

Knowledge Universe Education L.P. and Subsidiaries

Consolidated Financial Statements as of and for
the Years Ended December 31, 2011 and 2010,
and Independent Auditors' Report

KNOWLEDGE UNIVERSE EDUCATION L.P. AND SUBSIDIARIES

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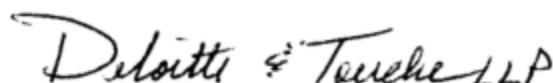
INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
KUE Management Inc., General Partner of
Knowledge Universe Education L.P. and Subsidiaries
Santa Monica, California

We have audited the accompanying consolidated balance sheets of Knowledge Universe Education L.P. and subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, partners' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company at December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



June 28, 2012

Member of
Deloitte Touche Tohmatsu Limited

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KNOWLEDGE UNIVERSE EDUCATION L.P. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2011 AND 2010 (Dollars in thousands)

	2011	2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 277,436	\$ 148,452
Short-term marketable securities	40,986	198,953
Accounts receivable, net	72,429	83,446
Income tax receivable	4,184	5,739
Deferred income taxes	49,658	23,046
Assets held for sale	238	10,785
Prepaid expenses and other current assets	44,932	40,774
Assets related to discontinued operations	<hr/> 86	<hr/> 86
Total current assets	489,863	511,281
PROPERTY AND EQUIPMENT, Net	1,018,394	1,008,204
LONG-TERM INVESTMENTS	136,634	223,936
GOODWILL	391,676	388,887
OTHER INTANGIBLE ASSETS, Net	130,376	132,826
ASSETS HELD FOR SALE	18,814	
OTHER ASSETS	<hr/> 46,953	<hr/> 59,379
TOTAL	<u>\$2,213,896</u>	<u>\$2,343,327</u>

(Continued)

KNOWLEDGE UNIVERSE EDUCATION L.P. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2011 AND 2010 (Dollars in thousands)

	2011	2010
LIABILITIES AND EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 34,876	\$ 25,920
Current portion of self-insurance	24,078	22,427
Income taxes payable	206	392
Accrued property and other taxes	12,135	12,763
Deferred revenue	59,561	50,547
Accrued interest	8,384	8,622
Accrued compensation and related expenses	42,094	45,428
Other accrued liabilities	59,495	52,830
Current portion of long-term debt	21,745	17,970
Current portion of capital lease obligations	3,105	3,073
Current portion of liabilities associated with assets held for sale	<u>29,964</u>	<u>29,964</u>
Total current liabilities	265,679	269,936
LONG-TERM DEBT	1,000,943	1,121,605
CAPITAL LEASE OBLIGATIONS	12,237	18,129
DEFERRED INCOME TAXES	68,699	85,336
LIABILITIES ASSOCIATED WITH ASSETS HELD FOR SALE	551	
OTHER LONG-TERM LIABILITIES	<u>90,031</u>	<u>95,281</u>
Total liabilities	<u>1,437,589</u>	<u>1,590,838</u>
EQUITY:		
Partners' equity:		
Common partner units — 2,239,551 units issued and outstanding	757,383	757,383
Accumulated other comprehensive income	31,014	104,261
Accumulated deficit	<u>(22,380)</u>	<u>(120,326)</u>
Total partners' equity attributable to Knowledge Universe Education L.P. Partners	766,017	741,318
Noncontrolling interests	<u>10,290</u>	<u>11,171</u>
Total equity	<u>776,307</u>	<u>752,489</u>
TOTAL	<u>\$2,213,896</u>	<u>\$2,343,327</u>

See notes to consolidated financial statements.

(Concluded)

KNOWLEDGE UNIVERSE EDUCATION L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Dollars in thousands)

	2011	2010
REVENUE	\$ 1,621,150	\$ 1,654,502
COST OF REVENUE	<u>1,179,475</u>	<u>1,241,369</u>
GROSS MARGIN	<u>441,675</u>	<u>413,133</u>
OPERATING EXPENSES (INCOME):		
General and administrative	286,749	236,839
Depreciation	117,858	112,249
Amortization of intangibles	5,987	7,679
Other	<u>3,426</u>	<u>(106)</u>
Total operating expenses, net	<u>414,020</u>	<u>356,661</u>
INCOME FROM OPERATIONS	<u>27,655</u>	<u>56,472</u>
NONOPERATING EXPENSE (INCOME):		
Losses (gains) on investments	8,570	(4,540)
Interest expense	81,639	92,903
Interest income	(11,060)	(19,895)
Other income, net	<u>(1,542)</u>	<u>(1,168)</u>
Nonoperating expense, net	<u>77,607</u>	<u>67,300</u>
LOSS BEFORE INCOME TAXES	<u>(49,952)</u>	<u>(10,828)</u>
INCOME TAX BENEFIT	<u>39,345</u>	<u>24,375</u>
(LOSS) INCOME FROM CONTINUING OPERATIONS	<u>(10,607)</u>	<u>13,547</u>
GAIN FROM DISCONTINUED OPERATIONS	<u>110,455</u>	<u>18,159</u>
NET INCOME	99,848	31,706
NET (INCOME) LOSS ATTRIBUTABLE TO NONCONTROLLING INTERESTS	<u>(1,902)</u>	<u>2,086</u>
NET INCOME ATTRIBUTABLE TO KNOWLEDGE UNIVERSE EDUCATION L.P. PARTNERS	<u>\$ 97,946</u>	<u>\$ 33,792</u>

See notes to consolidated financial statements.

KNOWLEDGE UNIVERSE EDUCATION L.P. AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF PARTNERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010**
(Dollars in thousands)

Knowledge Universe Education L.P.							Comprehensive Income
Common Partner Units	Amount	Accumulated Deficit	Accumulated Other Income	Comprehensive Income	Total Partners' Equity	Noncontrolling Interests	Total Equity
2,239,551	\$757,383	\$ (154,118)	\$ 52,160	\$ 655,425	\$ 4,967	\$ 660,392	\$ 31,706
BALANCE — January 1, 2010							
Net income (loss)							
Other comprehensive income:							
Foreign currency translation adjustments							
Noncontrolling interest related to CIS acquisition							
Unrealized gain on investments							
Total comprehensive income							
BALANCE — December 31, 2010	2,239,551	757,383	(120,326)	104,261	741,318	11,171	752,489
Net income							
Other comprehensive income (loss):							
Foreign currency translation adjustments							
Noncontrolling interest related to sale of KUE Digital Inc.							
Unrealized loss on investments — K12 Inc.							
Reclassification of loss on investment to net income							
Total comprehensive income							
BALANCE — December 31, 2011	2,239,551	\$757,383	\$ (22,380)	\$ 31,014	\$ 766,017	\$ 10,290	\$776,307

See notes to consolidated financial statements.

KNOWLEDGE UNIVERSE EDUCATION L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Dollars in thousands)

	2011	2010
OPERATING ACTIVITIES:		
Net income	\$ 99,848	\$ 31,706
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	105,645	106,966
Impairment of fixed assets	19,254	11,966
Stock-based compensation	(3,348)	212
Loss (gain) on sale of property and equipment and software rights	662	(3,196)
Loss (gain) on sales of debt securities	1,603	(111)
Losses on sale of investments	4,412	
Gain on sale of discontinued operations	(110,397)	(40,258)
Unrealized gain on marketable securities and derivatives	(3,633)	(5,183)
Return on equity method investments	(22)	
Amortization of deferred financing and other costs	4,746	3,922
Interest expense capitalized as long-term debt	210	767
Foreign currency exchange gain	(559)	(1,337)
Changes in:		
Accounts receivable	10,844	6,088
Prepaid expenses and other current assets	(6,506)	(162)
Income tax receivable	(2,724)	6,157
Assets held for sale	(101)	38
Deferred income taxes	(39,789)	(18,775)
Other assets	1,311	(2,988)
Accounts payable	19	18,497
Accrued expenses and other liabilities	26,994	14,740
Net cash used in discontinued operations	<u>(5,505)</u>	<u>(15,512)</u>
Net cash provided by operating activities	<u>102,964</u>	<u>113,537</u>
INVESTING ACTIVITIES:		
Purchases of property and equipment and software costs	(129,676)	(80,908)
Proceeds from sale of property and equipment	970	15,821
Proceeds from sale of investments	119,385	
(Increase) decrease in restricted cash	9,935	(4,856)
Receipts on long-term note receivable and tax refunds credited to goodwill	9	18
Investment in equity method investment		(3,514)
Purchases of short-term marketable securities	(423,082)	(1,150,123)
Proceeds from sales of short-term marketable securities	579,062	1,242,122
Acquisitions of businesses	<u>(11,766)</u>	<u>(6,561)</u>
Net cash provided by investing activities	<u>144,837</u>	<u>11,999</u>

(Continued)

KNOWLEDGE UNIVERSE EDUCATION L.P. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010 (Dollars in thousands)

	2011	2010
FINANCING ACTIVITIES:		
Payments on long-term debt and capital leases	\$(196,102)	\$(158,869)
Proceeds from long-term debt	77,285	64,867
Proceeds from related-party borrowing	2,146	
Debt issuance costs	(2,111)	
Net cash used in financing activities	<u>(118,817)</u>	<u>(93,967)</u>
EFFECT OF EXCHANGE RATES ON CASH		23
NET INCREASE IN CASH	128,984	31,592
CASH AND CASH EQUIVALENTS — Beginning of year	<u>148,452</u>	<u>116,860</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 277,436</u>	<u>\$ 148,452</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	<u>\$ 99,455</u>	<u>\$ 87,239</u>
Cash paid for income taxes, net of refunds	<u>\$ 2,608</u>	<u>\$ 8,489</u>
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Purchases of property and equipment included in current liabilities	<u>\$ -</u>	<u>\$ 643</u>
Assets acquired under capital leases	<u>\$ 713</u>	<u>\$ 5,319</u>
See notes to consolidated financial statements.		(Concluded)

KNOWLEDGE UNIVERSE EDUCATION L.P. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

1. GENERAL

Knowledge Universe Education L.P. was formed in April 2006 as a Cayman Islands exempted limited partnership. Knowledge Universe Education L.P. is a holding company, whose subsidiaries specialize in education in the preschool to 12th grade segment, mainly in the United States, Asia, and the United Kingdom (collectively, KUE L.P. or the "Company"). The major subsidiaries are as follows:

Knowledge Universe Education Holdings Inc. — Knowledge Universe Education Holdings Inc. (KUEH) was formed in May 2011 as a holding company for the early childhood education operations of its wholly owned subsidiary, Knowledge Universe Education LLC (KUE LLC) formerly, Knowledge Learning Corporation (KLC) and related subsidiaries and offers early childhood education programs to children aged six weeks through 12 years. These include toddler care, preschool and kindergarten classes, and before- and after-school programs. KUE LLC provides education and care programs within the following three categories:

Early Childhood Care and Education — KUEH provides early childhood care and education services, generally marketed under the names of KinderCare Learning Centers, Knowledge Beginnings, Cambridge Schools, and The Grove School. These services are provided through 1,618 community centers with a licensed capacity of 215,535 in 38 states.

Children's Creative Learning Centers — Children's Creative Learning Centers provides employer-sponsored early childhood care and education services, as well as back-up care, through 96 centers, eight before- and after-school sites, and four game-day sites for professional sport teams. These centers and sites have a licensed capacity of 12,055 in 22 states and the District of Columbia. CCLC operates in partnership with employer sponsors under a variety of arrangements, such as discounted rent, enrollment guarantees, or an arrangement whereby the center is managed by CCLC in return for a management fee.

Champions — KUEH provides customized before- and after-school educational enrichment and recreational programs for school-age and preschool children in partnership with elementary schools under the Champions brand. Champions offers approximately 405 education and enrichment programs for school-age children in 17 states and the District of Columbia. These programs primarily operate at preschool and elementary school facilities.

KC Distance Learning, Inc. — KC Distance Learning, Inc. (KCDL) sells middle and high school level courses via online and correspondence formats and provides related instructional services directly to private students, as well as to cyber and traditional schools and school districts. In July 2010, the Company sold its ownership in KCDL in exchange for shares of preferred stock in K12 Inc. KCDL's operating results have been classified as discontinued operations (see Note 4).

Knowledge Universe PTE Ltd. — Knowledge Universe PTE Ltd. is a Singapore holding company for the early childhood education operations of its wholly owned subsidiaries in Asia. Its primary operations include: Pat's Schoolhouse, Learning Vision, Asian International College, Learning Horizon, Global Educare, The Odyssey Creative Learning Centre, Canadian International Schools, and Brighton Montessori Centres.

Busy Bees Group Limited — The Company owns approximately 85% of Busy Bees Group Limited (“Busy Bees”). Busy Bees is the UK’s largest provider of care and education for children up to school age (five years age). It operates more than 122 child care centers across the UK with a capacity of more than 11,000 children. The nurseries provide complete child care services with child development programs and curricula designed to develop creativity, individuality, and self-confidence in the children.

Global Educare Sdn Bhd — The Company acquired Global Educare Sdn Bhd (“Global”) on May 14, 2010. The principal activity of Global is providing child care and educational services in Malaysia.

Canadian International School Pte Ltd. — The Company acquired a 60% joint venture interest in Canadian International School Pte Ltd. (CIS) on June 5, 2010. The principal activity of CIS is providing primary and secondary education services. CIS has constructed a new 463,000 square foot “Lakeside campus” at Jurong West in Singapore.

KUE Digital International LLC — KUE Digital International LLC (KUED) is a holding company for early-stage ventures that provide technology products and services in the education industry. The Company owned approximately 88% of KUED at December 31, 2010. KUED provides comprehensive online educational resources for students at all levels, teachers in grades K-12 and college, companies, schools, and school districts requiring administrative support for education and training programs. In January 2011, KUED sold its subsidiaries. The related assets and liabilities are reflected in assets held for sale as of December 31, 2010, and the operations are reflected in discontinued operations for the years ended December 31, 2011 and 2010 (see Note 4).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation — The consolidated financial statements include the accounts of KUE L.P. and its wholly owned subsidiaries, KUEH, Knowledge Universe Education Inc. (KUE Inc.), KCDL, Knowledge Universe Holdings Cooperatief U.A. (KUHC), Learning Group LLC, Knowledge Universe Online Services Inc., and its majority owned subsidiaries KUED and Busy Bees. All intercompany balances and transactions are eliminated in consolidation. The information presented herein is for the calendar years ended December 31, 2011 and 2010, with the exception of KUEH and KUHC. The information included herein reflects activity for the 52 weeks ended December 31, 2011, and January 1, 2011. For simplicity, all information herein is referred to as relating to the years ended December 31, 2011 and 2010. The noncontrolling interests represent the 12% noncontrolling ownership in KUED as of December 31, 2010, and the 15% noncontrolling ownership in Busy Bees and the 40% noncontrolling interest in CIS as of December 31, 2011 and 2010.

Use of Estimates — The consolidated financial statements are presented in conformity with accounting principles generally accepted in the United States of America. The preparation thereof requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Estimates have been prepared based on the most current and best available information and actual results could differ from those estimates. The most significant estimates underlying the consolidated financial statements include the allowance for doubtful accounts; long-lived assets, other intangible assets, and goodwill valuations and any resulting impairment; self-insurance obligations; valuation of stock appreciation rights; and recognition and measurement of uncertain tax positions and valuation allowances against deferred tax assets.

Revenue Recognition — The recognition of revenues meets the following criteria: the existence of an arrangement through an enrollment agreement, the rendering of child care and tutoring services, an age-specific tuition rate and/or fees, and probable collection. Tuition, fees, and other income are recognized as the related services are provided. Payments for these types of services may be received in advance of services being rendered, in which case the revenue is deferred and recognized over the appropriate service period. Deferred revenue for nonrefundable registration fees is recognized over the average enrollment period, not to exceed 12 months.

The Company's primary source of revenue is tuition paid by parents and supplemented, in some cases, by employer sponsors and government agencies. Revenues also include management fees paid by employer sponsors. In addition to tuition revenue and management fees, the Company receives fees for registration and other ancillary services.

Cash and Cash Equivalents — Cash and cash equivalents include interest-earning securities that mature within three months or less from the date purchased.

Restricted Cash — At December 31, 2011 and 2010, restricted cash of \$16.0 million and \$25.9 million, respectively, is included within other assets in the Company's consolidated balance sheets. Restricted cash of \$7.7 million and \$17.4 million at December 31, 2011 and 2010, respectively, is related to debt service requirements for properties sold that are held as collateral under the collateralized mortgage-backed security (CMBS) facility; consisting of a \$650.0 million mortgage loan and \$50.0 million senior mezzanine loan (see Note 12). Restricted cash of \$8.3 million at December 31, 2011 and 2010, is held as collateral on the Company's foreign currency hedge (see Note 14).

Concentration of Credit Risk — Financial instruments that subject the Company to credit risk consist primarily of cash and cash equivalents and trade receivables. Cash and cash equivalents are placed with high-credit-quality financial institutions. Concentration of credit risk with respect to trade receivables is generally diversified due to the large customer base and its geographic dispersion. The Company performs ongoing credit evaluations of its customers and maintains an allowance for doubtful accounts.

Accounts Receivable — Accounts receivable are composed primarily of tuition and reimbursable expenses due from government agencies, parents, and employers. Accounts receivable are presented at estimated net realizable value. The Company uses estimates in determining the ability to collect accounts receivable and must rely on its evaluation of historical experience, specific customer issues, governmental funding levels, and current economic trends to arrive at appropriate reserves.

Investments — The Company classifies investments in debt and equity securities as trading, held to maturity, or available for sale in accordance with Accounting Standards Codification (ASC) 320-10, *Investments — Debt and Equity*.

Available-for-sale securities include debt and equity securities, which the Company records at fair value, with unrealized gains and losses reported as part of accumulated other comprehensive income in the consolidated balance sheets. Trading securities include investments in short-term corporate debt securities. Unrealized gains and losses on these short-term marketable securities are included in nonoperating income in the consolidated statements of operations.

Our investments at December 31, 2011 and 2010, consisted of the following (in thousands):

	2011	2010
Available-for-sale equity securities — K-12 Inc.	\$ 133,098	\$ 212,516
Trading — short-term marketable securities	40,986	198,953
Equity method investments	<u>3,536</u>	<u>11,420</u>
 Total investments	 177,620	 422,889
Less short-term marketable securities	<u>40,986</u>	<u>198,953</u>
 Total long-term investments	 <u>\$ 136,634</u>	 <u>\$ 223,936</u>

Our investments in available-for-sale equity securities and trading short-term marketable securities at December 31, 2011 and 2010, consisted of the following (in thousands):

	2011			2010		
	Cost	Gross Unrealized Gain (Loss)	Estimated Fair Value	Cost	Gross Unrealized Gain (Loss)	Estimated Fair Value
Available for sale:						
Equity securities — K-12 Inc.	\$ 101,465	\$ 31,633	\$ 133,098	\$ 98,866	\$ 113,650	\$ 212,516
Trading — short-term marketable securities	41,879	(893)	40,986	200,092	(1,139)	198,953

Property and Equipment — Property and equipment are stated at cost, less accumulated depreciation. Depreciation is computed on a straight-line basis over the useful lives of the assets or, in the case of leasehold improvements, the lesser of the term of the related lease or the useful lives of the improvements. A summary of estimated useful lives is as follows:

Buildings and leaseholds	5–50 years
Land improvements	2–15 years
Furniture, fixtures, and equipment	2–10 years
Building and leasehold improvements	2–60 years

Maintenance, repairs, and minor refurbishments are expensed as incurred.

Assets Held for Sale — Assets held for sale include centers that are being actively marketed and are considered probable of being sold within one year. Such assets are recorded at the lower of their carrying amount or fair value less cost to sell. Long-lived assets are not depreciated while classified as held for sale. Also included in assets held for sale as of December 31, 2010, are the assets of KUED (see Note 4). There were no assets held for sale as of December 31, 2011.

Goodwill — Goodwill represents the excess of the cost over the fair value of the identifiable net assets of businesses acquired. The Company tests its goodwill for impairment on an annual basis, or more frequently, if circumstances indicate reporting unit carrying values exceed their fair values. Fair value is estimated by projecting future discounted cash flows from the reporting unit in addition to other quantitative and qualitative analyses. If the carrying amount of goodwill exceeds the implied estimated fair value (based on discounted cash flows), an impairment charge to current operations is recorded to reduce the carrying value to the implied estimated fair value. There was no impairment of goodwill in fiscal years 2011 or 2010.

Other Intangible Assets — Other intangible assets consist of customer lists, contract rights, accreditations, proprietary curricula, covenants not to compete, trade names, and trademarks. Other intangible assets subject to amortization are amortized on a straight-line basis over their estimated useful lives. The Company reviews and evaluates the remaining useful lives of such assets if events or changes in circumstances require impairment testing and/or a revision to the remaining period of amortization. Any such impairment analysis is based on a comparison of the carrying values to expected future cash flows.

Other intangible assets with indefinite useful lives are tested for impairment on an annual basis, or more frequently, if circumstances indicate the carrying values exceed their fair values. If the carrying amount exceeds the implied estimated fair value, an impairment charge to current operations is recorded to reduce the carrying value to the implied estimated fair value.

There was no impairment of other intangible assets in fiscal years 2011 or 2010.

Long-Lived Assets — The Company reviews and evaluates its long-lived assets, other than goodwill and other intangible assets, for impairment when events or changes in circumstances indicate that the carrying value of assets may not be recoverable through future undiscounted cash flows. Any impairment is measured as the amount by which the carrying values of such assets exceed their fair value (based on discounted cash flows). Impairment losses related to child care center property and equipment totaled \$19.3 million for 2011 and \$10.2 million for 2010. The impairment charges are included as a component of depreciation expense in the consolidated statements of operations.

Financial Instruments — In accordance with reporting and disclosure requirements of ASC 825-10, *Financial Instruments*, the Company calculates the fair value of financial instruments and includes this information in the Company's notes to consolidated financial statements when the fair value is different than the book value of those financial instruments. When fair value is equal to book value, no disclosure is made.

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, accrued compensation, and related expenses and other accrued liabilities, excluding derivatives, approximate fair value due to the short-term nature of these assets and liabilities.

The Company's derivatives include an interest rate swap agreement, an interest rate cap agreement, and a four-year forward currency hedge based on the British pound. These instruments are recognized in the consolidated balance sheets at fair value. None of these instruments have been designated as a hedge of specific underlying interest rate exposure and marked to market with the resulting gains or losses recognized as a component of interest expense in the consolidated statement of operations. Changes in the foreign currency hedge are included as a component of gains and losses on investments.

Deferred Financing Costs — Included in other assets are deferred financing costs incurred in connection with the issuance of debt. Deferred financing costs are amortized over the lives of the related debt facilities using a method that approximates the effective interest method. Deferred financing costs are recorded in other assets (see Note 11).

Income Taxes — The Company accounts for income taxes under the asset and liability method. Under this method, deferred tax liabilities and assets are recognized for the expected future consequences of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is established to reduce the amount of that deferred tax asset to the amount, more likely than not, to be recognized. Uncertain tax positions and the related interest and penalties are recognized in other liabilities and income tax expense (see Note 20).

Other Comprehensive Income — ASC 320-10 requires that investment securities with readily determinable market values be marked to market at each reporting period. Accumulated other comprehensive income includes unrealized gains and losses on marketable securities classified as available for sale, net of the related tax effects, and adjustments to reclassify losses to the consolidated statements of operations for securities that have been determined to have other-than-temporary impairment — net of the related tax effects.

ASC 323-10, *Investments-Equity Method and Joint Ventures*, requires that a transaction of an investee of a capital nature should be recorded based on the investor's proportionate share of stockholder's equity of the investee. Therefore, the Company has recorded its proportionate share of the investee's adjustments to other comprehensive income.

	2011	2010
Unrealized (losses) gains on available-for-sale securities:		
Unrealized (losses) gains on investment in K12 Inc.	\$ (82,143)	\$ 51,130
Unrealized gain (loss) on equity method investments:		
Reclassification of loss on investment in Blesbok LLC to net income	<u>9,025</u>	<u>(224)</u>
Adjustments for unrealized (loss) gain on investments — net of tax	(73,118)	50,906
Foreign currency translation adjustments — net	<u>(129)</u>	<u>1,195</u>
Other comprehensive (loss) income	<u>\$ (73,247)</u>	<u>\$ 52,101</u>

Advertising Costs — Costs incurred to produce media advertising for seasonal campaigns are expensed when the advertising first takes place. All other advertising costs are expensed as incurred. Total advertising expense was \$16.2 million and \$18.0 million for the years ended December 31, 2011 and 2010, respectively, and are included in general and administrative expenses.

Self-Insurance — KUEH is self-insured for certain levels of general liability, workers' compensation, auto, property, and employee medical insurance coverage. Estimated costs of these self-insurance programs are accrued at the undiscounted value of projected settlements for known and anticipated claims incurred. The self-insurance reserves established and claims paid at December 31, 2011 and 2010, are as follows (in thousands):

	2011	2010
Balance — beginning of year	\$ 41,648	\$ 41,505
Expense	107,574	100,338
Claims paid	<u>(106,015)</u>	<u>(100,195)</u>
Balance — end of year	<u>\$ 43,207</u>	<u>\$ 41,648</u>

Recent Accounting Pronouncements — In June 2011, the FASB modified the presentation of comprehensive income in the financial statements. The revised standard requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements and must be applied retrospectively. This standard eliminates the current option to report other comprehensive income and its components in the statement of changes in

equity. The revised standard does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. For nonpublic entities, the amendments are effective fiscal years ending after December 15, 2012, which will be our fiscal year ended December 31, 2012. We do not believe the amendment will have a significant impact on the consolidated financial statements.

3. RESTRUCTURE OF CERTAIN SUBSIDIARIES

In May 2011, a wholly owned subsidiary of KUE Inc., Knowledge Schools, Inc., the parent company of KLC, converted from a corporation into a limited liability company and changed its name to Knowledge Schools LLC (KS). In conjunction with this, the membership interest in KC Propco II LLC ("KC Propco") was distributed to KUE Inc. KUE Inc. then contributed all of its membership interest in KS to a newly formed wholly owned subsidiary, KUEH. KUE Inc. then distributed KUEH to its parent company, KUE LP. KUEH provides early childhood education programs. The real estate held by KC Propco is utilized by KUEH. This restructuring activity did not have an impact on the consolidated financial statements.

4. DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE

KCDL — On July 23, 2010, the Company sold its wholly owned subsidiary, KCDL to K12 Inc. in exchange for 2,750,000 shares of Series A Special Preferred Stock in K12 Inc., which had a fair value of \$66.8 million on the date of sale and a fair value of \$49.3 million and \$78.8 million at December 31, 2011 and 2010, respectively. The carrying value of KCDL was \$26.5 million on the date of the sale. As a result, in 2010 the Company recognized a gain on the transaction of approximately \$40.3 million, which is included under discontinued operations in the consolidated statements of operations. These Series A Special Preferred Stock shares are eligible for conversion into K12 Inc. common stock on a one-for-one basis upon the approval of the conversion rights by K12 Inc. shareholders. On January 27, 2011, the right to convert the Series A Special Preferred Stock to common stock was approved by the shareholders of K12 Inc. As a result, these shares are now convertible. These securities have been treated as available-for-sale securities and are included within long-term investments in the consolidated balance sheet at December 31, 2011 and 2010.

The table below discloses certain information regarding KCDL included in discontinued operations for 2010 as follows (in thousands):

	2010
Revenues	\$ 17,730
Cost of revenues	<u>5,999</u>
 Gross margin	 11,731
 Operating expenses	 <u>14,962</u>
 Loss from operations	 (3,231)
 Other income, including gain on sale	 <u>(39,775)</u>
 Gain before income taxes	 36,544
 Income tax benefit	 <u>1,383</u>
 Net gain	 <u>\$ 37,927</u>

KUED — On January 3, 2011, KUED sold its wholly owned subsidiaries KUE Digital Inc., ExLogica, and Excelsior for approximately \$140 million, and recognized a gain of approximately \$110 million after consideration of noncontrolling interests.

The table below discloses certain information regarding KUED included in discontinued operations for 2011 and 2010 as follows (in thousands):

	2011	2010
Revenues	\$ -	\$ 11,308
Cost of revenues	<u>9,325</u>	<u>9,325</u>
 Gross margin	 -	 1,983
 Operating expenses	 <u>22,175</u>	 <u>22,175</u>
 Loss from operations	 -	 (20,192)
 Gain on sale	 110,397	
Other income	<u>(353)</u>	<u>(353)</u>
 Gain (loss) before income taxes	 110,397	 (19,839)
 Income tax expense	 <u>(16)</u>	 <u>(16)</u>
 Net gain (loss)	 <u>\$ 110,397</u>	 <u>\$ (19,855)</u>

Summarized assets and liabilities of KUED included in assets held for sale as of December 31, 2010, were as follows (in thousands):

	2010
Assets held for sale:	
Current assets	\$ 10,328
Noncurrent assets	<u>18,814</u>
Total assets	<u>\$ 29,142</u>
Liabilities associated with assets held for sale:	
Current liabilities	\$ 29,964
Noncurrent liabilities	<u>551</u>
Total liabilities	<u>\$ 30,515</u>

Current assets held for sale at December 31, 2010, also include assets of KC Propco centers of \$320 and assets of KUHC of \$137.

Supplemental Education Services — In July 2008, KUEH announced that it would no longer operate the Supplemental Education Services (SES) programs effective August 1, 2008. SES provided no revenue in fiscal 2011 or 2010. SES had no assets as of December 31, 2011, and less than \$0.1 million of total assets as of December 31, 2010.

5. ACQUISITIONS

The following acquisitions were accounted for by the purchase method of accounting, and accordingly, the results of operations have been included in the consolidated statements of operations since the acquisition dates.

Acquisition of Global Educare SDN BHD — On May 14, 2010, KUHC acquired Global Educare, for a total cash consideration of \$1.2 million, net of cash acquired of \$2.2 million. The principal activity of Global Educare is providing child care and educational services.

The allocation of the purchase price for Global Educare is as follows (in thousands):

Trade and other receivables	\$ 158
Property and equipment	256
Goodwill	1,373
Intangible assets subject to amortization:	
Customer lists (4 years)	324
Trade names and trademarks (10 years)	943
Trade and other payables	(1,475)
Deferred tax liability	<u>(317)</u>
Total purchase price	<u>\$ 1,262</u>

Acquisition of Canadian International School Pte Ltd. — On June 5, 2010, KUHC acquired a 60% equity interest in Canadian International School Pte Ltd. for cash consideration of \$5.6 million, net of cash acquired of \$2.1 million. The terms also include certain put and call options under which the seller may require KUHC to purchase the remaining 40% of the interest in CIS, and alternatively, KUHC may require the noncontrolling interest holder to sell it the remaining ownership in CIS. Additionally, there are certain options and performance contingencies that also allow the noncontrolling interest holder to buy back shares from KUHC upon the occurrence of certain events. The principal activity of CIS is providing primary and secondary education service.

The allocation of the purchase price for Canadian International School Pte Ltd. is as follows (in thousands):

Cash paid, net of cash acquired of \$2.2 million	\$ 5,613
Noncontrolling interest	6,391
Fair value of options	<u>1,779</u>
 Total purchase consideration	 <u>\$ 13,783</u>
 Trade and other receivables	 \$ 9,493
Property and equipment	24,298
Goodwill	1,883
Trade names and trademarks (indefinite)	6,615
Intangible assets subject to amortization:	
Customer lists (4 years)	5,107
Acquired curriculum (4 years)	384
Trade and other payables	(31,939)
Deferred tax liability	<u>(2,058)</u>
 Total purchase price	 <u>\$ 13,783</u>

Acquisition of Q Day Nurseries Limited — On June 30, 2011, KUHC acquired 100% of Q Day Nurseries Limited for total consideration of \$1.0 million, net of cash acquired of \$0.2 million. Q Day Nurseries Limited is in the business of providing children day nurseries, operating three centers in the UK.

The allocation of the purchase price for Q Day Nurseries Limited is as follows (in thousands):

Cash paid, net of cash acquired of \$0.2 million	\$ 1,620
Less indebtedness repayment	<u>(601)</u>
 Total purchase consideration	 <u>\$ 1,019</u>
 Trade and other receivables	 \$ 283
Intangible assets subject to amortization — customer lists (4.25 years)	105
Goodwill	1,782
Trade and other payables	<u>(1,151)</u>
 Total purchase price	 <u>\$ 1,019</u>

Acquisition of Brighton Montessori Centres Pte Ltd. (BMC) — On August 1, 2011, KUHC acquired the stock of BMC, a Singapore entity for a total consideration of \$7 million, net of cash acquired of \$1.0 million. BMC is in the business of nurseries and kindergarten and providing child care services for preschool children, operating four centers in Singapore, operating primarily under the child care name brand Brighton Montessori International. This acquisition is in line with the Company's overall strategic plans to expand operations globally.

The allocation of the purchase price for BMC is as follows (in thousands):

Cash paid, net of cash acquired of \$1.0 million	\$ 5,439
Management earn out	<u>1,540</u>
 Total purchase consideration	 <u>\$ 6,979</u>
 Trade and other receivables	 \$ 21
Property and equipment	182
Other assets	100
Intangible assets subject to amortization:	
Customer lists (4 years)	2,668
Trade names and trademarks	1,799
Goodwill	3,620
Trade and other payables	(652)
Deferred tax liability	<u>(759)</u>
 Total purchase price	 <u>\$ 6,979</u>

Acquisition of Early Years Childcare Limited — On December 30, 2011, KUHC acquired 100% of Early Years Childcare Limited for total consideration of \$4.7 million, net of cash acquired of \$0.6 million. Early Years Childcare Limited is in the business of providing children day nurseries, operating nine centers in the UK.

The allocation of the purchase for Early Years Childcare Limited is as follows (in thousands):

Trade and other receivables	\$ 117
Property and equipment	2,102
Deferred tax asset	23
Unfavorable lease agreements	2,008
Intangible assets subject to amortization — customer lists (4.25 years)	317
Goodwill	1,716
Trade and other payables	<u>(1,028)</u>
 Total purchase price	 <u>\$ 5,255</u>

6. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, included the following at December 31 (in thousands):

	2011	2010
Tuition	\$ 64,842	\$ 74,976
Other	13,599	16,022
Allowance for doubtful accounts	<u>(6,012)</u>	<u>(7,552)</u>
Accounts receivable — net	<u>\$ 72,429</u>	<u>\$ 83,446</u>

7. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets at December 31, 2011 and 2010, included the following (in thousands):

	2011	2010
Prepaid rent	\$ 11,777	\$ 11,627
Supplies and inventory	7,038	8,056
Prepaid maintenance	1,311	2,122
Prepaid insurance	2,487	2,165
Prepaid property taxes	5,163	5,351
Lease premiums	7,432	7,615
Other	<u>9,724</u>	<u>3,838</u>
Total prepaid expenses and other current assets	<u>\$ 44,932</u>	<u>\$ 40,774</u>

8. PROPERTY AND EQUIPMENT, NET

Property and equipment, net, at December 31, 2011 and 2010, included the following (in thousands):

	2011	2010
Land and improvements	\$ 311,346	\$ 317,364
Buildings and improvements	651,671	712,164
Leasehold improvements	343,581	202,237
Furniture, fixtures, and equipment	<u>315,385</u>	<u>308,347</u>
Total property and equipment	1,621,983	1,540,112
Accumulated depreciation	<u>(603,589)</u>	<u>(531,908)</u>
Property and equipment — net	<u>\$ 1,018,394</u>	<u>\$ 1,008,204</u>

Construction in progress included in buildings and improvements was \$10.5 million as of December 31, 2011, and \$32.1 million as of December 31, 2010. Construction in progress included in furniture, fixtures, and equipment was \$2.2 million as of December 31, 2011, and \$3.0 million as of December 31, 2010.

Depreciation expense, not including impairment of long-lived assets, was \$99.5 million and \$102.6 million for 2011 and 2010, respectively.

9. GOODWILL

Changes in the carrying amount of goodwill were as follows (in thousands):

Balance — December 31, 2009		\$ 386,770
Acquisition of Canadian International School Pte Ltd.	1,883	
Acquisition of Global Educare	1,373	
Currency exchange difference	(1,139)	
Balance — December 31, 2010		388,887
Acquisition of Q Day Nurseries Limited	1,782	
Acquisition of Brighton Montessori Centres Pte Ltd.	3,620	
Acquisition of Early Years Childcare Limited	1,169	
Other	521	
Reduction in goodwill related to tax adjustment for 2009 Busy Bees acquisition	(3,975)	
Currency exchange difference	(328)	
Balance — December 31, 2011		<u>\$ 391,676</u>

10. OTHER INTANGIBLE ASSETS, NET

The gross carrying amount and accumulated amortization of other intangible assets at December 31 were as follows (in thousands):

	Amortization Period	2011	2010
Amortizable intangible assets:			
Customer lists	2–7 years	\$ 37,369	\$ 40,503
Contracts	2–14 years	22,773	22,518
Accreditations	3–4 years	12,100	12,100
Intellectual property and proprietary curricula	3–14 years	7,646	5,134
Trade names and trademarks	1.5–10 years	1,500	4,895
Covenants not to compete	3–8 years	200	1,450
Favorable leases acquired	8 years	850	850
Gross carrying amount		82,438	87,450
Accumulated amortization		(63,746)	(59,470)
Net intangible assets subject to amortization		18,692	27,980
Intangible assets not subject to amortization — trade names and trademarks		111,684	104,846
Total other intangible assets — net		<u>\$ 130,376</u>	<u>\$ 132,826</u>

Amortization expense, not including impairment, was \$6.0 million and \$7.7 million for 2011 and 2010, respectively. Estimated future amortization expense for finite-lived intangible assets at December 31, 2011, is as follows (in thousands):

2012	\$ 5,859
2013	3,800
2014	3,041
2015	2,524
2016	1,985
Thereafter	<u>1,483</u>
 Total	 <u>\$ 18,692</u>

11. OTHER ASSETS

Other assets at December 31, 2011 and 2010, included the following (in thousands):

	2011	2010
Deferred financing costs — net of accumulated amortization	\$ 11,135	\$ 14,510
Restricted cash (Note 2)	15,982	25,917
Deferred compensation	6,365	6,486
Deposits	3,954	5,818
Derivative contract	2,616	2,936
Long-term receivables	1,145	1,977
Other	<u>5,756</u>	<u>1,735</u>
 Total other assets	 <u>\$ 46,953</u>	 <u>\$ 59,379</u>

12. LONG-TERM DEBT

Long-term debt at December 31, 2011 and 2010, included the following (in thousands):

	2011	2010
Secured:		
CMBS loan	\$ 604,825	\$ 616,525
Senior mezzanine loan	46,525	47,425
Junior mezzanine loan from affiliate, net of discount of \$927	50,255	
Singapore construction loan	56,762	16,555
Singapore lease loan	3,287	4,774
UK Bank loans	52,390	45,856
Unsecured:		
Senior subordinated notes	260,000	260,000
Loan from affiliate	100,000	
Other, net of discount of \$12 and \$18 in 2011 and 2010, respectively	1,503	1,664
Fair value adjustment	<u>(2,604)</u>	<u>(3,479)</u>
 Total	 1,022,688	 1,139,575
 Current portion	 <u>(21,745)</u>	 <u>(17,970)</u>
 Long-term portion	 <u>\$1,000,943</u>	 <u>\$1,121,605</u>

Secured Loans — On November 9, 2005, KC Propco completed a refinancing of all of its senior debt that was assumed in connection with the KinderCare acquisition. The refinancing involved a 10-year fixed-rate \$650.0 million CMBS loan and a \$50.0 million senior mezzanine loan collectively referred to as the “CMBS facility.” The refinancing also included a \$150.0 million junior mezzanine loan from an affiliate, which was repaid during 2011. Under the CMBS loan agreement, all of the property and equipment of KC Propco are pledged as collateral.

The CMBS loan matures in December 2015. The weighted-average interest rate on the CMBS loan is 5.46% and is payable monthly.

Principal and interest payments on the CMBS loan are due in arrears on the 1st day of each month. The monthly principal amount due on the CMBS loan is approximately \$1.0 million through December 1, 2015.

The CMBS loan contains various customary nonfinancial covenants. The key nonfinancial covenants applicable to KC Propco restricts KC Propco’s ability to, among other things, amend lease provisions; impair the value of KUEH’s operating companies’ leasing arrangements; collect any rents more than one month in advance; consent to assign or sublease arrangements under the KUEH lease; surrender, terminate, modify, or cancel the asset management agreement; establish liens on any of the original 713 CMBS properties; cancel or forgive any debt owed to KC Propco; initiate or consent to any rezoning of the CMBS properties; engage in any nonexempt transaction prohibited under the Employee Retirement Income Security Act of 1974; allow a joint assessment of any of the CMBS properties; enter into or modify any reciprocal easement agreement; or, make any alterations or enter into any agreements that may have an adverse effect on the CMBS Properties.

The CMBS loan also contains customary covenants that restrict KC Propco's ability to, among other things, engage in any other business other than the ownership, operation, and maintenance of the CMBS properties, acquire or own any other assets, merge into or consolidate with another entity or change its legal structure, own or invest in any subsidiary, commingle its assets, incur any additional debt, enter into any contract or agreement with any principal, assume or guarantee any debts, make any loans or advances, acquire obligations or securities, and make changes to name, identity, or structure.

Furthermore, the CMBS loan agreement includes a provision that requires KUEH to provide to the lender a consolidated financial statements for the trailing 12 months to determine compliance with minimum thresholds of earnings before interest, taxes, depreciation, and amortization (EBITDA), which, if not maintained, could result in a sweep of 50% or 100% of excess cash flow, depending upon the amount of the shortfall. Any funds swept pursuant to these provisions would be held by the lender in a cash management account owned by KC Propco as additional loan collateral and would be available for distribution upon the lender determining that for the immediately preceding 12-month period, the EBITDA for KUEH was equal to or greater than \$108 million at the end of two consecutive calendar quarters. KC Propco was in compliance with the covenants of the CMBS loan as of December 31, 2011.

The calculation of consolidated EBITDA for the trailing 12 months ending March 31, 2012, did not meet the threshold. In accordance with the terms of the loan agreement, effective in May 2012, 50% of KC Propco's future Excess Cash Flow will be swept into a cash management account.

For the CMBS loan, management's estimate of fair value is based on available information and was determined with assistance from an external valuation firm. The loan's fair value is in the range of \$507.0 million to \$510.9 million, as compared to its carrying value of \$604.8 million, as of December 31, 2011, and in the range of \$548.6 million to \$559.0 million, as compared to its carrying value of \$616.5 million, as of December 31, 2010.

Singapore Construction Loan — In March 2010, CIS obtained a loan of \$65.3 million for the construction of a new school building in Singapore. The loan will be drawn down over two years and will be repayable over 15 years. As of December 31, 2011, the amount of the loan was \$56.8 million. Total assets of CIS amounting to \$134.6 million were pledged as security against the bank loan. Monthly repayments begin in June 2012 and continue for 13 years. The interest rate is the prevailing margin and swap offer rate, which was 4% at December 31, 2011. The Company has not entered into any hedging instrument to hedge the floating interest rate of the loan.

Singapore Land Lease Loan — In 2007, CIS entered into an agreement with Singapore Land Authority for a 30-year lease of land on which the new school building is to be constructed. The installment payments bear an effective interest rate of 9.5% per annum and are repayable over 84 months beginning in April 2007. The balance of \$3.3 million at December 31, 2011, will be paid in installments.

UK Bank Loans — On December 21, 2010, Busy Bees obtained a loan from HSBC Bank that it used to repay its RBS bank parent company loans. The loan is made up of two facilities: Facility A is a 15-year facility for \$40 million, which is repayable in 60 quarterly installments of \$0.7 million beginning in March 2013. Facility B is a six-year facility for \$7 million, which is repayable in 24 quarterly installments of \$0.3 million beginning in June 2012. On December 19, 2011, Busy Bees increased its HSBC Bank loan by \$10.8 million, which it used to fund the acquisition of Early Years Childcare Limited on December 30, 2011, for \$5.4 million and also partly fund the repayment of \$10.8 million of preference share capital and accrued interest on December 19, 2011. The facility A loan was increased to \$46.9 million and is repayable in 56 quarterly installments of \$0.84 million ending on December 31, 2025. The facility B loan was increased to \$6.9 million and is repayable in 20 quarterly installments of

\$0.35 million ending on December 31, 2016. The loan is secured by the assets of all of the child care centers in the United Kingdom. The interest rate on the facility, as defined in the agreement, is the aggregate of a margin, London InterBank Offered Rate (LIBOR) and fees which was 5.51% at December 31, 2011. Interest payments shall be made on the last day of each interest period. The Company has entered into an interest rate swap on the additional HSBC facility in addition to the swaps held on the already existing HSBC facility and the previous RBS facility. These swaps fix the interest rate on two thirds of the loan at an effective rate of 5.51% through maturity. As the interest rate swap has not been designated as a hedge of specific underlying interest rate exposure, it has been marked to market with the resulting gains or losses recognized as a component of interest expense in the consolidated statement of operations. The fair value of the interest rate swap at December 31, 2011, was \$1.7 million. The unrealized loss of \$1.7 million has increased by \$1.3 million in 2011 and this increase is included in interest expense for 2011. The swap converts \$38.2 million of notional debt from floating rate to fixed rate of 5.55% and matures on January 29, 2016. The Company was in compliance with the covenants of the UK Bank loans as of December 31, 2011.

Unsecured Senior Subordinated Notes — In February 2005, senior subordinated notes (the “Notes”) in the amount of \$260.0 million were issued to refinance certain indebtedness in connection with the acquisition of KinderCare Learning Centers. The Notes bear interest at 7.75%, payable semiannually on February 1 and August 1 of each year, and are due in February 2015.

The Notes may be redeemed at any time, in whole or in part, after February 2011 at a redemption price equal to 102.58% of the principal amount of the Notes and declining yearly to par in February 2015, plus accrued and unpaid interest, if any, to the date of redemption.

Upon the occurrence of a change of control, KUEH’s subsidiary, KUE LLC, will be required to make an offer to repurchase all Notes properly tendered at a price equal to 101.0% of the principal amount plus accrued and unpaid interest through the date of repurchase.

The indenture governing the Notes contains various nonfinancial covenants that limit KUE LLC’s ability to, among other things, enter into agreements that restrict KUE LLC’s subsidiaries from paying dividends or other distributions, making loans or otherwise transferring assets to KUE LLC or to any other subsidiaries, incurring additional debt or issuing preferred stock, establishing new liens on assets, making certain restricted payments and investments, selling assets or capital stock of subsidiaries in excess of established limits, engaging in certain transactions with affiliates, and making certain fundamental changes to the business.

Loan from Affiliate — In January 2005, the Company borrowed \$200 million from an affiliate in connection with the Company’s acquisition of KinderCare. In December 2010, the Company repaid \$100 million of this loan. In April 2011, the Company repaid the balance.

Credit Agreement — In June 2010, KUEH’s subsidiary, KUE LLC, entered into an amended and restated four-year credit agreement with a group of syndicated lenders (the “Credit Agreement”). The Credit Agreement consists of an \$85.0 million revolving line of credit, with increased borrowing capacity available as additional lenders enter the facility, up to a total of \$100.0 million. At KUE LLC’s discretion, borrowings under the revolving line of credit bear interest at the base rate plus 1.75% or the LIBOR plus 2.75%. The base rate is the higher of the lender’s prime rate or 0.50% in excess of the federal funds effective Rate. In addition, the Credit Agreement allows for a maximum of \$75.0 million for letters of credit against the current borrowing capacity of the revolving line of credit and up to \$10.0 million for selected short-term borrowings. KUE LLC pays fees on the outstanding balance of letters of credit at an annual rate of 2.75%, plus a fronting fee of 0.25%. KUE LLC is also required to pay fees of 0.63% on the unborrowed and uncommitted balances under the Credit Agreement.

As of December 31, 2011 and 2010, KUE LLC had no borrowings under the Credit Agreement and outstanding letters of credit totaled \$46.0 million and \$49.8 million, respectively.

The Credit Agreement contains various financial and nonfinancial loan covenants and provisions. The key financial loan covenants include a maximum leverage ratio, a minimum fixed-charge coverage ratio, and a minimum interest-coverage ratio. The key nonfinancial loan covenants restrict KUE LLC's ability to, among other things, incur additional debt, make fundamental changes to the business, open new learning centers in excess of established limits, make certain restricted payments and investments, or enter into certain sale-leaseback transactions. The Credit Agreement expires in June 2014.

KUEH's subsidiary, KUE LLC, was not in compliance with the maximum leverage ratio financial covenant contained in the Credit Agreement as of December 31, 2011. As a result, KUE LLC received waivers of the financial covenants contained in the Credit Agreement and on June 28, 2012 signed an amendment to the Credit agreement. The amendment changed certain terms of the Credit Agreement, including reduction of the borrowing base to \$75 million, elimination of the fixed charge and leverage covenants, addition of a minimum EBITDA covenant, and changes to the interest rate. KUEH and KUE LLC were in compliance with the nonfinancial covenants of the Credit Agreement and the covenants of the Notes as of December 31, 2011. While certain defaults under either of the loan agreements may cause a cross-default under the other loan agreement, no cross-default provisions have been triggered as of December 31, 2011.

Debt Maturities — Principal payments on long-term debt during the next five years and thereafter at December 31, 2011, are as follows (in thousands):

2012	\$ 21,745
2013	23,825
2014	23,711
2015	883,134
2016	9,584
Thereafter	<u>63,305</u>
 Total	 <u>\$ 1,025,304</u>

13. OTHER LONG-TERM LIABILITIES

Other long-term liabilities at December 31, 2011 and 2010, included the following (in thousands):

	2011	2010
Unfavorable leases	\$ 26,577	\$ 27,915
Reserves for uncertain tax positions	6,756	10,072
Self-insurance reserves — long term	19,129	19,221
Deferred rent	14,100	14,785
Deferred compensation plan	6,365	6,357
Deferred gain on sale leasebacks		2,218
Property taxes	4,157	4,162
Real estate obligation	9,922	6,862
Other	<u>3,025</u>	<u>3,689</u>
 Total other long-term liabilities	 <u>\$ 90,031</u>	 <u>\$ 95,281</u>

14. DERIVATIVE CONTRACTS

The Company has entered into an interest rate swap, on December 19, 2011, on the additional HSBC facility in addition to the swaps held on the already-existing HSBC facility and the previous RBS facility. These swaps fix the interest rate on two thirds of the loan at an effective rate of 5.51% through maturity. As the interest rate swaps have not been designated as a hedge of specific underlying interest rate exposure, they have been marked to market with the resulting gains or losses recognized as a component of interest expense in the consolidated statement of operations. The fair value of the interest rate swaps at December 31, 2011, was \$1.7 million. The unrealized loss of \$1.7 million has increased by \$1.3 million in the year and this increase is included in interest expense for 2011. The swaps convert \$38.2 million of notional debt from floating rate to fixed rate of 5.55% and mature on January 29, 2016.

In June 2009, the Company entered into a four-year forward currency hedge based on the British pound. The Company sold 25 million British Pounds at a rate of 1.65205 on a forward leg maturing in June 2013. As the foreign currency hedge has not been designated as a hedge of specific underlying interest rate exposure, it has been marked to market with the resulting gains or losses recognized as a component of (gains) losses on investments in the consolidated statement of operations. The mark to market at December 31, 2011, resulted in an asset of \$2.6 million recorded in other assets in the accompanying consolidated balance sheet (see Note 17). The unrealized loss of \$0.3 million in 2011 and the unrealized gain of \$4.3 million in 2010 are included in (gains) losses on investments in the consolidated statements of operations.

KUEH had an interest rate swap with a notional amount of \$100.0 million, which was entered into in May 2005 and matured in January 2012. To the extent LIBOR was less than the stated rate, KUEH paid the spread between the stated rate of 4.35% and the one-month LIBOR. In the event that LIBOR increased beyond the stated rate, the counterparty paid KUEH the spread between LIBOR and the stated rate.

As the interest rate swap has not been designated as a hedge of specific underlying interest rate exposure, it is marked to market with the resulting gains or losses recognized as a component of interest expense in the consolidated statement of operations. Total gain recognized was \$4.0 million and \$2.0 million for the years ended December 31, 2011 and 2010, respectively. As of December 31, 2011 and 2010, the fair value of the interest rate swap resulted in a liability of \$0.2 million and \$4.2 million, respectively, which is recorded in other accrued liabilities in the accompanying combined and consolidated balance sheet.

15. LEASE OBLIGATIONS

The Company and its subsidiaries lease certain child care and office facilities, vehicles, and equipment under both capital and operating leases. Many of these operating leases contain renewal options and escalation clauses. For scheduled rent escalation clauses during the lease terms, the Company records minimum rental expenses on a straight-line basis over the terms of the leases in the consolidated statements of operations. Real estate obligations represent the Company's financing obligation for certain assets constructed under built-to-suit lease arrangements with lessors. The following represents future minimum fixed payments under operating and capital leases, not including unexercised renewal options, real estate taxes, insurance, and maintenance costs (in thousands):

	Capital Leases	Real Estate Obligations	Operating Leases	Total Leases
2012	\$ 4,343	\$ 1,275	\$ 133,126	\$ 138,744
2013	4,255	1,275	114,783	120,313
2014	3,096	1,275	93,962	98,333
2015	1,599	1,275	75,295	78,169
2016	1,164	1,275	58,584	61,023
Thereafter	<u>7,067</u>	<u>9,576</u>	<u>289,106</u>	<u>305,749</u>
 Total minimum payments*	 21,524	 15,951	 <u>\$ 764,856</u>	 <u>\$ 802,331</u>
 Less amounts representing interest	 <u>(6,182)</u>	 <u>(5,485)</u>		
	15,342	10,466		
 Less current portion of lease obligations	 <u>(3,105)</u>	 <u>(544)</u>		
 Long-term capital leases and real estate obligations	 <u>\$ 12,237</u>	 <u>\$ 9,922</u>		

*Minimum payments have not been reduced by minimum sublease rentals of \$1.6 million in the future under noncancelable subleases.

The majority of the vehicles in the Company's fleet are leased pursuant to the terms of a 12-month noncancelable master lease that may be renewed on a month-to-month basis after the initial 12-month lease period. Payments under the vehicle leases vary with the number, type, model, and age of the vehicles leased. The vehicle leases require that KUEH guarantee specified residual values upon cancellation. As of December 31, 2011, our residual guarantee was \$7.2 million. In most cases, KUEH expects that substantially all of the leases will be renewed or replaced by other leases as part of the normal course of business. All such leases are classified as operating leases. Lease expense for vehicle leases, included in rent expense in the consolidated statement of operations, was \$11.7 million and \$11.3 million for the years ended December 31, 2011 and 2010, respectively.

Assets related to capital leases and real estate obligations, net of accumulated depreciation, included within property and equipment totaled \$22.1 million as of December 31, 2011, and \$24.3 million as of December 31, 2010.

16. NONCONTROLLING INTERESTS

KUED had noncontrolling interest holders that had a combined ownership interest of approximately 12.38% at December 31, 2010. The Company has recorded the proportionate share of the KUED net losses, as net loss attributable to noncontrolling interests in the consolidated statements of operations. KUED was sold in January 2011.

Busy Bees has noncontrolling interest holders that have a combined ownership interest of approximately 15% at December 31, 2011. The Company has recorded the proportionate share of the Busy Bees' net losses, as net loss attributable to noncontrolling interests in the consolidated statement of operations.

CIS has noncontrolling interest holders that have a combined ownership interest of approximately 40% at December 31, 2011. The terms of the acquisition also include certain put and call options under which the seller may require KUHC to purchase the remaining 40% of the interest in CIS, and alternatively, KUHC may require the noncontrolling interest holder to sell it the remaining ownership in CIS. Additionally, there are certain options and performance contingencies which also allow the noncontrolling interest holder to buy back shares from KUHC upon the occurrence of certain events.

Changes in the balance of the noncontrolling interests for 2011 and 2010 are as follows (in thousands):

	2011	2010
Balance — January 1	\$ 11,171	\$ 4,967
Sale of KUE Digital Inc.	(2,153)	
Allocation of income (losses)	1,902	(2,086)
Noncontrolling interest related to CIS acquisition	7,996	
Other	<u>(630)</u>	<u>294</u>
Balance — December 31	<u><u>\$ 10,290</u></u>	<u><u>\$ 11,171</u></u>

17. FAIR VALUE MEASUREMENTS

Fair value guidance defines fair value as the exchange price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date. Fair value guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels are described as follows:

- Level 1: Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.
- Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instruments' valuation.

The fair value hierarchy for those assets and liabilities measured at fair value at December 31, 2011 and 2010, is as follows (in thousands):

	2011 Fair Value				Balance Sheet Classification
	Level 1	Level 2	Level 3	Total	
Assets:					
Cash equivalents	\$ 53,467	\$ -	\$ -	\$ 53,467	Cash and cash equivalents
Short-term marketable securities	35,072	5,914		40,986	Short-term marketable securities
Impaired long-lived assets		1,362		1,362	Property and equipment, net
Investments	83,692	52,942		136,634	Long-term investments
Foreign currency hedge		2,616		2,616	Other assets
Investments in deferred compensation plan		6,365		6,365	Other assets
Liabilities:					
Interest rate swaps		1,560		1,560	Other accrued liabilities
2010 Fair Value					
	Level 1	Level 2	Level 3	Total	Balance Sheet Classification
Assets:					
Cash equivalents	\$ 77,713	\$ -	\$ -	\$ 77,713	Cash and cash equivalents
Short-term marketable securities	198,953			198,953	Short-term marketable securities
Impaired long-lived assets		60,807		60,807	Property and equipment, net
Investments	141,607	82,329		223,936	Long-term investments
Foreign currency hedge		2,936		2,936	Other assets
Investments in deferred compensation plan		6,357		6,357	Other assets
Liabilities:					
Interest rate swaps		4,632		4,632	Other accrued liabilities

Cash Equivalents — The Company has invested in short-term marketable money market funds with maturity dates less than three months at date of purchase.

Short-Term Marketable Securities — The Company has invested in corporate debt securities which it generally holds for periods of less than six months from date of purchase.

Derivatives — Derivative assets and liabilities within the scope of ASC 815, *Derivatives and Hedging*, are required to be recorded at fair value. The Company has two interest rate swaps that are marked to market based on observable rates at commonly quoted intervals for the full term of the swaps and, therefore, are considered to be Level 2 financial instruments. The Company has also entered into a four-year forward currency hedge based on the British pound. The hedge is marked to market based on observable daily quotes in the currency markets for the British pound and is, therefore, considered a Level 2 financial instrument (see Note 14).

Long-Lived Assets, Purchase Price Allocation Adjustment of Property, and Equipment and Assets Held for Sale — In accordance with guidance related to the impairment of long-lived assets, the Company performs an impairment test whenever events and changes in circumstances indicate that impairment might have occurred.

As of December 31, 2011, these tests revealed that certain long-lived assets, with a carrying amount of \$20.7 million, needed to be written down to an estimated fair value of \$1.4 million, resulting in an impairment charge of \$19.3 million, which was included in depreciation expense for the fiscal year ended December 31, 2011.

As of December 31, 2010, these tests revealed that certain long-lived assets, with a carrying amount of \$71.0 million, needed to be written down to an estimated fair value of \$60.8 million, resulting in an impairment charge of \$10.2 million, which was included in depreciation expense for the fiscal year ended December 31, 2010.

The estimation of fair value required quoted prices for similar assets and liabilities in active markets, quoted prices for similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data.

Long-Term Debt — For the CMBS loan and the Notes, management's estimate of fair value was determined with assistance from an external valuation firm. The carrying value of the RBS loan approximates its fair value. For the senior mezzanine loan, the junior mezzanine loan from affiliate, and the loan from affiliate, it is not practicable to estimate fair value due to limited market activity and the junior mezzanine's and loan from affiliate's related-party nature. These estimated fair values at December 31, 2011 and 2010, are as follows (in thousands):

	2011 Fair Value	2010 Fair Value
CMBS loan	\$ 509,000	\$ 554,000
Senior subordinated notes	241,000	256,000

18. PARTNERS' EQUITY

Common Partner Units — At December 31, 2011 and 2010, the Company had 2,239,551 common partner units outstanding, of which KUE Management Inc., the Company's general partner, held 1,464 units and limited partners held the remaining units.

Profits Participation Limited Partner Units — At December 31, 2011 and 2010, the Company had 251,164 profits participation limited partner units (PPUs) outstanding. PPUs were issued in conjunction with the sale of units to investors. PPUs are limited to 11% of the aggregate number of total units outstanding. KULG LLC (KULG) is entitled to hold 9/11ths and employees and others are limited to 2/11ths of the PPUs. KULG held 224,164 PPUs; employees and others held 27,000 PPUs. The PPUs entitle the holders to share in increases in value of the Company, upon distributions, liquidation, or sale of the Company, based on the number of PPUs they hold divided by the total number of common partner units and PPUs outstanding.

For the PPUs held by employees and others, this sharing percentage applies to the Company's value in excess of the value of total contributions. The PPUs held by KULG participate after the value of the Company is in excess of the total value of contributions, plus 8% per annum.

PPUs held by employees and others vest over a four-year period, and will result in compensation expense to the extent that the Company's value increases to a level where amounts are due to the holders. PPUs held by KULG were fully vested upon issuance. At December 31, 2011 and 2010, no amounts were due under either of these PPU arrangements.

19. EMPLOYEE BENEFIT PLANS

ASC 718, *Compensation — Stock Compensation*, requires that compensation costs relating to share-based payment transactions be recognized in the consolidated financial statements, with the cost measured based on the estimated fair value of the equity or liability instruments issued. Costs attributable to stock appreciation rights and unit appreciation rights granted subsequent to the adoption of ASC 718 are recognized in accordance with the graded vesting attribution method.

KUE L.P. Unit Appreciation Rights — KUE L.P. has a Unit Appreciation Rights Plan. KUE L.P.'s Unit Appreciation Rights Plan has been approved by the Board of Directors of KUE Management Inc., the Company's general partner, and provides the Company with the authority to grant unit appreciation rights to directors, officers, and key employees of the Company. The unit appreciation rights vest annually over a period of up to five years from the grant date, have an expiration date of 10 years from the grant date, and are redeemable in cash at the holder's discretion. Fifty percent of the unit appreciation rights that vest during a year are exercisable upon vesting, and the remaining balance is exercisable upon occurrence of certain conditions, such as termination of employment.

At December 31, 2011 and 2010, KUE L.P. had 3,829 and 9,976 unit appreciation rights outstanding, respectively, of which 2,026 and 8,872 unit appreciation rights, respectively, were fully vested. During 2011, the Company canceled 8,527 unit appreciation rights. No compensation expense has been recorded for 2011 and 2010, as the exercise price of the unit appreciation rights was higher than the approximate fair values at December 31, 2011 and 2010.

KS Stock Appreciation Rights — KUEH's subsidiary, KS, adopted a stock appreciation rights (SARs) plan in April 2004. The SARs plan has been approved by KS' Board of Directors and provides KS with the authority to grant SARs to certain employees of KS and its subsidiaries. SARs have been granted to certain directors and key employees of KUEH. The SARs vest annually over a period of up to five years from the grant date, have an expiration date of 10 years from the grant date, and are redeemable in cash at the holder's discretion. KS recognizes a liability for the vested portion and compensation expense is charged for the change in the intrinsic value of the vested awards during the year. The intrinsic value is the estimated fair value at the end of the reporting period. KUEH recognizes compensation expense for the change in the intrinsic value of the SARs granted to KUEH employees.

As of December 31, 2011, KS had 3,629 SARs outstanding, related to certain directors and key employees of KUEH and its subsidiaries, of which all were fully vested. As of December 31, 2010, KS had 3,733 shares of SARs outstanding related to certain directors and key employees of KUEH and its subsidiaries, of which 3,661 were fully vested. No SARs were issued or exercised during either of the fiscal years 2011 or 2010. During the fiscal year 2011, KUEH recognized a \$3.3 million reduction in compensation expense related to SARs. Compensation expense related to SARs was \$0.2 million during fiscal year 2010. The intrinsic values of the SARs outstanding and exercisable were \$2.3 million and \$5.6 million as of December 31, 2011 and 2010, respectively.

KS awards stock option grants to certain directors and key employees of KUEH and its subsidiaries. As of December 31, 2011 and 2010, KS had no stock options outstanding. As the stock options are redeemable at the holder's discretion, upon vesting, KUEH recognizes a liability for the vested portion and compensation expense is charged or credited for the change in the intrinsic value of the vested awards during the year. During fiscal years 2011 and 2010, no compensation expense was recognized in connection with vested options. There were no intrinsic values of stock options outstanding and exercisable as of December 31, 2011 or 2010.

The weighted-average remaining contractual term for SARS outstanding and exercisable was 2.6 years as of December 31, 2011.

401(k) Plan — Certain employees are eligible to enroll in the Knowledge Learning Corporation Savings and Investment Plan (the “401(k) Plan”) on January 1, April 1, July 1, or October 1 following their date of hire and can contribute between 1% and 100% of pay up to the IRS maximum allowable. KUEH will match 40 cents for each dollar contributed on the first 5% of compensation.

Nonqualified Deferred Compensation Plan — KUEH offers highly compensated employees who are excluded from participating in the 401(k) Plan the ability to participate in the Knowledge Learning Corporation Nonqualified Deferred Compensation Plan. This plan allows employees to defer between 1% and 100% of base and bonus compensation. KUEH will match 40 cents for each dollar contributed on the first 5% of compensation.

Employer matching contribution expense for the 401(k) Plan and the Nonqualified Deferred Compensation Plan totaled \$2.3 million in fiscal years 2011 and 2010.

20. INCOME TAXES

The provision for income taxes at December 31, 2011 and 2010, included the following (in thousands)

	2011	2010
Continuing operations:		
Current:		
Federal	\$ (132)	\$ 1,394
State	(2,411)	(3,831)
Foreign	<u>1,909</u>	<u>14,226</u>
Total current (expense) benefit	<u>(634)</u>	<u>11,789</u>
Deferred:		
Federal	25,523	6,579
State	8,231	2,524
Foreign	<u>6,225</u>	<u>3,483</u>
Total deferred benefit	<u>39,979</u>	<u>12,586</u>
Income tax benefit from continuing operations	<u>\$ 39,345</u>	<u>\$ 24,375</u>

Under ASC 740, *Income Taxes*, deferred taxes are recorded to give recognition to temporary differences between the tax basis of assets or liabilities and their reported amounts in the consolidated balance sheets. The tax effects of these temporary differences are recorded as deferred tax assets or deferred tax liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in future years. Deferred tax liabilities generally represent items that have been deducted for tax purposes, but have not yet been recorded in the consolidated statements of operations.

Deferred tax assets and liabilities as of December 31, 2011 and 2010, included the following:

	2011	2010
Deferred tax assets:		
Tax credits	\$ 16,008	\$ 13,486
Compensation payments	6,607	9,680
Net operating loss carryforwards	46,509	28,219
Self-insurance reserves	17,019	16,316
Capital lease obligations	17,653	19,862
Other	<u>26,441</u>	<u>20,902</u>
Total deferred tax assets	130,237	108,465
Valuation allowance	<u>(5,733)</u>	<u>(5,417)</u>
Net deferred tax assets	124,504	103,048
Deferred tax liabilities — fixed assets/intangibles	<u>(143,545)</u>	<u>(165,338)</u>
Net deferred tax liability	<u>\$ (19,041)</u>	<u>\$ (62,290)</u>

The Company had federal net operating loss carryforwards of \$87.5 million as of December 31, 2011, and \$42.7 million as of December 31, 2010. The Company had state net operating loss carryforwards of \$164.5 million as of December 31, 2011, and \$97.8 million as of December 31, 2010, which start expiring in 2012. The Company had federal tax general business, foreign tax, and alternative minimum tax credit carryforwards of \$13.5 million as of December 31, 2011, and \$11.3 million as of December 31, 2010, which start expiring in 2020. The Company had state credit carryforwards of \$1.5 million as of December 31, 2011, and \$1.3 million as of December 31, 2010, which have an unlimited carryforward period. The Company also operates in several foreign jurisdictions. As of December 31, 2011 and 2010, it had foreign net operating losses of \$18.8 million and \$30.4 million, respectively, which have an unlimited carryforward period.

The Company cannot assert on a more-likely-than-not basis that the acquired foreign net operating losses, certain capital losses, and certain federal and state net operating losses and tax credits will be utilized before they expire. Therefore, at December 31, 2011, the Company had recorded a valuation allowance of \$5.7 million to offset deferred tax assets related to those net operating losses, capital losses, and tax credits. During 2011, the recorded valuation allowance increased by \$0.3 million.

The Company or any one of its subsidiaries files income tax returns in the United States, various states, Canada, United Kingdom, Singapore, and various other foreign jurisdictions. With few exceptions, all domestic subsidiaries of the Company are no longer subject to examinations by tax authorities for years before 2008. Canadian tax years remain open from 2004. All other foreign statutes remain open from 2008.

As of December 31, 2011 and 2010, the liability for the Company's uncertain tax positions, including interest and penalties, totaled \$6.6 million and \$10.7 million, respectively. As of December 31, 2011 and 2010, the estimated potential tax-related interest and penalties were \$1.2 million and \$2.8 million, respectively. The Company recognizes accrued interest and penalties related to uncertain tax positions in federal, state, and foreign income tax expense. If the Company's positions were sustained by the taxing authority in favor of the Company, approximately \$6.1 million for December 31, 2011, and approximately \$8.9 million for December 31, 2010, would be recognized as a reduction in the tax provision, which would reduce the Company's effective tax rate.

The Company believes it is reasonably possible that, within the next 12 months, \$4.1 million of previously unrecognized tax benefits related to certain federal, state, and foreign filing positions, all of which would reduce the Company's effective tax rate, will be recorded primarily as a result of the expiration of federal, state, and foreign statutes of limitation.

A reconciliation of the beginning and ending amount of unrecognized tax benefits for 2011 and 2010 is as follows:

	2011	2010
Gross unrecognized tax benefits — beginning of year	\$ 7,975	\$ 17,103
Gross (decrease) increase in tax positions for prior years	(229)	815
Gross increase in tax positions for current years	230	620
Settlements		
Lapse of statute of limitations	<u>(2,589)</u>	<u>(10,563)</u>
Gross unrecognized tax benefits — end of year	<u>\$ 5,387</u>	<u>\$ 7,975</u>

21. RELATED-PARTY TRANSACTIONS

Fixed Overhead Payment Agreement — KUE Inc. and KUE LLC are required to pay annually to related parties KULG and Knowledge Universe Limited LLC \$17.5 million and \$2.5 million, respectively, for services provided to the Company and its subsidiaries. The payments are made in quarterly installments and cover salaries and bonuses of the affiliates' employees providing services to the Company and its subsidiaries, fees, and expenses related to financing transactions and acquisitions, professional fees, and other administrative expenses. These expenses are included within general and administrative expenses in the consolidated statements of operations.

Real Estate Services — One of KUE LP's affiliates, Greenstreet Real Estate Partners, L.P., provides real estate asset management and consulting services to KC Propco for an annual management fee of \$8.3 million.

KUEH's subsidiary, KUE LLC had leases for nine child care facilities owned by subsidiaries of Greenstreet Real Estate Holdings, L.P. ("Greenstreet Holdings") as of December 31, 2010. During the fiscal year ended December 31, 2011, Greenstreet Holdings sold one of these facilities to an affiliate of KUE LLC and another to a third party, both of which continue to lease the facilities to KUE LLC on the same terms and conditions as existed prior to the sale. As of December 31, 2011, there are seven remaining leases for child care facilities with Greenstreet Holdings. These leases have an average duration of 15 years from their respective lease commencement dates.

Long-Term Debt — Condors, LLC, an affiliate of KC Propco, was the lender under the junior mezzanine loan entered into in connection with the CMBS financing. This loan was fully repaid during 2011 (see Note 12).

In connection with this loan, KC Propco paid interest to Condors, LLC of \$1.5 million and \$6.5 million during fiscal years 2011 and 2010, respectively.

Knowledge Universe Holdings LLC (KUH), an affiliate of the Company, was the lender under a \$100 million loan arrangement with KUE Inc. (see Note 12). In connection with that loan, KUE Inc. paid interest to KUH of \$0.8 million and \$9.0 million, during the fiscal years 2011 and 2010, respectively.

22. COMMITMENTS AND CONTINGENCIES

The Company is subject to claims and litigation arising in the ordinary course of business. The Company believes that none of the claims or litigation of which it is aware will materially affect its consolidated financial statements, although assurance cannot be given with respect to the ultimate outcome of any such actions.

23. SUBSEQUENT EVENTS

The Company had no other subsequent events to report as evaluated through June 28, 2012, the date the consolidated financial statements were available to be issued.

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