$41.40	$33.57
Second Quarter	$48.74	$38.74
Third Quarter	$47.94	$31.74
Fourth Quarter	$40.47	$32.13

THE ADVISORY BOARD COMPANY

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