

# Electronic Education Report



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Business Intelligence on Opportunities in the Educational Software Industry

## Pearson Expands with eCollege, Harcourt Units

Pearson's (London) \$477 million acquisition of eCollege (Chicago) this month could drive the growth of course management systems in K-12 while Pearson's \$950 million acquisition last month of Harcourt Education International (Oxford, U.K.) and Harcourt Assessment (San Antonio), furthers its international aspirations in education and enhances its offerings in the U.S. testing market.

Pearson anticipates that its scale and reach will enable eCollege to serve new customers in schools, higher education, and the professional/vocational markets in the U.S. and globally. Additionally, the two companies will reduce costs by sharing hosting, technical and support services while eliminating eCollege's corporate and public company costs.

See 'Pearson' on p. 4

## Scientific Learning on Track For Year After Q1

Scientific Learning (Oakland, Calif.) this month reported higher first-quarter revenue and lower first-quarter booked sales versus one year ago, while reaffirming overall guidance for the year.

First-quarter revenue was \$8.8 million, up 13% from \$7.8 million in 2006. The company reported an operating loss of \$3.1 million and a net loss of \$2.6 million as investments in sales and marketing were made in advance of the peak selling season. Management, which views booked sales as a better measure of company results than revenue, reported booked sales declined 4% in the quarter, versus a first-quarter 2006 increase of 44%.

"Our quarterly growth rates are frequently lumpy, and the first quarter is

See 'Scientific Learning' on p. 6

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### EER PULSE

#### Public High School Drop-Out Rates, 2003-2004

- Dropout rates ranged from 1.8% in Connecticut and New Jersey to 7.9% in Louisiana.
- 12 states had dropout rates of less than 3%: Connecticut, New Jersey, North Dakota, Iowa, Kansas, Indiana, Maine, Vermont, Nebraska, Virginia, Pennsylvania, Mississippi.
- 5 states had dropout rates over 6%: Delaware, Washington, Arizona, Alaska, Louisiana.

Source: NCES, May 2007

## E-Rate Marks 10 Years of Funding Telecommunications Services for Schools

The E-Rate program, which is credited with helping to bridge the technology gap between lower income and more affluent school districts, begins its second decade poised to help schools sustain their current technology access levels and expand bandwidth to keep pace with the expansion of digital resources available online.

A provision of the Telecommunications Act of 1996, the E-Rate program was established under the Federal Communications Commission in 1997 to provide schools and libraries, particularly those in rural and low-income urban areas,

with access to new telecommunications technology and the resources of the Internet.

According to the Schools and Libraries Division of the Universal Service Administrative Co., which administers E-Rate for the Federal Communications Commission, \$3.69 billion was requested by schools and libraries for funding year 2007, up from the \$3.55 billion requested for funding year 2006. The number of applications increased from 39,416 to 40,354.

Several factors traditionally reduce the funds requested as the process moves along, including elimination of duplicate or ineligible requests and incomplete applications. The annual E-Rate funding cap is \$2.25 billion.

Late in April, the first wave of E-Rate funding for 2007,

totaling more than \$202 million was released. Earlier this month, Wave 51 for funding year 2006 was released, bringing cumulative funding approved for the year to \$1.9 billion. Funding year 2006 is ahead of the pace of 2005 when 48 waves of funding, totaling \$1.67 billion, had been released by mid-May.

Peter Kaplan, director of regulatory affairs at Funds for Learning, which provides E-Rate support services to technology service providers, schools and libraries, told *EER* that E-Rate funding has been critical to connecting schools to the Internet because E-Rate funding is the largest dedicated pot of technology money available. It will be critical to helping schools meet the ongoing costs of Internet access, he said, noting that E-Rate funding is not subject to the annual fluctuations of other budget streams.

"It's predictable, sustainable and school districts are making use of it," Kaplan said. Dealing with E-Rate can be stressful and difficult as rules and deadlines change, according to Kaplan. Because there is high turnover in districts of people who handle E-Rate there is an ongoing need for training and support, which some, but not all, states provide, he said.

"Most schools and libraries participate in E-Rate, but many could get more than they apply for," Kaplan said. He described E-Rate as a "kinder, gentler" program in recent years, with E-Rate officials understanding the need to



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## What E-Rate Does

The E-Rate program provides up to \$2.25 billion annually in discounts on telecommunications, Internet access and internal networking to public and private schools and public libraries.

Schools and libraries apply for discounts of between 20% and 90% on advanced telecommunications services. The discounts are based on each applicant's poverty level and each applicant pays the non-discounted portion of the services. Since 1998, the E-Rate fund has provided nearly \$19 billion in discounted telecommunications services.

Funds are requested for Internet connections, Internet access and telecom services. Partly due to the program, 99% of public schools are now connected to the Internet.

**10-YEAR E-RATE DISCOUNT TOTALS**  
(in thousands)

<b>State</b>	<b>Commitment</b>	<b>State</b>	<b>Commitment</b>
Alabama	\$276,548	Nebraska	\$62,498
Alaska	\$132,326	Nevada	\$38,098
American Samoa	\$15,069	New Hampshire	\$15,875
Arizona	\$439,350	New Jersey	\$435,858
Arkansas	\$154,410	New Mexico	\$343,260
California	\$2,567,516	New York	\$2,538,425
Colorado	\$157,759	North Carolina	\$365,002
Connecticut	\$226,176	North Dakota	\$32,629
Delaware	\$11,045	No. Mariana Islands	\$9,649
District of Columbia	\$107,469	Ohio	\$611,378
Florida	\$572,259	Oklahoma	\$348,423
Georgia	\$578,706	Oregon	\$114,282
Guam	\$18,822	Pennsylvania	\$629,303
Hawaii	\$34,311	Puerto Rico	\$253,966
Idaho	\$37,227	Rhode Island	\$58,959
Illinois	\$832,208	South Carolina	\$390,243
Indiana	\$204,168	South Dakota	\$42,258
Iowa	\$90,204	Tennessee	\$445,989
Kansas	\$114,872	Texas	\$1,967,501
Kentucky	\$300,780	Utah	\$92,394
Louisiana	\$375,262	Vermont	\$15,714
Maine	\$50,523	Virgin Islands	\$25,195
Maryland	\$151,823	Virginia	\$238,422
Massachusetts	\$305,671	Washington	\$198,201
Michigan	\$537,033	West Virginia	\$80,233
Minnesota	\$209,942	Wisconsin	\$236,611
Mississippi	\$317,240	Wyoming	\$22,969
Missouri	\$351,149	<b>Total</b>	<b>\$18,817,387</b>
Montana	\$34,185		

Source: E-Rate: 10 Years of Connecting Kids and Community

reach out to help schools access money, rather than looking for reasons to deny funding.

A good example of the persistent barriers to optimal use of E-Rate funding is the fact while \$96 million was set aside late in 2005 to help districts in Alabama, Louisiana

and Mississippi directly affected by Hurricane Katrina restore their telecommunications, only \$28 million was requested and only \$17 million was committed. Schools were offered a 90% discount on requests for internal connections, referring to the wiring and computer equipment that provide the Internet and networked commu-

nications, in line with schools' existing technology plans or to restore equivalent systems to what they had been before Katrina.

Kaplan attributed the low funding request total to all of the issues schools were dealing with post-Katrina, as well as their inability to know how many students would be returning. "Schools will use E-Rate as they build back," he said, adding schools will not be built back to what they were, but will reflect the changing times. ■

### **Pearson, cont'd. from p. 1**

eCollege provides on-demand software services, including course management, virtual campuses and assessment and reporting tools. The company partners with educational institutions to design, build and support online degree, certificate, diploma and professional development programs.

Pearson is acquiring the eLearning division of eCollege, which generated \$52.1 million in revenue in 2006 and is projecting 20% to 23% revenue growth in 2007 to \$62.5 million to \$64.5 million. In addition to its eLearning Division, eCollege operates an Enrollment Division, offering products and services to help institutions drive new enrollments and increase student retention, which resulted from the company's 2003 acquisition of Datamark. The enrollment division will be sold for \$41 million to an investor group led by Oakleigh Thorne, eCollege's chairman and CEO.

Trace Urdan, managing director at investment bank Signal Hill Capital (Baltimore), told *EER* that the \$477 million Pearson is paying for eCollege is a reasonable price for a fast-growing, highly profitable technology business. eCollege has expectations of growing earnings by 30% per year and the \$22.45 price per share paid is only 7% above where the stock closed last Friday, he said.

Urdan sees Pearson's acquisition of eCollege, along with Blackboard (Washington D.C.) and eCollege announcements of new K-12 clients each quarter, as an endorsement of the course management product category in schools. Standard as a way for students and teachers to interact on college campuses, Urdan said course management systems are gaining wider acceptance in K-12, particularly at the high school level.

### **Harcourt Acquisitions**

Pearson's \$950 million purchase price for Harcourt Education International and Harcourt Assessment is almost twice reported 2006 revenue of \$524 million for the two business units. The cash transaction is expected to be completed in stages in the second half of the year as the regulatory review process unfolds.

Pearson, the largest educational publisher in the U.S. with total global revenue from its K-12 segment of \$2.68 billion in 2006, generated almost all of that in the U.S. Harcourt's international business, including school textbooks and nonfiction publishing, generated about \$171 million in revenue in 2006.

Pearson, the largest administrator and scorer of tests, saw U.S. testing revenue increase between 5% and 10% in 2006 and is expected to benefit from Harcourt's strength in test development. The two have partnered in the past on state testing contracts. Harcourt Assessment has gone through a rough patch, including a management shake-up, after declining revenue in 2005 and 2006 (down 4% to about \$353 million in 2006), when it failed to capture a significant share of the large contract opportunity in 2005 and was beset with scoring and reporting problems that cost it a contract in Illinois last year. A particular attraction for Pearson is the *Stanford Achievement Test* as Pearson Educational Measurement does not have such an offering.

The pending sale of Harcourt Education International and Harcourt Assessment leaves Harcourt's basal textbook and supplemental materials businesses to be sold. These businesses had reported combined revenue of \$1.11 billion in 2006 and operating profit of \$228 million. Harcourt's parent Reed Elsevier (London) said in February that it would sell the education business to focus on its science, medical, legal and business information businesses, which are migrating to digital delivery more quickly than education. ■

### **Princeton Review, Educate and Kaplan Grow Revenue in Q1**

Princeton Review first quarter 2007 revenue increased 19.5% versus first-quarter 2006 to \$40.2 million, driven by gains in K-12 Services and Test Preparation Services.

First-quarter 2007 results included a gain of \$4.5 million from the February sale of the company's Embark college admissions services business, which helped turn a net loss of \$1.9 million in first quarter 2006 to net income of \$4.7 million in first quarter 2007.

"Even discounting the sale of Embark, underlying financial performance improved this quarter," CEO John Katzman said. "We continue to grow revenues and reduce our cost structure. We feel we're getting back on track."

K-12 Services revenue for the quarter was \$13.1 million, up 71.4% from the prior year's quarter. A major contributor to the growth was \$3.5 million in revenue from contracts that closed in the first quarter, rather than fourth quarter 2006, although the company also expanded in K-12 in Florida, California and Colorado.

Test Preparation Services revenue increased 5.6% from \$25.1 million in first quarter 2006 to \$26.5 million in 2007. The increase largely resulted from gains in SES revenue and better-than-expected demand for small-group tutoring, which were partially offset by lower SAT and MCAT revenue.

#### Educate Up Ahead of Privatization

Educate's first-quarter 2007 revenue increased 4.6% versus first quarter 2006 to \$97.2 million, led by growth in Educate Online, Educate Products, Educate Services and Progressus school-based and early intervention therapy services provider.

Educate Online revenue grew 54.3% to \$7.8 million as a result of expanded service offerings to students in *No Child Left Behind* programs paid for through government education funding. Increased online revenue resulted in operating profit improvement as incremental hours of service contributed toward the fixed costs of the program.

Educate Products revenue grew 35.4% to \$3.7 million because of a larger portfolio of education products, which now includes Hooked on Spanish, Hooked on the Bible and Hooked on English, and expanded distribution channels.

The 6.4% increase in Educate Services revenue to \$45.9 million was driven by additional contracts for Catapult Learning, including renewal of services in New Orleans and expansion of the European business.

### PRINCETON REVIEW, EDUCATE & KAPLAN Q1 2007 VS. 2006 (\$ in thousands)

Princeton Review			
	2007	2006	% Chg.
Total Rev.	\$40,170	\$33,612	19.5%
Test Prep	\$26,462	\$25,061	5.6%
K-12 Serv.	\$13,082	\$7,631	71.4%
Op. Income	-\$622	-\$1,994	NA
Net Income	\$4,696	-\$1,908	265.3%
Educate			
Total Rev.	\$97,183	\$92,925	4.6%
Services	\$45,929	\$43,165	6.4%
Franchise	\$13,336	\$14,284	-6.6%
Catapult	\$22,069	\$20,075	9.9%
European	\$10,524	\$8,806	19.5%
Owned Ctrs.	\$32,614	\$35,873	-9.1%
Products	\$3,701	\$2,733	35.4%
Progressus	\$7,171	\$6,120	17.1%
Ed. Online	\$7,768	\$5,034	54.3%
Op. Income	\$8,410	\$5,915	42.2%
Net Income	\$2,351	\$3,333	-29.5%
Kaplan			
Total Rev.	\$475,781	\$408,934	16.3%
Test Prep	\$134,279	\$109,819	22.3%
Op. Income	\$34,343	\$52,645	-34.8%
Test Prep	\$14,631	\$22,132	-33.9%

Source: Princeton Review, Educate, Kaplan

Catapult Learning provides educational services, including summer school programs, to schools.

The management buyout that will take Educate private is expected to be completed in June 2007.

#### Kaplan Test Prep Revenue Up

Revenue at Kaplan Inc. (New York) increased 16.3% in the first quarter 2007 to \$475.8 million, while revenue for the Test Preparation division grew 22.3% to \$134.3 million. Test preparation, which includes standardized test prep-

aration, English-language offerings, and the K-12 and Score! businesses, grew largely due to acquisitions while revenue from the K-12 and Score! centers declined. Test prep operating income declined 33.9% to \$14.6 million largely due to the weaker results from K-12 and Score! ■

### Scientific Learning, cont'd. from p. 1

by far the smallest sales and revenue quarter of the year," chairman and CEO Bob Bowen said. "Entering the second quarter with a larger sales organization and record pipelines, we remain confident about our prospects for the year overall."

Scientific Learning is projecting 2007 revenue will be in the range of \$49 million to \$52 million, up from \$41 million in 2006. The company expects to report a net profit of between \$3.7 million and \$4.6 million compared to \$208,000 in 2006. Fully diluted earnings per share in 2007 are expected to be in the range of 20 cents to 25 cents compared to 1 cent in 2006.

#### Progress on Key Objectives

As Scientific Learning celebrated the 10<sup>th</sup> anniversary of its first Fast ForWord product, management reported continued progress on its key objectives of building acceptance of Fast ForWord as a mainstream intervention solution, increasing capacity and productivity in sales and expanding the product line.

At the end of the first quarter, Scientific Learning had 46 quota-bearing sales positions, up from 39 at the end of first quarter 2006. The company goal is 53 representatives by the end of the year versus 42 in the prior year.

#### SCIENTIFIC LEARNING FINANCIALS Q1 2007 vs. Q1 2006 (\$ in millions)

	2007	2006
Revenue	\$8.8	\$7.8
Operating loss	-\$3.1	-\$2.3
Net loss	-\$2.6	-\$2.2

Source: Company reports

Progress continues on two Scientific Learning product initiatives developed in response to customer interest. The company is conducting technical field tests for its Reading Progress Indicator, a short electronic assessment to assesses student progress that is expected to lead to quicker, wider implementations. Research has been completed for a 30-minute protocol for Fast ForWord Language use with the shorter protocols, requested by schools to ease scheduling problems, scheduled for August release.

With the addition of a new partnership to bring Scientific Learning to South Korea, Fast ForWord products will be available in 38 countries. The company expects to reach the 1 million user mark in the second quarter 2007. ■

### Curriculum Advantage Acquires Training Resource Associates

Curriculum Advantage (Duluth, Ga.) this month acquired the assets, customers and employees of educational training company Training Resource Associates (Ridgeland, Miss.) for an undisclosed sum.

Training Resource Associates provides training programs around motivation and team-building, classroom management and advancing student-teacher learning throughout the Southeast U.S.

Curriculum Advantage management said the Training Resource Associates acquisition will expand Curriculum Advantage's reach and effectiveness in the Southeast, while providing a broad array of professional development courses to complement Curriculum Advantage's flagship product Classworks, a network-based system of K-12 reading and mathematics curriculum and learning tools.

"Additionally, the personnel from Training Resource Associates are a highly trained and well-respected group of leaders in their field who will be a great addition to the Curriculum Advantage team," said Curriculum Advantage president and CEO Lindsey Cooke. Jo Ann Walton, who founded TRA in 1998, was named Curriculum Advantage's vice president of sales for the Southern region.

#### Moving to the Internet

Also this month, Curriculum Advantage completed the

first part of its plan to make Classworks available over the Internet by providing district and school administrators with Web access to results. The Web-based access allows a superintendent or principal to bring up a dashboard to review all Classworks implementations with views of whole district scores, individual classes, demographics or students at anytime from anywhere. Classworks also can generate status reports to be e-mailed throughout the district.

The second phase of Classworks on the Internet, currently under development, is a teacher interface, which will allow classroom teachers to monitor and assign individual learning plans for each student from any computer with an Internet connection.

The third phase converts Classworks' content—5,000 hours of lessons, quizzes and remediation—to a form available via the Internet. To date, some 4,000 of 10,000 activities are ready for browser-based access. ■

## LeapFrog Sales Decline in Q1 While Losses Grow

LeapFrog Enterprises (Emeryville, Calif.) this month reported first-quarter 2007 sales of \$5 million for its

SchoolHouse division, down 35.1% from \$7.7 million in the first quarter 2006. The division's operating loss for the quarter was \$600,000 as gross margin declined from 63.6% in the first quarter 2006 to 56.5% in the first quarter 2007.

President and CEO Jeffrey Katz said SchoolHouse is on track with the targets the company has set for the division. At the end of 2006, LeapFrog announced plans to align its SchoolHouse division to the company's consumer strategy, reducing the size of the unit in an attempt to cut losses.

The SchoolHouse team is focused on the second quarter, the most important quarter for the division, Katz said. He reiterated overall company expectations for full year 2007 saying a modest sales decline from 2006 sales of \$502.3 million is projected along with a decline in operating expenses and an improvement in net loss.

### Decision on Patent Infringement Affirmed

Also this month, the United States Court of Appeals for the District of Delaware affirmed a lower court ruling that Fisher-Price and Mattel did not infringe on a LeapFrog technology patent for its LeapPad interactive books when Fisher Price introduced its PowerTouch reading system.

## EER STOCKWATCH

Share Price Values for Instructional Software Publishers, April 27 - May 11, 2007  
(closing prices)

	Ticker	May 11	May 4	April 27	% Chg. 5/11-4/27	% Chg. YTD
LeapFrog*	LF	\$10.22	\$11.12	\$11.13	-8.2%	7.8%
Plato Learning	TUTR	\$4.21	\$4.20	\$4.22	-0.2%	-21.7%
Renaissance Learning	RLRN	\$12.12	\$11.95	\$12.30	-1.5%	-32.3%
Scientific Learning	SCIL	\$6.74	\$6.95	\$6.98	-3.4%	24.6%
Siboney Corp.	SBON.OB	\$0.10	\$0.12	\$0.09	11.1%	-9.1%
Average for Group		\$6.68	\$6.87	\$6.95	-3.9%	-12.7%
NASDAQ Nat'l. Mkt. Composite Index		2,562.22	2,572.15	2,557.21	0.2%	5.4%

\*LeapFrog is the only index company listed on the NYSE, all others listed on NASDAQ

Source: Yahoo! Finance; Simba Information

LEAPFROG FINANCIALS Q1 2007 VS. Q1 2006 (\$ in millions)		
	2007	2006
Revenue	\$60.9	\$66.5
SchoolHouse	\$5.0	\$7.7
Operating loss	-\$30.2	-\$29.2
Net loss	-\$30.4	-\$23.6
Source: Company reports		

LeapFrog filed the original suit in 2003. Following a deadlocked jury trial in May 2005, the parties agreed the case would be submitted to the trial court for decision. The court ruled that the patent was not infringed in March 2006, prompting the LeapFrog appeal.

“We are disappointed in the outcome but we will continue to defend our intellectual property,” LeapFrog’s general counsel Peter Wong told *EER*, adding. “We do not expect this ruling to have an impact on our business.” Since Fisher Price no longer sells PowerTouch, it probably will not. ■

## GenevaLogic Adds to Classroom Management Options

GenevaLogic (Portland, Ore. and Switzerland) is building out its line of classroom management software as schools integrate more technology into daily lessons.

CEO Kurt Grenier told *EER* that GenevaLogic’s products are used primarily in media centers and labs to give an instructor control over students’ computers from the front of the room, but the company is looking to expand usage.

Founded in 1996, GenevaLogic’s flagship product is its Vision classroom management software that is in more than 50,000 classrooms worldwide. Grenier said 80% of the company’s business comes from the U.S. with usage primarily in high schools.

GenevaLogic’s focus is on teachers, addressing their changing need, and helping them use technology to optimize instruction, Grenier said. Teachers use Vision

to supervise student progress, monitor or prevent Web browsing, share computer screens and remotely control student computers.

The company has grown from a four-person startup to over 50 employees, including four sales account managers. Products also are sold through a channel of 60 resellers. In December 2006, GenevaLogic opened an office in Beijing to represent the company in China and other Asian countries.

In January, GenevaLogic introduced the Vision Class Kit, the Vision School Kit and the Vision School Kit Plus which bundle company products together. Grenier said the new kits were designed to provide an easy and cost-effective way to provide the company’s most requested tools to teachers.

The Vision Class Kit includes App-Control, which keeps the whole class learning together by remotely launching applications, sharing documents and managing access, and Surf-Lock2, which allows teachers to turn browsing on or off from their computer with a single click, limits students’ access to selected Web sites, and stops or limits browsing instantly for a single student or the entire class.

The Vision School Kit was designed for schools that want to provide classroom management software tools to numerous classrooms or multiple computer labs. It includes school-wide licenses for Vision6, App-Control, SurfLock2 and Pointer, a plug-in that allows teachers to annotate text or graphics on the computer while teaching.

With the Vision School Kit Plus, schools customize their classroom management software by adding Protect-On2, which allows teachers to save and store the original configuration of classroom computers to avoid viruses and unwanted downloads, or Print-Limit Pro, which helps schools manage printing across multi-platform environments. Grenier said helping schools track printer usage to see trends reduces printing costs by 40% to 70%.

The Vision Class Kit is priced at \$999 per lab or classroom, with a limit of two per school. A site license for the Vision School Kit is \$3,999 for schools with fewer than 1,000 students and \$4,499 for schools with 1,000 or more students. Vision School Kit Plus site licenses are \$4,499 for schools with fewer than 1,000 students and \$5,999 for schools with 1,000 or more students. ■