The Advisory Board Company

Annual Report to Shareholders

Fiscal Year 2005

"A stand can be made against invasion by an enemy;
no stand can be made against invasion by an idea."

-Victor Hugo

The Advisory Board Company

The Advisory Board Company in Brief

The Advisory Board Company provides best practice research and analysis to the health care industry, focusing on business strategy, operations, and general management issues. Our research services are offered through discrete annual programs to a membership of more than 2,500 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.

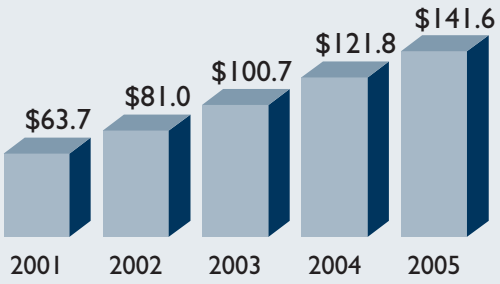
For a fixed annual fee, members of each of our programs have access to an integrated set of services designed to provide valuable, timely information derived from lessons learned from the industry's most progressive participants. These services can include:

- 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.

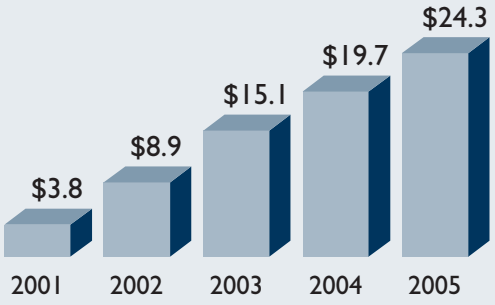
Annual Revenues for Fiscal Years Ending March 31

In Millions

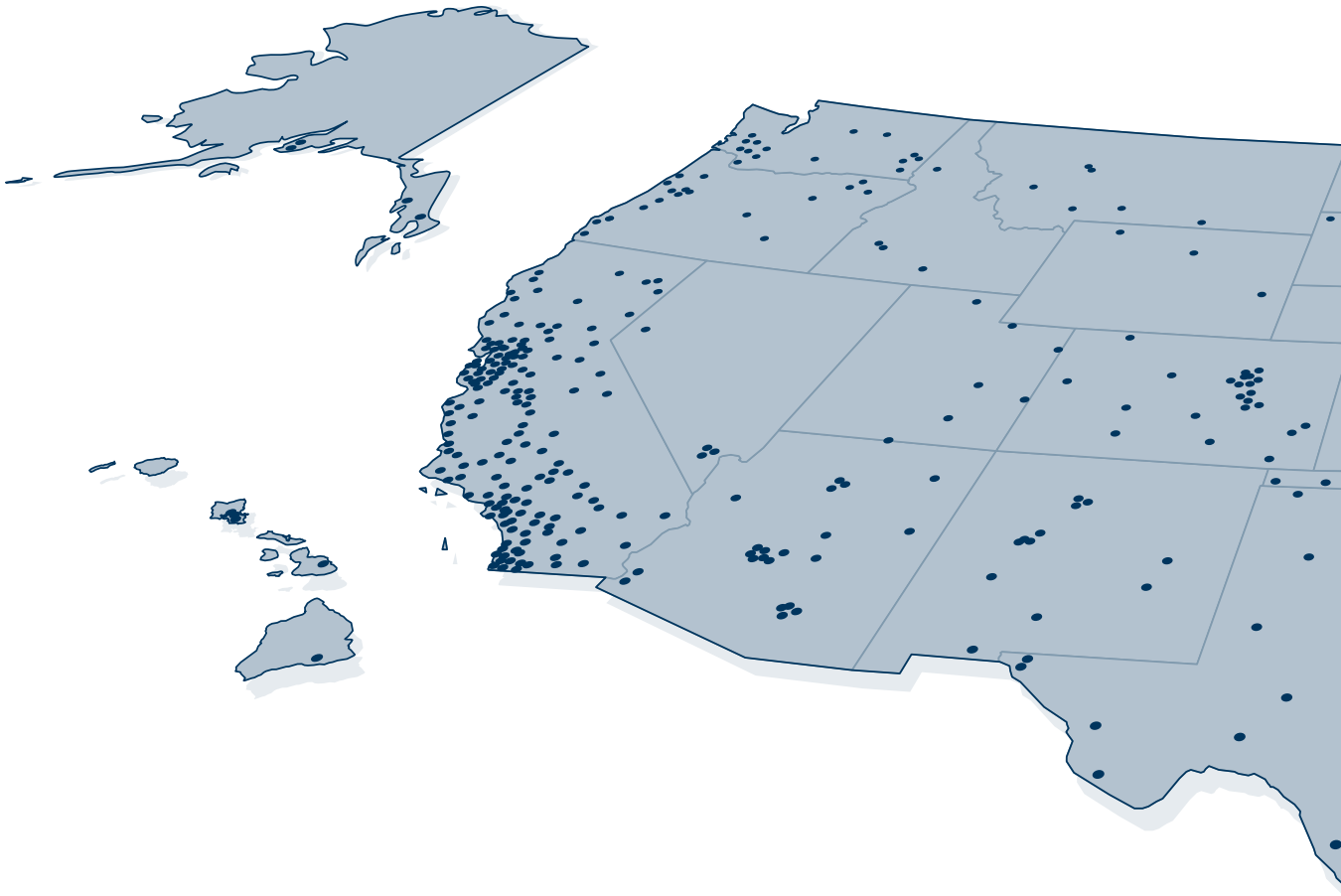


Pro Forma Net Income* for Fiscal Years Ending March 31

In Millions



* Pro forma results are not presented in accordance with Generally Accepted Accounting Principles (GAAP). See page 7 for a reconciliation of GAAP to pro forma results.



Representative Adv

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
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 Maryland Medical Center
University of Michigan Medical Center
University of Wisconsin Hospital
Yale-New Haven Hospital

Teaching Hospitals

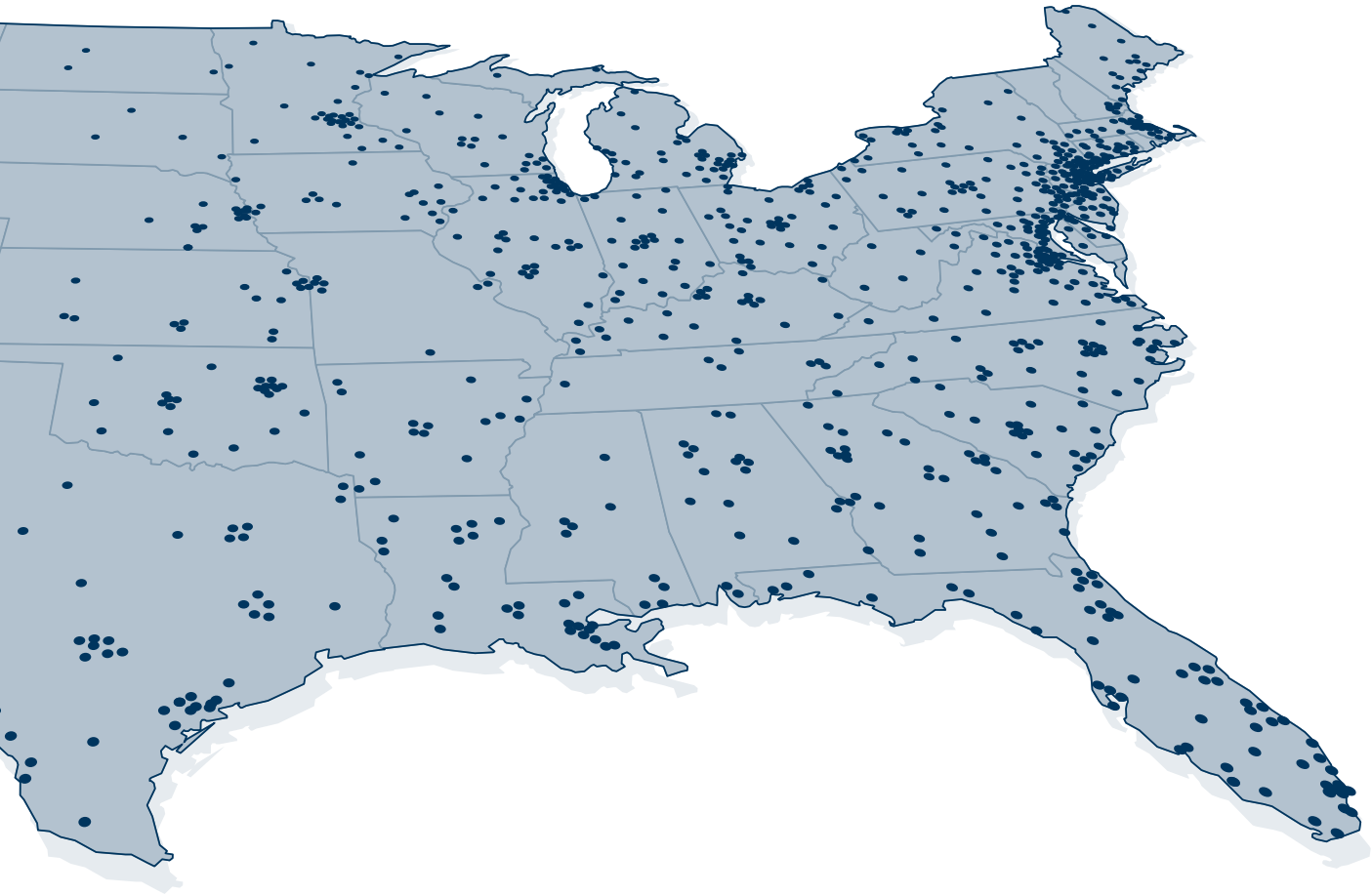
Bayview Medical Center
Detroit Medical Center
Detroit Receiving Hospital
Grace Hospital
Grady Memorial Hospital
Harborview Medical Center
Harper University Hospital
Harris County Hospital District
Hurley Medical Center
Lenox Hill Hospital
Long Beach Memorial Medical Center
Overlook Hospital
Parkland 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
Iasis Healthcare
Inova Health System
Legacy Health System
North Shore-Long Island Jewish Health System
OSF Healthcare System
Providence 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 Hospital

Baptist University Hospital for Women
Barbara Ann Karmanos Cancer Institute
Baylor Specialty Hospital
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



visory Board Members

Mayo Foundation
Memorial Sloan-Kettering Cancer Center
Methodist Specialty and Transplant Hospital
National Institutes of Health
New York Eye and Ear Infirmary
Ochsner Clinic Foundation
Presbyterian Specialty Hospital
Roswell Park Cancer Institute
University Specialty Hospital
University of Texas M.D. Anderson Cancer Center

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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
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
Reading Hospital and Medical Center
Resurrection Medical Center
Saint Francis Hospital
St. Joseph Regional Medical Center
St. Luke's Hospital
St. Luke's Regional Medical Center
St. Mary's Regional Medical Center
Tucson Medical Center
Valley Baptist Medical Center
Washoe Medical Center

Insurers and Managed Care

Aetna
Blue Shield of California
Blue Cross and Blue Shield of Florida
Blue Cross and Blue Shield of Montana
Blue Cross Blue Shield of Tennessee
Espirito Santo Saude
Excellus Blue Cross Blue Shield
Harvard Pilgrim Health Care
Highmark Blue Cross Blue Shield
HIP
Horizon Blue Cross Blue Shield of New Jersey
Triple-S Management
WellChoice, Inc.
Wellpoint, Inc.

Health Care Corporations

Aptium Oncology
Boston Scientific Corporation
California HealthCare Foundation
Cardinal Health, Inc.
Elekta Oncology Systems, Inc.
Emergency Medical Associates
Emageon UV, Inc.
Freeman White
Fresenius Medical Care Extracorporeal Alliance
GE Clinical Systems
Hammes Company
Hill-Rom
IBM Corporation
IDX Systems Corporation
Kaiser Permanente
McKesson
MedAmerica, Inc.
MedCath, Inc.
Medtronic, Inc.
Siemens Medical Solutions, USA
St. Jude Medical Inc.
Striker Orthopaedics
Trammell Crow Company
US Oncology
Varian Medical Systems
Xerox

Pharmaceutical and Biotechnology

Amgen, Inc.
Becton Dickinson Health Care Systems
Biosite Diagnostics, Inc.
Bristol-Myers Squibb
Eli Lilly and Company
Hospira, Inc.
Merck & Company
Novartis Pharmaceuticals Corporation
Roche Laboratories
Sanofi-Aventis Pharmaceuticals
Schering-Plough

To Our Shareholders

At the close of fiscal year 2005, I am proud to report that the Advisory Board Company sustained its strong record of consistent growth and outstanding performance. As we complete our fourth year as a public company, I am very pleased with the underlying health of our business and our continued ability to offer a compelling value proposition to our member organizations. Accordingly, one metric from the past year that rises above all others as an indication of our continued program quality and member satisfaction is our member renewal rate of 92 percent, the highest renewal rate in our history.

Our strategic foresight, best practices, analytical tools, and advisory services continue to be especially relevant for success in today's dynamic health care industry. As a result, our membership of progressive institutions grew to more than 2,500 health care organizations by the end of fiscal 2005. Similarly, we have increased the number of membership programs that we offer to 25 and expanded the range of topics on which we maintain deep expertise. For our member organizations and shareholders alike, we delivered tangible economic return through timely insights on the health care industry, created a uniquely scalable business model, and attracted a talented staff dedicated to service of the highest standard.

Delivering another year of strong financial results, the Advisory Board Company surpassed its operational and financial targets. In fiscal 2005, revenues grew 16 percent to $141.6 million from $121.8 million, net income increased to $23.3 million from $18.7 million, and earnings per diluted share rose to $1.22 from $1.00 in the prior year. Pro forma net income—which excludes expenses related to stock options and, for fiscal 2005, includes income taxes at 41 percent—was $24.3 million in fiscal 2005 versus $19.7 million in fiscal 2004, with pro forma earnings per diluted share increasing 20 percent to $1.27 from $1.06 in the prior year.

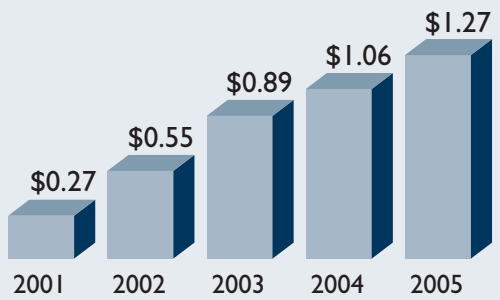
Two Decades Serving the Health Care Industry

In fiscal 2006, the Advisory Board will commemorate 20 years of service to the health care community. Across those two decades, it has been our privilege to document the remarkable advance of great ideas in this industry and to enable our members to carry them more broadly into their enterprises. We still operate on the same two premises—that there are correct answers to complex business questions and that knowledge can be obtained from experienced executives who have dealt with those questions.

Our consistently high renewal rates are a testament to the continued strength of our founding principles. Moreover, our success as an organization relies on our ability to identify proven best practices across a range of topic areas. With our membership base of over 2,500 of the largest and most progressive health care institutions in the United States, the Advisory Board is uniquely positioned to execute on this endeavor.

Not only do we work with a broad group of diverse organizations, but we are privileged to have served all

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



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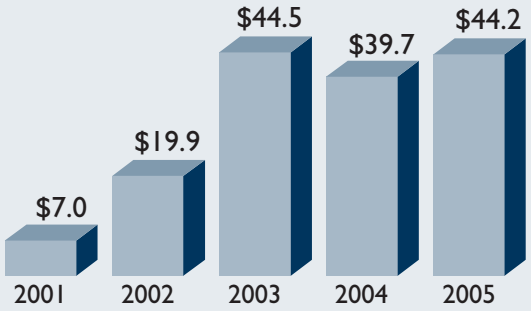
Cash Flow from Operations
for Fiscal Years Ending March 31

In Millions



14 hospitals in the U.S. News & World Report "2005 Best Hospitals" rankings, 90 of the largest 100 health care delivery systems, and 20 of the world's largest pharmaceutical and medical device companies.

> *"One metric from the past year that rises above all others as an indication of our continued product quality and member satisfaction is our record-breaking member renewal rate of 92 percent."*

Across our membership, we serve a range of constituencies, including senior executives and their broader management teams. Our programs currently reach over 5,000 chief executives and chief operating officers and over 45,000 vice presidents and clinical leaders. The advantages of this management network are twofold.

First, through surveys, interviews, and executive roundtables, we are able to focus on the most pressing issues facing health care executives today in an extremely complex and fast-paced environment.

Second, because these members rely upon and are actively involved with our research, they offer us unparalleled access to the best practices in health care strategy, management, and operations across the nation. In fiscal 2005 alone, our staff researched more than 1,400 such practices, adding to our proprietary library of more than 30,000 cutting-edge strategic and operational tactics assembled across the last 20 years.

The health care CEO's agenda has never been more crowded, nor the issues that they face more complex. Consequently, we are seeing continued reliance on our best-practice research and strong utilization of our advisory services. Our research staff has responded with prodigious effort to earn their privileged place as trusted counselors and thought leaders. In fiscal 2005, we published more than 60 major industry studies, authored over 3,500 research briefs, provided executive education to over 45,000 health system leaders, and delivered daily and weekly news briefings to more than 57,000 health care professionals.

Solving an Industry's Most Vexing Problem

Beyond sheer volume, we are able to leverage our industry-wide and ever-increasing intellectual capital to tackle health care's largest and most difficult questions. This year, no single issue garnered more of our attention than patient safety in our nation's hospitals.

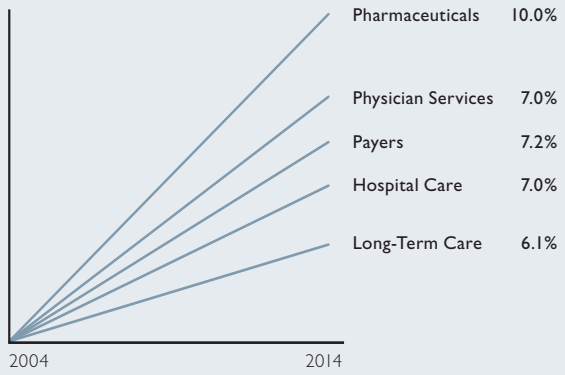
The health care industry is still reeling six years after a groundbreaking 1999 Institute of Medicine report on medical errors estimated that preventable mistakes kill between 44,000 and 98,000 hospitalized Americans each year. Since then, myriad national and state watchdog groups have heightened their scrutiny of the industry, payers have implemented quality-based pay-for-performance structures, and employers have begun choosing health care providers based on clinical quality outcomes. Unfortunately, despite these efforts, a nationwide survey recently revealed that most consumers do not believe that the nation's health care quality has improved in the last six years.

In response, the Advisory Board initiated an in-depth and comprehensive inquiry into the challenge of ensuring high-quality, low-cost care amid escalating reporting requirements. In fiscal 2005, across our program portfolio, we provided data, insights, and advice in this area, delivering a comprehensive set of resources for health care leaders as they seek to manage their institutions toward meeting the new quality imperative:

- For senior hospital executives, we convened meetings and published extensively on how to craft the right strategic plan given the need for greater transparency in clinical care. Our work focused on the key business

Serving a $1.8 Trillion Health Care Industry

*Annual Growth in Spending**



- Health care is a $1.8 trillion market, growing across all major segments that we serve.
- By 2014, total health spending is projected to constitute 18.7% of GDP, from 15.4% today.
- The hospital market alone represents $550 billion in spending today, growing to $1.0 trillion by 2014.

* 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.

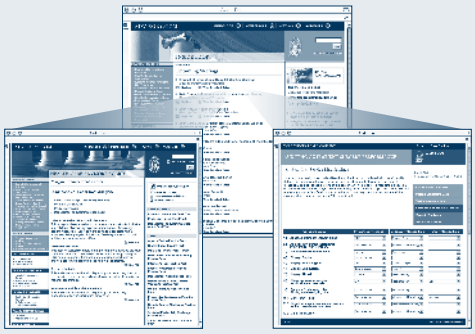
questions of whether reimbursement will be tied to quality and how quality ratings will ultimately affect market share.

> *Our programs currently reach over 5,000 chief executives and chief operating officers and over 45,000 vice presidents and clinical leaders.*

- For operations and clinical leaders, our research was more tactical, focusing on the revenue, cost, and clinical benefits of investing in various quality initiatives. Given the number of organizations involved in the quality debate, we presented a "grade the graders" report card to help hospitals determine which rating organizations matter most from an economic and clinical perspective.
- Our program for chief information officers examined the impact of technology in advancing the patient safety agenda, profiling specific types of clinical information technologies and their relative ability to reduce medical errors. For example, our research found that while computerized physician order entry systems offer a significant long-term opportunity to improve clinical quality, there are other technology solutions that health systems can implement more readily to address safety problems.

Innovative Delivery Channels

Online Reach and Capability



Market Forecasting Tool **Outpatient Surgery Dashboard**

- Today, far more of the Advisory Board's services and products are accessed through online delivery channels than through any other traditional means of delivery, such as hardcopy books and in-person meetings.
- Each year, more than 57,000 members receive our online 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 institution-specific audit tools, analyses, and dashboards, our online channel innovations are enabling us to significantly increase our value proposition.

Across our constituencies, recent member feedback has been overwhelmingly uniform on two points. First, that the quality question is a critical area where concrete assistance is needed and, second, that our programs are providing enormous insight and applicable solutions to members wrestling with this set of challenges.

As these examples illustrate, it is our ability to provide a comprehensive solution to our members' most important problems that ultimately drives our historically high and consistent renewal rates.

Cutting-Edge Research and Reporting

As deeply as our research staff delved into the topic of patient safety, it was but one of numerous industry trends, management developments, operational advances, and clinical technologies that we profiled in fiscal 2005, including:

- Maximizing revenue capture in hospitals by using management and technology practices to identify and recover denied claims in an era of cost containment
- Broadening interest in neurosciences as the "next big service line" in light of increasing threats to the traditional pillars of hospital profitability
- Quantifying the determinants of outstanding nursing unit performance and profiling the unit-specific practices that make a difference
- Identifying the drivers of health benefit costs and the ways top-performing employers are using employee awareness, cost sharing, and coverage design to staunch double-digit growth

As these examples illustrate, health care is a dynamic industry experiencing rapid change and innovation, and we are privileged to be in a unique position to provide health care executives with the intellectual ballast to maintain balance and to navigate true north.

> *We are privileged to be in a unique position to provide health care executives with the intellectual ballast to maintain balance and to navigate true north.*

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.

- A 500-bed hospital in the Southeast realized a 9 percent decrease in days in accounts receivable and $8 million increase in cash on hand in the first 100 days of membership in our revenue cycle performance program. By using our management practices and Web-based revenue cycle tool, the hospital assailed the root causes of bad debt and brought newfound discipline to its coding and collection departments.
- A 400-bed hospital in the Midwest worked with us to install best practices in operating room throughput and efficiency—such as start time and turnover matrices and productivity-based block allocation—and achieved a 500 percent improvement in on-time start rate and 34 percent decrease in turnover times.
- A 350-bed hospital in the Northeast implemented several of our management practices on reining-in runaway supply costs. The hospital, which had previously seen its supply costs increase by 15 percent each year, brought its 2004 increase down to 3 percent and projects that supply costs will increase by only 1.5 percent in 2005.
- A vice president of patient care services who attended an Advisory Board meeting learned about a federal program that provides discounts to certain hospitals for drugs prescribed to Medicaid recipients. As a result of implementing several clinical tactics and being accepted into the federal program, the 200-bed hospital in the Northwest saved $1 million in annual prescription drug costs.

These are but a few of the many tangible economic improvements that our members have experienced as a result of their Advisory Board memberships.

A Significant Growth Opportunity

In the United States alone, health care is a $1.8 trillion industry with a demonstrated need for best-practice research. As in the past, our growth in fiscal 2005 was driven by four primary sources: cross-selling programs to existing members, the addition of new member institutions, price increases, and new program launches.

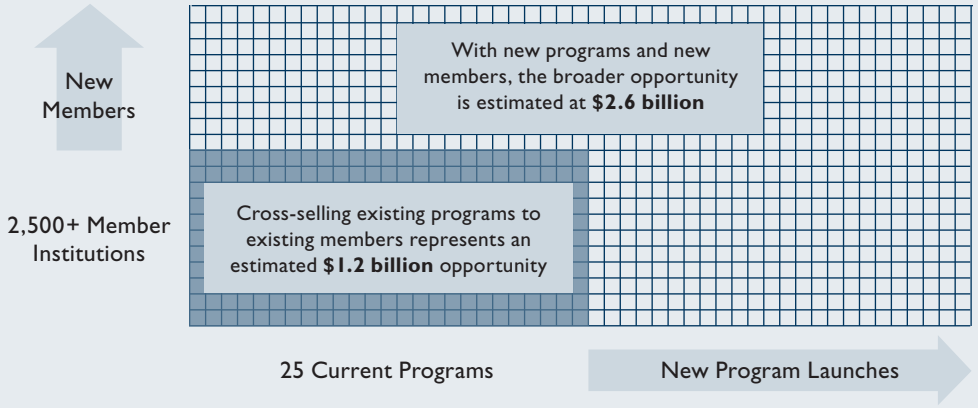
In fiscal 2005, with constant guidance and support from our membership, we embarked upon four new program introductions in human resource strategy, philanthropy, frontline nursing, and nursing business performance.

Already building momentum and performing well, these new programs are setting a new standard of excellence in their respective terrains and adding a number of premier organizations to our membership rosters.

Our membership of over 2,500 organizations represents an attractive market for our existing 25 programs—an estimated $1.2 billion in cross-sell potential. With a contract value of $146.1 million at the close of fiscal 2005, we have a tremendous opportunity to enhance the penetration of our existing programs to our current members. Accordingly, our cross-sell strategy calls for the development of compelling new services to meet the business needs of health care executives in order to leverage our existing relationships.

Attractive Market Opportunity Serving the Health Care Industry

The Five-Year Sales Opportunity



For fiscal 2006, we will continue to target three to four new program launches, capitalizing on our strong industry reputation and our new product pipeline of more than 25 concepts in development. Because we are in constant contact with our member executives, we are able to consistently align our research priorities, service enhancements, and new launches with the most important issues facing the industry. The Advisory Board's recent performance has demonstrated that even in a more challenging business environment, our research provides substantial value to organizations facing 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 to receive a substantial return on their membership fees.

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—both its technology and talent.

To that end, we continued to enhance our online services and capabilities, launching new Web-based publications, interactive forecasting tools, online performance audits, and data-driven benchmarking services. In fiscal 2005, we welcomed over 55,000 health care professionals to our password-protected websites. Collectively, these websites offer our members over 200,000 discrete, content-rich items available for download.

"For fiscal 2006, we will continue to target three to four new program launches, capitalizing on our strong industry reputation and our new product pipeline of more than 25 concepts in development."

Not only do these online services allow us to penetrate more deeply into our member organizations, but they also significantly enhance our value proposition, enabling real time decision support and innovations in program services. For example, this year we developed an online forecasting tool that enables hospital executives to apply our research-based predictions of future inpatient utilization and profitability to their own markets. By uploading their institutions' data to the forecasting tool, executives can create customized performance dashboards, financial projections, and market analyses. This tool, and many more like it, has received enormous praise for its specificity, relevance, and analytical sophistication.

Across the year, we continued to invest in developing our staff of nearly 700 employees, who represent top talent from the best undergraduate and graduate programs, consulting firms, and health care institutions. In fiscal 2005, we offered over 1,200 hours of internal training and leadership development courses to enhance our performance. In addition, we continue to focus on bringing together the necessary elements to create an extraordinary workplace—efforts that have directly contributed to our success at retaining our career research staff, with retention rates in the high 80s. As a result, we have in place a leadership team that is committed to building the premier source of intellectual capital for the health care industry.

Closing Thoughts

I have the daily privilege of working with a team of extremely talented and committed individuals, who take a great deal of pride in our accomplishments of the past year as well as our prospects for continued growth in the future. On their behalf and mine, thank you for your continued interest and support.

Frank Williams
Chairman and 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, *Chairman and Chief Executive Officer*
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, 2001, and for the fiscal year in the period ended March 31, 2001, has 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, 2004 and 2005 and for the four fiscal years in the period ended March 31, 2005, 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)	2001	2002	2003	2004	**2005**
Statement of Operations Data:					
Revenues	$63,727	$ 80,970	$100,714	$121,847	**$141,649**
Costs and expenses:					
Cost of services (excluding special compensation and stock option related expenses of $1,821, $645, $615, $560 and $550)[1] [2]	33,644	37,142	41,598	50,167	**58,354**
Member relations and marketing (excluding special compensation and stock option related expenses of $679, $0, $133, $256 and $216)[1] [2]	12,588	16,100	19,842	24,599	**28,347**
General and administrative (excluding special compensation and stock option related expenses of $344, $837, $399, $857 and $487)[1] [2] [3]	9,768	10,659	12,507	15,445	**15,965**
Depreciation and loss on disposal of fixed assets	1,539	2,030	1,827	1,415	**1,820**
Special compensation and stock option related expenses[1] [2]	2,844	1,482	1,147	1,673	**1,253**
Affiliate company charge[4]	4,505	2,676	—	—	**—**
Total costs and expenses	64,888	70,089	76,921	93,299	**105,739**
Income (loss) from operations	(1,161)	10,881	23,793	28,548	**35,910**
Interest income	471	453	1,038	2,911	**3,971**
Income (loss) before income taxes	(690)	11,334	24,831	31,459	**39,881**
Benefit (provision) for income taxes[5]	68	(1,358)	(10,392)	(12,739)	**(16,534)**
Net income (loss)	$ (622)	$ 9,976	$ 14,439	$ 18,720	**$ 23,347**
Earnings (loss) per share:					
Net income (loss) per share—basic	$ (0.04)	$ 0.73	$ 1.10	$ 1.19	**$ 1.32**
Net income (loss) per share—diluted	$ (0.04)	$ 0.62	$ 0.85	$ 1.00	**$ 1.22**
Basic weighted average number of shares outstanding	13,977	13,748	13,139	15,745	**17,738**
Diluted weighted average number of shares outstanding	13,977	16,089	16,996	18,680	**19,161**

	March 31,				
(In thousands)	2001	2002	2003	2004	**2005**
Balance Sheet Data:					
Cash and cash equivalents and marketable securities	$20,853	$ 23,959	$ 90,407	$139,809	**$152,914**
Working capital (deficit)	(6,793)	(20,374)	(18,110)	(10,044)	**(24,421)**
Total assets	44,009	48,506	117,923	203,999	**245,139**
Deferred revenues	39,270	51,538	63,653	72,410	**82,262**
Total stockholders' (deficit) equity	(1,531)	(16,587)	41,495	115,623	**145,314**

	March 31,				
	2001	2002	2003	2004	**2005**
Other Operating Data:					
Membership programs offered	12	15	18	21	**25**
Total members	2,086	2,170	2,297	2,347	**2,572**
Member renewal rate[6]	86%	88%	89%	87%	**92%**
Contract value (in thousands)[7]	$69,873	$86,108	$106,745	$124,929	**$146,137**
Contract value per member[8]	$33,496	$39,681	$ 46,472	$ 53,229	**$ 56,819**

	Fiscal Year Ended March 31,				
	2001	2002	2004	2004	**2005**
Reconciliation of GAAP to Pro Forma Results:[9]					
(Loss) income from operations	$(1,161)	$10,881	$ 23,793	$ 28,548	**$ 35,910**
Special compensation and stock option related expense	2,844	1,482	1,147	1,673	**1,253**
Affiliate company charge	4,505	2,676	—	—	**—**
Pro forma income from operations	6,188	15,039	24,940	30,221	**37,163**
Interest income	471	453	1,038	2,911	**3,971**
Pro forma income before provision for income taxes	6,659	15,492	25,978	33,132	**41,134**
Pro forma provision for income taxes	(2,830)	(6,584)	(10,877)	(13,418)	**(16,865)**
Pro forma net income	$ 3,829	$ 8,908	$ 15,101	$ 19,714	**$ 24,269**
Pro forma earnings per share:					
Basic	$ 0.27	$ 0.65	$ 1.15	$ 1.25	**$ 1.37**
Diluted	$ 0.27	$ 0.55	$ 0.89	$ 1.06	**$ 1.27**

(1) As a private company, we entered into certain 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, $1,673,000 and $1,253,000 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, fiscal 2004 and fiscal 2005, respectively.

(3) General and administrative expenses prior to fiscal 2003 include certain amounts paid to Atlantic Media Company (formerly DGB Enterprises, Inc., a corporation owned by our former principal stockholder), for management services. Since our initial public offering, we provide these management services internally at a cost similar to the amounts paid to Atlantic Media Company in the past. See note 9 to our financial statements for a detailed description of the arrangements with Atlantic Media Company.

(4) Charges from Atlantic Media Company for strategic direction and oversight. 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 in November 2001, 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 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, analyzes and describes 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 membership business model allows us to focus on issues relevant to a broad audience of health care organizations, while promoting frequent use of our programs and services by our members. This facilitates growth through cross-sell opportunities to existing members and the development of new programs. Our revenues grew 16.3% in fiscal 2005 over fiscal 2004, and grew 21.0% in fiscal 2004 over fiscal 2003. We also increased our contract value by 17.0% at March 31, 2005 over March 31, 2004, and by 17.0% at March 31, 2004 over March 31, 2003. 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. Our member renewal rate in each of the past four years has equaled or exceeded 87%.

Memberships in each of our 18 best practices research programs are renewable at the end of their one-year membership contracts. Our seven other best practices programs provide installation support. These 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 2005, with the balance of our revenues generated by installation support programs.

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 2005, our income from operations was $35.9 million, compared to $28.5 million in fiscal 2004.

Our operating costs and expenses consist of cost of services, member relations and marketing, general and administrative expenses, depreciation and stock option related expenses. 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. Depreciation expense includes the cost of depreciation of our property and equipment. Stock option related expenses includes additional payroll taxes for compensation expense as a result of the taxable income employees recognized upon the exercise of common stock options. In addition, in fiscal 2003, we incurred special compensation charges of $366,000 with respect to arrangements entered into prior to our initial public offering.

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,		
	2003	2004	**2005**
Revenues	100.0%	100.0%	**100.0%**
Costs and expenses:			
Cost of services	41.3	41.2	**41.2**
Member relations and marketing	19.7	20.2	**20.0**
General and administrative	12.4	12.7	**11.3**
Depreciation and loss on disposal of fixed assets	1.8	1.2	**1.3**
Special compensation and stock option related expenses	1.2	1.3	**0.8**
Total costs and expenses	76.4	76.6	**74.6**
Income from operations	23.6	23.4	**25.4**
Interest income	1.0	2.4	**2.8**
Income before provision for income taxes	24.6	25.8	**28.2**
Provision for income taxes	(10.3)	(10.4)	**(11.7)**
Net income	14.3%	15.4%	**16.5%**

FISCAL YEARS ENDED MARCH 31, 2003, 2004 AND 2005

Revenues

Total revenues increased 21.0% from $100.7 million in fiscal 2003 to $121.8 million in fiscal 2004, and increased 16.3% to $141.6 million in fiscal 2005. The increase in revenues was primarily due to the introduction and expansion of new programs and cross-selling existing programs to existing members. To a lesser degree, our revenue growth was also driven by sales to new member organizations and price increases. We offered 18 membership programs as of March 31, 2003, 21 as of March 31, 2004 and 25 as of March 31, 2005. Our contract value increased 17.0% from $106.7 million at March 31, 2003 to $124.9 million at March 31, 2004, and increased 17.0% to $146.1 million at March 31, 2005. Our average contract value per member increased from $46,472 for fiscal 2003 to $53,229 for fiscal 2004, and increased to $56,819 for fiscal 2005. 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 20.6% from $41.6 million, in fiscal 2003, to $50.2 million, in fiscal 2004 and increased 16.3% to $58.4 million in fiscal 2005. The increase in cost of services is primarily due to increased staffing and other costs associated with the development and delivery of our program content and tools. As a percentage of revenue, cost of services has remained relatively constant at 41.3%, 41.2% and 41.2% for fiscal 2003, fiscal 2004 and fiscal 2005, respectively. 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 2003, it has remained constant as a percentage of revenues.

Member relations and marketing

Member relations and marketing expense increased 24.0% from $19.8 million or 19.7% of revenues in fiscal 2003 to $24.6 million, or 20.2% of revenues, in fiscal 2004, and increased 15.2% to $28.3 million, or 20.0% of revenues, in fiscal 2005. 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 $12.5 million, or 12.4% of revenues, in fiscal 2003 to $15.4 million, or 12.7% of revenues, in fiscal 2004, and increased to $16.0 million, or 11.3% of revenues, in fiscal 2005 with the development of new programs and the expansion of several administrative functions to support overall organizational growth. The decrease as a percent of revenues in fiscal 2005 reflects the leveraging of resources across our larger revenue base and the increased investment in recruiting and hiring efforts in the member relations and new product development areas that took place across fiscal 2004. General and administrative expense includes approximately $0.7 million, $1.0 million and $0.6 million in fiscal 2003, 2004 and 2005, respectively, of net charges from Atlantic Media Company 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 our arrangements with Atlantic Media Company.

Depreciation

Depreciation expense decreased from $1.8 million, or 1.8% of revenues in fiscal 2003, to $1.4 million, or 1.2% of revenues in fiscal 2004, and increased to $1.8 million, or 1.3% of revenues in fiscal 2005. The decrease in fiscal 2004 was due to lower capital expenditures in fiscal 2003 and fiscal 2004 as compared to prior years. The increase in fiscal 2005 is related to additional depreciation on the build-out of our new headquarters facility.

Special compensation and stock option related expenses

Special compensation and stock option related expenses increased from $1.1 million in fiscal 2003 to $1.7 million in fiscal 2004, and decreased to $1.3 million in fiscal 2005. In fiscal 2003, 2004 and 2005, we recognized approximately $781,000, $1.7 million and $1.3 million, respectively, 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. In fiscal 2003, we incurred additional charges of $366,000 with respect to special compensation arrangements we entered into as a private company. 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.

Interest income

Interest income increased to $4.0 million in fiscal 2005, from $2.9 million in fiscal 2004 and $1.0 million in fiscal 2003. 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 $10.4 million, $12.7 million and $16.5 million in fiscal 2003, 2004 and 2005, respectively. Our effective income tax rate increased from 40.5% to 41.5% primarily due to new legislation enacted in October 2004 that disallows certain Washington, D.C. tax deductions, as well as adjustments made to certain deferred tax assets to agree to our recently filed income tax returns.

We intend to file our 2004 Washington, D.C. income tax return 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 $8.7 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 $44.5 million in fiscal 2003, $39.7 million in fiscal 2004 and $44.2 million in fiscal 2005. We had approximately $152.9 million in cash and cash equivalents and marketable securities at March 31, 2005. 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 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, 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, offset by $13.4 million in proceeds on the redemption of marketable securities. We used net cash flows in investing activities in fiscal 2005 of $35.4 million, consisting of purchases of marketable securities of $51.9 million offset by $20.7 million in proceeds on the redemption of marketable securities and purchases of property and equipment of $4.1 million primarily related to the build-out of our new headquarters facility.

Cash flows from financing activities

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, 2004 and 2005, we received approximately $351,000, $331,000 and $276,000, respectively, in proceeds from the issuance of common stock under our employee stock purchase plan. In fiscal 2005 we used $22.4 million in financing activities. We generated $21.8 million from the receipt of cash for the exercise of stock options in conjunction with sales of our common stock by our employees. In fiscal 2004 and 2005 we repurchased 349,320 and 1,303,364 shares of our common stock at a total cost of approximately $12.2 million and $44.5 million, respectively. In January 2004, our Board of Directors authorized a share repurchase of up to $50 million of our common stock, and our Board of Directors increased this amount by an additional $50 million in October 2004.

The lease on our former headquarters facility expired May 31, 2004. Beginning June 1, 2004, our headquarters are located in approximately 106,000 square feet of office space in Washington, D.C. The facilities accommodate research, delivery, 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, 2005, 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, 2005 and the effect such obligations are expected to have on our liquidity and cash flows in future periods. These obligations are more fully described in note 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	$47,386	$2,958	$9,484	$7,504	$27,440
Facilities services contract	954	545	409	—	—
Total	$48,340	$3,503	$9,893	$7,504	$27,440

OFF-BALANCE SHEET ARRANGEMENTS

At March 31, 2004 and 2005, 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. The authorized amount was increased by our Board to $100 million in October 2004. 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 option holders under our 1997 and 2001 stock-based incentive compensation plans were exercised to acquire shares sold in public offerings at various times in fiscal 2003, 2004 and 2005. Upon the exercise of these options we received a total of approximately $21.5 million, $26.8 million and $21.8 million in fiscal 2003, 2004 and 2005, respectively, in cash in payment of option exercise prices.

We recognized approximately $781,000, $1.7 million and $1.3 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, 2004 and 2005, respectively. We 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 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, $40.0 million, and $30.9 million in fiscal 2003, 2004 and 2005, respectively. Although the provision for income taxes for financial reporting purposes did not change, our actual cash payments will be reduced as the deferred tax asset is utilized.

SIGNIFICANT RELATED PARTY TRANSACTIONS

Lease and Sublease Agreements

In fiscal 2000 we assigned our office lease to Atlantic Media Company (formerly DGB Enterprises, Inc., an entity created in 1997 by our founder, David G. Bradley, to manage his various business interests including his ownership in us), and subsequently entered into a sublease agreement with them on terms consistent with the original agreement. The lease agreement ran through May 2004. We incurred rent expense under this arrangement of $3.4 million, $3.6 million and $0.6 million in fiscal 2003, 2004 and 2005, respectively.

Administrative Services

In July 2001, we entered into an administrative services agreement whereby Atlantic Media Company provided us with services related to the facilities associated with our shared leased space, and we provided Atlantic Media Company with certain administrative services. Fees for the services were 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. We believe these charges approximated the costs which would have been incurred had we operated on a stand-alone basis. We incurred net charges under the agreement of $0.7 million, $1.0 million and $0.6 million in fiscal 2003, 2004 and 2005, respectively.

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 3 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, 2003, 2004 and 2005, approximately $0.3 million, $1.3 million and $1.0 million, respectively, of deferred revenues were to be recognized beyond the following 12 months.

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 incentives and other charges

Direct incentive compensation related to the negotiation of new and renewal memberships and other direct and incremental costs are deferred and amortized on a straight line basis over the term of the related memberships.

Deferred tax asset recoverability

We have deferred income taxes consisting primarily of net operating loss carry forwards 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 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 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 laws and rates. We will recognize an adjustment to income 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 legislation

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 "2000 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"). During the year ended March 31, 2005, the Fiscal Year 2005 Budget Support Act of 2004 (the "2004 Act") was enacted which, among other things, clarified certain provisions of the 2000 Act.

We have performed an analysis to support our position that we meet the definition of a QHTC under the provisions of the 2000 Act and we have submitted a claim for refund of certain prior-year sales and use taxes paid to the District of Columbia. As a QHTC, our Washington, D.C. income tax rate would be 0.0% for five years and 6.0% thereafter, and we would be eligible for certain Washington, D.C. income tax credits. In addition we would 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 consolidated financial statements because of uncertainties inherent in the regulations and the audit process by which the Office of Tax and Revenue would approve the claim for refund.

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 as of March 31, 2005, we would have recorded a noncash charge to earnings of approximately $8.7 million, representing the impact on our existing deferred tax asset of lowering the Washington, D.C. income tax rate to 0.0%, net of any income tax credits discussed above. Upon acceptance by the Office of Tax and Revenue of 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.

Concentrations of credit risk

Financial instruments that potentially expose us to significant concentrations of credit risk consist principally of cash and cash equivalents, marketable securities and membership fees receivable. We maintain cash and cash equivalents and marketable securities with financial institutions. Any unrealized losses on marketable securities are determined to be other-than-temporary, due to the nature of the investments. The concentration of credit risk with respect to membership fees receivable is generally diversified due to our large number of members. However, we may be exposed to a declining membership base in periods of unforeseen market downturns, severe competition or regulatory developments. We perform periodic evaluations of the financial institutions and our membership base and establish allowances for potential credit losses.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board ("FASB") issued revised Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment—an Amendment of FASB Statement Nos. 123 and 95." SFAS 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services or incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments, focusing primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires public entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions) and recognize the cost over the period during which an employee is required to provide service in exchange for the award. Under the provisions of SFAS No. 123(R), the amount of tax benefit relating to stock option compensation included in operating cash flows for periods prior to the effective date, will be reported in financing cash flows once the statement becomes effective. SFAS No. 123(R) further allows for either a modified prospective method of adoption or a retrospective method of adoption, which may be back to the original issuance of SFAS No. 123 or only to interim periods in the year of adoption. We are required to adopt SFAS No. 123(R) in the quarter beginning April 1, 2006. We are evaluating the transition methods and the impact of SFAS No. 123(R) and expect that we will record substantial noncash compensation expenses following adoption. The adoption of SFAS No. 123(R) is not expected to have a significant effect on our financial condition or net cash flows but is expected to have a significant adverse effect on the reporting of our results of operations.

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, 2005, our marketable securities consist of $11.7 million in tax-exempt notes and bonds issued by the District of Columbia, $22.9 million in tax-exempt notes and bonds issued by other states, and $90.5 million in U.S. government agency securities. The average maturity on all our marketable securities as of March 31, 2005 was approximately 5.2 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

THE BOARD OF DIRECTORS AND STOCKHOLDERS OF THE ADVISORY BOARD COMPANY AND SUBSIDIARIES:

We have audited the accompanying consolidated balance sheets of The Advisory Board Company and subsidiaries as of March 31, 2004 and 2005, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended March 31, 2005. 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 at March 31, 2004 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2005, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of The Advisory Board Company and subsidiaries internal control over financial reporting as of March 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 9, 2005 expressed an unqualified opinion thereon.

Ernst & Young LLP

Baltimore, Maryland
June 9, 2005

Consolidated Balance Sheets

The Advisory Board Company and Subsidiaries

(In thousands, except share amounts)	March 31, 2004	**2005**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 41,389	**$ 27,867**
Marketable securities	3,737	**3,003**
Membership fees receivable, net	14,338	**21,320**
Prepaid expenses and other current assets	1,745	**2,430**
Deferred income taxes	17,123	**19,774**
Total current assets	78,332	**74,394**
Property and equipment, net	6,701	**9,023**
Deferred incentive compensation and other charges	3,751	**6,189**
Deferred income taxes, net of current portion	20,532	**33,489**
Marketable securities	94,683	**122,044**
Total assets	$203,999	**$245,139**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Deferred revenues	$ 72,410	**$ 82,262**
Accounts payable and accrued liabilities	8,262	**8,733**
Accrued incentive compensation	7,704	**7,820**
Total current liabilities	88,376	**98,815**
Other long-term liabilities	—	**1,010**
Total liabilities	88,376	**99,825**
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, 18,323,526 and 19,917,813 shares issued at March 31, 2004 and 2005, respectively, and 17,974,206 and 19,265,129 shares outstanding at March 31, 2004 and 2005, respectively	183	**199**
Additional paid-in capital	88,885	**142,040**
Retained earnings	37,694	**27,925**
Accumulated elements of other comprehensive income (losses)	1,031	**(1,273)**
Treasury stock, 349,320 and 652,684 shares at March 31, 2004 and 2005, respectively	(12,170)	**(23,577)**
Total stockholders' equity	115,623	**145,314**
Total liabilities and stockholders' equity	$203,999	**$245,139**

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, 2003	2004	**2005**
Revenues	$100,714	$121,847	**$141,649**
Costs and expenses:			
Cost of services (excluding special compensation and stock option related expenses of $615, $560 and $550)	41,598	50,167	**58,354**
Member relations and marketing (excluding special compensation and stock option related expenses of $133, $256 and $216)	19,842	24,599	**28,347**
General and administrative (excluding special compensation and stock option related expenses of $399, $857 and $487)	12,507	15,445	**15,965**
Depreciation and loss on disposal of fixed assets	1,827	1,415	**1,820**
Special compensation and stock option related expenses	1,147	1,673	**1,253**
Total costs and expenses	76,921	93,299	**105,739**
Income from operations	23,793	28,548	**35,910**
Interest income	1,038	2,911	**3,971**
Income before provision for income taxes	24,831	31,459	**39,881**
Provision for income taxes	(10,392)	(12,739)	**(16,534)**
Net income	$ 14,439	$ 18,720	**$ 23,347**
Earnings per share:			
Net income per share—basic	$ 1.10	$ 1.19	**$ 1.32**
Net income per share—diluted	$ 0.85	$ 1.00	**$ 1.22**
Basic weighted average number of shares outstanding	13,139	15,745	**17,738**
Diluted weighted average number of shares outstanding	16,996	18,680	**19,161**

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	Retained Earnings	Accumulated Elements of Other Comprehensive Income (Losses)	Treasury Stock	Total	Annual Comprehensive Income
Balance at March 31, 2002	12,149,735	$ 121	$ (20,877)	$ (366)	$ 4,535	$ —	$ —	$ (16,587)	
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
Exercise of stock options	2,585,103	26	21,976	—	—	—	—	22,002	$ —
Tax benefit on exercise of options	—	—	30,903	—	—	—	—	30,903	—
Issuance of common stock under employee stock purchase plan	9,184	—	276	—	—	—	—	276	—
Purchase of treasury stock	(1,303,364)	—	—	—	—	—	(44,533)	(44,533)	—
Retirement of treasury stock	—	(10)	—	—	(33,116)	—	33,126	—	—
Net unrealized losses on available-for-sale marketable securities, net of income taxes	—	—	—	—	—	(2,304)	—	(2,304)	(2,304)
Net income	—	—	—	—	23,347	—	—	23,347	23,347
Balance at March 31, 2005	**19,265,129**	**$199**	**$142,040**	**$ —**	**$27,925**	**$(1,273)**	**$(23,577)**	**$145,314**	**$21,043**

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, 2003	2004	**2005**
Cash flows from operating activities:			
Net income	$ 14,439	$ 18,720	**$ 23,347**
Adjustments to reconcile net income to net cash flows provided by operating activities —			
Depreciation	1,722	1,415	**1,704**
Loss on disposal of fixed assets	105	—	**116**
Special compensation arrangements	(363)	—	**—**
Deferred income taxes	237	(616)	**1,913**
Tax benefits resulting from the exercise of common stock options	5,903	13,260	**14,954**
Amortization of marketable securities premiums	352	755	**724**
Changes in operating assets and liabilities:			
Membership fees receivable	4,865	(5,104)	**(6,982)**
Prepaid expenses and other current assets	(657)	(145)	**(351)**
Deferred incentive compensation and other charges	(365)	(1,492)	**(2,438)**
Deferred revenues	12,115	8,757	**9,852**
Accounts payable and accrued liabilities	4,955	3,356	**268**
Accrued incentive compensation	1,240	805	**116**
Other liabilities	—	—	**1,010**
Net cash flows provided by operating activities	44,548	39,711	**44,233**
Cash flows from investing activities:			
Purchases of property and equipment	(531)	(5,225)	**(4,142)**
Redemption of marketable securities	—	13,350	**20,713**
Purchases of marketable securities	(56,515)	(54,661)	**(51,940)**
Net cash flows used in investing activities	(57,046)	(46,536)	**(35,369)**
Cash flows from financing activities:			
Proceeds on issuance of stock from exercise of options	21,453	26,772	**21,846**
Reimbursement of offering costs	992	149	**188**
Payment of offering costs and other distributions	(956)	(169)	**(163)**
Issuance of common stock under employee stock purchase plan	351	331	**276**
Purchase of treasury shares	—	(12,170)	**(44,533)**
Net cash flows provided by (used in) financing activities	21,840	14,913	**(22,386)**
Net increase (decrease) in cash and cash equivalents	9,342	8,088	**(13,522)**
Cash and cash equivalents, beginning of year	23,959	33,301	**41,389**
Cash and cash equivalents, end of year	$ 33,301	$ 41,389	**$ 27,867**
Supplemental disclosure of cash flow information:			
Cash paid during the year for income taxes	$ 1,000	$ —	**$ 33**

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. BASIS OF PRESENTATION

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.

Certain amounts in the prior years' consolidated financial statements have been reclassified to conform with the current year's presentation.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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, 2004 and 2005, 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. Fair value is generally determined using estimates of discounted cash flows. 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, 2004 and 2005.

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, 2003, 2004 and 2005, approximately $0.3 million, $1.3 million and $1.0 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 incentives and other charges

Direct incentive compensation related to the negotiation of new and renewal memberships and other direct and incremental costs are 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 increased by the dilutive effects of potential common shares outstanding during the period. The number of potential common shares 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,		
	2003	2004	**2005**
Basic weighted average common shares outstanding	13,139	15,745	**17,738**
Potential common shares outstanding	3,857	2,935	**1,423**
Diluted weighted average common shares outstanding	16,996	18,680	**19,161**

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. Any unrealized losses on marketable securities are determined to be other-than-temporary, due to the nature of the investments. 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, 2003, 2004 and 2005, 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 bases. 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 programs are expensed when incurred. Research and development costs were immaterial for the fiscal years ended March 31, 2003, 2004 and 2005.

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,		
	2003	2004	**2005**
Risk free interest rate	3.91%	2.63%	**3.84%**
Dividend yield	—	—	**—**
Weighted average expected lives of options	7.5 years	5 years	**5 years**
Expected volatility	48%	40%	**28%**
Weighted average fair values of options granted	$19.01	$13.62	**$12.39**

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.

The special compensation and stock option expenses included in the consolidated statements of operations relates to additional Federal Insurance Corporation Act ("FICA") taxes as a result of the taxable income that employees recognized on the exercise of stock options. The Company did not recognize any stock compensation expense in accordance with APB No. 25. 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,		
	2003	2004	**2005**
Net income, as reported	$14,439	$18,720	**$23,347**
Deduct: Total stock-based compensation expense determined under fair value based methods for all awards, net of related tax effects	(7,753)	(8,843)	**(8,670)**
Pro forma net income	$ 6,686	$ 9,877	**$14,677**
Pro forma net income per share:			
Basic—as reported	$ 1.10	$ 1.19	**$ 1.32**
Diluted—as reported	$ 0.85	$ 1.00	**$ 1.22**
Basic—pro forma	$ 0.51	$ 0.63	**$ 0.83**
Diluted—pro forma	$ 0.41	$ 0.54	**$ 0.79**

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 December 2004, the Financial Accounting Standards Board ("FASB") issued revised Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment—an Amendment of FASB Statement Nos. 123 and 95." SFAS 123(R) establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services or incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments, focusing primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. SFAS No. 123(R) requires public

entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exceptions) and recognize the cost over the period during which an employee is required to provide service in exchange for the award. Under the provisions of SFAS No. 123(R), the amount of tax benefit relating to stock option compensation included in operating cash flows for periods prior to the effective date, will be reported in financing cash flows once the statement becomes effective. SFAS No. 123(R) further allows for either a modified prospective method of adoption or a retrospective method of adoption, which may be back to the original issuance of SFAS No. 123 or only to interim periods in the year of adoption. The Company is required to adopt SFAS No. 123(R) in the quarter beginning April 1, 2006. The Company is evaluating the transition methods and the impact of SFAS No. 123(R) and expects that it will record substantial noncash compensation expenses following adoption. The adoption of SFAS No. 123(R) is not expected to have a significant effect on the Company's financial condition or net cash flows but is expected to have a significant adverse effect on the reporting of the Company's results of operations.

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, 2005			
	Market Value	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**
U.S. government agency obligations	**$ 90,466**	**$ 92,237**	**$ 3**	**$(1,775)**
Washington, D.C. tax exempt obligations	**11,688**	**11,523**	**165**	**—**
Tax exempt obligations of other states	**22,893**	**23,455**	**3**	**(565)**
	$125,047	**$127,215**	**$ 171**	**$(2,340)**

	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)

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

	As of March 31, 2005	
	Fair Market Value	**Amortized Cost**
Matures in less than 1 year	**$ 3,003**	**$ 3,011**
Matures after 1 year through 5 years	**48,527**	**49,291**
Matures after 5 years through 10 years	**73,517**	**74,913**
	$125,047	**$127,215**

The average maturity on all marketable securities held by the Company as of March 31, 2005 was approximately 5.2 years.

5. MEMBERSHIP FEES RECEIVABLE

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

	As of March 31,	
	2004	**2005**
Billed fees receivable	$ 9,718	**$12,517**
Unbilled fees receivable	6,270	**10,653**
	15,988	**23,170**
Allowance for uncollectible revenue	(1,650)	**(1,850)**
Membership fees receivable, net	$14,338	**$21,320**

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,	
	2004	**2005**
Leasehold improvements, furniture, fixtures and equipment	$ 13,426	**$ 17,078**
Software and web development costs	4,060	**4,066**
	17,486	**21,144**
Accumulated depreciation	(10,785)	**(12,121)**
Property and equipment, net	$ 6,701	**$ 9,023**

7. INCOME TAXES

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

	Year Ended March 31,		
	2003	2004	**2005**
Current	$10,155	$ 13,357	**$ 14,374**
Deferred	237	(618)	**2,160**
Provision for income taxes	$10,392	$ 12,739	**$ 16,534**

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,	
	2004	**2005**
Deferred income tax assets:		
Net operating loss carryforward	$ 34,522	**$ 50,478**
Compensation accrued for financial reporting purposes	3,750	**4,197**
Unrealized losses on available-for-sale securities	—	**895**
Reserve for uncollectible revenue	684	**767**
Long-term membership contracts	354	**—**
Other	—	**533**
Deferred income tax liabilities:		
Depreciation	—	**(1,797)**
Unrealized gains on available-for-sale securities	(670)	**—**
Deferred incentive compensation and other deferred charges	(985)	**(1,810)**
Net deferred income tax assets	$ 37,655	**$ 53,263**

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,		
	2003	2004	**2005**
Statutory U.S. federal income tax rate	35.0%	35.0%	**35.0%**
State income tax, net of U.S. federal income tax benefit	6.5	6.5	**6.5**
Tax-exempt interest income	(0.7)	(1.3)	**(1.5)**
Other permanent differences, net	1.1	0.3	**1.5**
Effective tax rate	41.9%	40.5%	**41.5%**

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 federal net operating loss carryforwards in the amount of approximately $118.0 million and state net operating loss carryforwards of approximately $133.2 million at March 31, 2005. The net operating losses expire between 2022 and 2025. The Company utilized tax benefits from the exercise of stock options that were recorded in the consolidated statements of stockholders' equity to offset the current tax provision that was recorded in the consolidated statements of income which resulted in no current tax liability for the year ended March 31, 2005.

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 "2000 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"). During the year ended March 31, 2005, the Fiscal Year 2005 Budget Support Act of 2004 (the "2004 Act") was enacted which, among other things, clarified certain provisions of the 2000 Act.

The Company has performed an analysis to support its position that it meets the definition of a QHTC under the provisions of the 2000 Act and has submitted a claim for refund of certain prior-year sales and use taxes paid to the District of Columbia. As a QHTC, the Company's Washington, D.C. income tax rate would be 0.0% for five years and 6.0% thereafter, and the Company would be eligible for certain Washington, D.C. income tax credits. In addition the Company would 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 financial statements because of uncertainties inherent in the regulations and the audit process by which the Office of Tax and Revenue would approve the claim for refund.

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, 2005, it would have recorded a noncash charge to earnings of approximately $8.7 million, representing the impact on its existing deferred tax asset of lowering the Washington, D.C. income tax rate to 0.0% for five years, net of any income tax credits discussed above. Upon acceptance by the Office of Tax and Revenue of 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, 2003, 2004 and 2005 was $15.0 million, $19.2 million and $21.0 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 net unrealized gains and losses on marketable securities net of applicable income taxes.

9. TRANSACTIONS WITH AFFILIATES

Lease and Sublease Agreements

In fiscal 2000 the Company assigned its office lease to Atlantic Media Company (formerly DGB Enterprises, Inc., an entity created in 1997 by the Company's founder, David G. Bradley, to manage his various business interests including his ownership in the Company), and subsequently entered into a sublease agreement with them on terms consistent with the original agreement. The lease agreement expired in May 2004. The Company incurred rent expense under this arrangement of $3.4 million, $3.6 million and $0.6 million in fiscal 2003, 2004 and 2005, respectively.

Administrative Services

In July 2001, the Company entered into an administrative services agreement whereby Atlantic Media Company provided the Company with services related to the facilities associated with the Company's shared leased space, and the Company provided Atlantic Media Company with certain administrative services. Fees for the services were 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. The Company believes these charges approximated the costs which would have been incurred had the Company operated on a stand-alone basis. The Company incurred net charges under the agreement of $0.7 million, $1.0 million and $0.6 million in fiscal 2003, 2004 and 2005, respectively. Services under this arrangement generally ended in connection with the Company's move to a new headquarters facility in June 2004.

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, fiscal 2004 and fiscal 2005. Upon the exercise of these options the Company received a total of approximately $21.5 million, $26.8 million and $22.0 million in fiscal 2003, 2004 and 2005, respectively, in cash in payment of option exercise prices.

The Company recognized approximately $781,000, $1.7 million and $1.3 million in compensation expense reflecting additional FICA taxes as a result of the taxable income that employees recognized upon the exercise of non-qualified common stock options in fiscal 2003, 2004 and 2005, 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, $40.0 million, and $30.9 million in fiscal 2003, 2004 and 2005, 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.

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 the Company's 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 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, plus any remaining shares not issued under the 1997 Plan. All options granted under the 2001 Plan to date 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.

Stock Option Repurchase Agreements

During fiscal 2002, the Company entered into an agreement to repurchase certain stock options from an employee at a fixed price. Compensation expense was recognized under this agreement over the relevant required employment periods. Total compensation expense under the agreement was $0.4 million in fiscal 2003 and is included in special compensation and stock option related expenses.

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, 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
Options granted	971,832	34.32–39.45	38.51
Options exercised	(2,585,103)	7.13–34.81	8.51
Options cancelled	(106,000)	19.00–36.89	31.10
Outstanding at March 31, 2005	**3,257,158**	**$ 7.13–47.49**	**$28.77**

Exercise prices for options outstanding at March 31, 2005, 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– 9.50	486,478	$ 7.13	2.7	450,272	$ 7.13
9.50–14.25	26,992	11.88	3.4	26,992	11.88
19.00–23.75	473,440	19.00	6.5	116,940	19.00
28.49–33.24	434,000	30.34	7.8	54,500	29.50
33.24–37.99	1,050,248	34.82	9.0	85,416	34.25
37.99–42.74	764,000	39.45	7.0	—	—
42.74–47.49	22,000	47.46	8.5	5,500	47.46
$ 7.13–47.49	3,257,158	$28.77	7.0	739,620	$14.26

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, 2003, 2004 and 2005 were approximately $499,000, $573,000 and $648,000, respectively.

Employee Stock Purchase Plan

In October 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. For the years ended March 31, 2003, 2004 and 2005, the Company issued 13,450, 10,663 and 9,184 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 sub-lease agreement (the Sublease) with DGB Enterprises, which expired in May 2004.

In October 2003, the Company entered into a new lease for its headquarters space (New Lease) which took effect on 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 New Lease, including expansion space but excluding rental escalation and executory costs, are as follows (in thousands):

Year Ending March 31,	
2006	$ 2,958
2007	2,278
2008	3,367
2009	3,839
2010	3,782
Thereafter	31,162
Total	$47,386

Rent expense during the years ended March 31, 2003, 2004 and 2005 was approximately $3.6 million, $3.7 million and $4.0 million, respectively.

The Company entered into a $3.2 million letter of credit agreement with a commercial bank which expires October 5, 2005, 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 $50,000 per month through December 2006.

13. QUARTERLY FINANCIAL DATA (UNAUDITED)

Unaudited summarized financial data by quarter for the years ended March 31, 2004 and 2005 is as follows (in thousands, except per share amounts):

	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

	Fiscal 2005 Quarter Ended			
	June 30	**September 30**	**December 31**	**March 31**
Revenues	**$33,025**	**$34,680**	**$36,206**	**$37,738**
Cost of services	**13,674**	**14,166**	**15,059**	**15,455**
Income from operations	**8,516**	**8,925**	**8,763**	**9,706**
Income before income taxes	**9,409**	**9,841**	**9,764**	**10,867**
Net income	**5,598**	**5,855**	**5,482**	**6,412**
Earnings per share:				
Basic	**$ 0.31**	**$ 0.34**	**$ 0.31**	**$ 0.35**
Diluted	**$ 0.29**	**$ 0.31**	**$ 0.29**	**$ 0.33**

Management's Report on Internal Control Over Financial Reporting

The Advisory Board Company and Subsidiaries

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934, as amended). Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, the Company assessed the effectiveness of internal control over financial reporting as of March 31, 2005. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), an *Internal Control—Integrated Framework*. The Company's management has concluded that, as of March 31, 2005, internal control over financial reporting is effective based on these criteria. Our independent registered public accounting firm, Ernst & Young, LLP, has issued an attestation report on our assessment of internal control over financial reporting, which follows.

Report of Independent Registered Public Accounting Firm

THE BOARD OF DIRECTORS AND STOCKHOLDERS OF THE ADVISORY BOARD COMPANY AND SUBSIDIARIES:

We have audited management's assessment, included in the accompanying Report of Management's Assessment of Internal Controls, that The Advisory Board Company and subsidiaries maintained effective internal control over financial reporting as of March 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Advisory Board Company and subsidiaries management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that The Advisory Board Company and subsidiaries maintained effective internal control over financial reporting as of March 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, The Advisory Board Company and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of March 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of The Advisory Board Company and subsidiaries as of March 31, 2004 and 2005, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended March 31, 2005 and our report dated June 9, 2005 expressed an unqualified opinion thereon.

Ernst & Young LLP

Baltimore, Maryland
June 9, 2005

Executive Officers and Directors

Frank J. Williams
Chairman of the Board and Chief Executive Officer

Marc N. Casper†‡
Director

Kelt Kindick*†‡
Lead Director

Joseph E. Laird, Jr.†‡
Director

Mark R. Neaman*‡
Director

Leon D. Shapiro†‡
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, 2005 (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 2005, there were approximately 11,000 holders of the common stock, including five 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 Registered Accountant
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, 2005		
First Quarter	$37.45	$31.85
Second Quarter	$35.98	$29.80
Third Quarter	$38.77	$29.88
Fourth Quarter	$44.59	$33.42
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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