INVESTOOLS INC
Form 10-K
March 17, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2007
Commission File Number: 000-52012

INVESTOOLS INC.

(Exact name of Registrant as specified in its charter)

Delaware	**76-0685039**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
45 Rockefeller Plaza, Suite 2012, New York, New York	**10111**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:
(801) 816-6918

Name of exchange on which registered:	**The NASDAQ Stock Market LLC**
Securities registered pursuant to Section 12(b) of the Act:	**Common Stock, $.01 par value per share**
Securities registered pursuant to Section 12(g) of the Act:	**NONE** (Title of Class)

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No ý

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer ý	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Act). Yes o No ý

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant as of June 30, 2007 (the last business day of the Registrant's most recently completed second fiscal quarter) based on the closing price of the common stock on the NASDAQ Global Market for such date, was $429.0 million. The number of shares of the Registrant's common stock outstanding on March 12, 2008 was 66,013,765.

Documents Incorporated by Reference:

The registrant's definitive proxy statement filed or to be filed with the Securities and Exchange Commission pursuant to Regulation 14A involving the election of directors at the annual meeting of the shareholders of the registrant scheduled to be held on June 6, 2008 is incorporated by reference in Part III of the Form 10-K.

INVESTOOLS INC.
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Forward Looking Statement

Certain statements in this Annual Report on Form 10-K that are not purely historical information, including, without limitation, estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Examples of such forward-looking statements include, but are not limited to, the statements concerning trends in revenue, costs and expenses; our accounting estimates, assumptions and judgments; our business plans relating to each of our products and services; our ability to scale our operations in response to changing demands and expectations of our customers; the level of demand for our products and services; and the competitive nature of and anticipated growth in our markets. Such forward-looking statements may be identified by words such as "believe", "intend", "expect", "may", "could", "would", "will", "will be", "will continue", "should", "plan", "estimate", "project", "contemplate", "anticipate", or other words and terms of similar meaning. In addition, from time to time, we (or our representatives) may make forward-looking statements of this nature in our annual report to shareholders, proxy statement, quarterly reports on Form 10-Q, current reports on Form 8-K, webcasts, press releases or in oral or written presentations to shareholders, securities analysts, members of the financial press or others. All such forward-looking cautionary statements, whether written or oral, and whether made by us or on our behalf, are expressly qualified by these cautionary statements and any other cautionary statements which may accompany the forward-looking statements.

Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, many of which are beyond our control, which may cause actual results, performance or trends to differ materially from those expressed in the forward-looking statements. Potential risks, among others, that could cause actual results to differ materially are discussed under "Item 1A Risk Factors." We assume no obligation to update or revise any forward-looking statements made herein or any other forward-looking statements we make, whether as a result of new information, future events, or otherwise.

PART I

ITEM 1. BUSINESS

Overview

Investools Inc. (referred to as "Investools", the "Company", "we", "us", or "our") operates in two reportable segments: Investor Education and Brokerage Services. We entered the Brokerage Services segment on February 15, 2007, through a merger with thinkorswim Group, Inc. You will find information concerning the financial results and the total assets of each segment in Note 17 to the Consolidated Financial Statements. Information concerning the merger with thinkorswim Group, Inc. will be discussed further in this Annual Report on Form 10-K, which is incorporated herein by reference.

The Company offers market-leading investor education and brokerage and related financial products and services for self-directed investors. Our Investor Education segment offers a full range of investor education products and services that provide lifelong learning in a variety of interactive delivery formats. Our educational products and services cover a broad range of financial products, including equity securities, options, fixed income, index products, futures, other derivatives and foreign exchange. Our Investor Education segment's mission is to educate and empower individual investors to make their own financial decisions to achieve their financial goals at any time or place live or online. Our education products and services offer a unique integration of a disciplined investing process, web-based tools, personalized instruction and support. We have more than 337,000 graduates of our foundation courses and 102,800 active subscribers to our websites.

On February 15, 2007, the Company merged with thinkorswim Group, Inc. ("thinkorswim"), a leading online brokerage firm and provider of related technology-based financial services to self-directed options traders and retail investors. thinkorswim offers customers a broad range of products including equity securities, index products, exchange traded options, futures, mutual funds, bonds and foreign exchange. Since it began its brokerage operations in 2001, thinkorswim has been creating innovative technology for its customers. thinkorswim provides sophisticated trading tools and analytics, including tools for devising and implementing complex, multi-leg options strategies as well as other investment strategies. thinkorswim also provides unique scalable software, desktop, mobile and wireless front-end trading platforms that allow its customers to trade electronically and to implement these complex strategies with single clicks. thinkorswim offers its customers an automated and user friendly account opening process and provides its customers access to its trade desk, which is staffed with experienced traders, who provide real-time customer support via email, chat and telephone. thinkorswim customers are able to monitor their positions, view their account balances, positions, profits and losses on a real time basis. The combination of thinkorswim's unique technology and its customer service has resulted in a high degree of customer loyalty. thinkorswim, Inc. is registered as a broker-dealer with the Securities and Exchange Commission ("SEC") and is registered as an introducing broker with the Commodity Futures Trading Commission ("CFTC"). It is a member of and regulated by the Financial Industry Regulatory Authority ("FINRA") and the National Futures Association ("NFA"). All securities transactions are cleared on a fully disclosed basis pursuant to a clearing agreement with our primary clearing broker, Penson Financial Services.

In connection with the merger with thinkorswim, we acquired thinkorswim Advisors, Inc. ("Advisors"), a subsidiary of thinkorswim and an SEC registered investment advisor. Advisors provides investment management services based upon diversified portfolios, which include alternative investment styles. It also offers traditional and return enhanced investment strategies. Advisors' Red Option division provides a monthly subscription service that provides trade recommendations for a number of options trading strategies. Advisors has an educational division focused on options trading, called Option Planet.

The products and services offered by Investools Inc. have received numerous accolades from third parties including thinkorswim's ranking by Barron's as its top rated software-based online broker and best for options traders in 2006 and 2007, and Prophet's top Barron's ranking for best technical analysis tools from 2002 to 2006.

Investools is a Delaware corporation that was incorporated in 2001. Our corporate offices are located at 45 Rockefeller Plaza, Suite 2012, New York, New York 10111, and our telephone number is 801-816-6918. We also maintain significant operational offices in Draper, Utah and Chicago, Illinois.

We maintain an Internet website at www.investools.com and www.thinkorswim.com. We make available on the Investor Relations section of our website, free of charge, our Annual Reports to shareholders, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4, 5 as soon as reasonably practicable after filing such documents with, or furnishing such documents to, the SEC.

We include our website addresses throughout this filing only as textual references. The information contained on our websites is not incorporated by reference into this Form 10-K.

2007 Significant Business Developments

Acquisition of thinkorswim Group, Inc.

On February 15, 2007, Atomic Acquisition Corp., a wholly-owned subsidiary of Investools merged with and into thinkorswim Group, Inc., a Delaware corporation, and a leading online brokerage company specializing in options. thinkorswim shareholders received merger consideration of $181.7 million in cash and 19.1 million shares of stock valued at $8.75 per share. Also on February 15, 2007, we entered into a Credit Agreement with JPMorgan which provided us with a senior secured term loan of $125 million to fund a portion of the cash consideration and, separately, also provided us with a committed senior secured revolving credit facility of $25 million. Immediately following the transaction, thinkorswim shareholders held approximately 30 percent of the ownership of Investools, and two former thinkorswim shareholders became members of our expanded, eight-member Board of Directors. In connection with the merger with thinkorswim, certain employees and consultants of thinkorswim will now be eligible to participate in a retention bonus pool which equals, in the aggregate, $20 million conditioned upon continued employment. The bonuses will be paid in equal annual installments over the three-year period following the closing of the merger. Such amounts are being expensed over the retention period of three years. The first payment was made in February 2008. In addition, we granted employees and consultants of thinkorswim options to purchase 2,255,563 shares of Common Stock under our 2001 Stock Option Plan, half with an exercise price equal to the fair market value of the underlying Common Stock at the time of grant, and half with an exercise price equal to 150% of such fair market value. Approximately 125,000 of these stock options were granted to consultants to thinkorswim. We have accounted for these in accordance with EITF No. 96-18, "*Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods or Services*".

Acquisition of Certain Exclusivity Rights and Expanded Relationship

On February 27, 2007, we entered into a long-term relationship and acquired certain exclusive rights and intellectual property of a group of active option traders, which was an existing customer of thinkorswim. Pursuant to a definitive agreement, Investools issued 650,000 unregistered common shares, and subject to meeting certain thresholds over annual and cumulative three-year periods, will issue an additional 950,000 contingent shares of unregistered common shares to these traders. The value of the contingent shares were measured in accordance with EITF 96-18 "*Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods or Services*" based upon the value of the common shares at the time the contingent shares are earned. Under the agreement thinkorswim will indefinitely be the exclusive provider for brokerage services to this group of active option traders and their customers, subject to limited termination rights granted to each party.

Business Strategy

We offer retail investors a full range of financial services technology as a leading online broker for the educated investor. Our diverse portfolio of student and brokerage account acquisition channels seeks to initiate each customer relationship based on consistent use of our products and services to create maximum lifetime value per customer. We achieve this goal by offering our students and traders a full range of investor education and transaction services through a broad curriculum of courses in equity securities, options, forex, futures, index products, other derivates and fixed income investment analysis integrated with award winning online brokerage services accessed through software, web-based and mobile applications.

Our business strategy is based on educating our students and accounts to understand, analyze and manage investment and portfolio risk with the objective of preserving capital. Customers are instructed in a seven step disciplined, risk-adjusted approach to the capital markets which includes creating a watch list of investments in our paperMoney application to practice trading strategies prior to entering the markets. Building our retail customer relationships on the foundation of investor education, we have created a high value, active account base for our brokerage services with a profitable customer acquisition model for students sourced through our investor education business unit. We believe that this business strategy is scalable and positions us for continued growth in customer acquisition, sales and profitability.

Investor Education Business Strategy

We offer a comprehensive suite of investor education products and services for stock, option, foreign exchange, futures, mutual fund and fixed-income investors. Our products and services are primarily built around an investing method that is designed to teach both experienced and beginning investors how to approach the selection process for investment securities and actively manage their investment portfolios. Course offerings are generally combined with web-based tools, personalized instruction techniques and ongoing service and support and are offered in a variety of learning formats, which solidify the students' understanding of the investing process and help in their effort to take control of their financial future.

We seek to offer students a full range of investor education products that provide lifelong learning. Generally, students are introduced to our products and services through a free preview event, either live or online. Attendees of the preview event also have the opportunity to attend a more comprehensive instructor-led live workshop or an in-depth online home study program. Following completion of the initial workshop or home study program, graduates are offered continuing education and advanced courses to build on what they have learned. These continuing education bundles often contain personalized one-on-one coaching and one-to-many online coaching sessions, which are spread out over a period of time and include ongoing support through a live 800-number and a live-chat hotline for continuing education assistance.

Investor Education Segment Learning Formats / Course Offerings

The content and services available to students, i.e., length of workshop, types of coaching services, length of time over which services are performed, and access to certain Investools Online features may vary. The different learning formats are as follows:

Preview Event A free event, either live or online, that introduces students to fundamental investing concepts and provides a broad overview of the financial markets. Students are offered an opportunity to purchase a more comprehensive, live workshop, and are offered access to a comprehensive online course featuring hours of multimedia content, quizzes, forums, and live, online-presentations.

Workshops Live, instructor-led investing workshops that cover topics ranging from fundamental investing principles to advanced investment and option strategies. The workshops provide training for using our proprietary Investools Online website.

Home Study/Online Courses We also offer all of our courses in an online format. The home study programs provide training using our proprietary Investools Online website. The Foundation course includes a six-month subscription to the Investools Online website. Additional online courses on advanced topics are also available.

Coaching Services Coaching services, including interactive workshops, provide students with a personal learning experience, on-demand access to coaches via the telephone, live events or online. Offered in connection with our education curriculum, the coaching services allow students to learn at their own pace and apply what they are learning. The interactive coaching workshops (Interactive Stocks and Options, High Probability Trading) are taught by our most experienced coaches and are delivered online or live at either our Chicago or Utah facility. On-demand and one-to-many coaching services are subscription products offered in one to sixty-month time periods. One-to-many coaching services include weekly, topic-driven live webinar sessions (Trading Rooms), advanced strategy-based group discussions (Active Investor Talk), and market-based group instruction (Masters Talk®).

Ongoing Support and Tutorials (web subscriptions) As long as graduates maintain an active subscription to Investools Online, they have access to student and technical support through a live-chat online support option and through an 800-number hotline. Alumni can access a series of inexpensive or free topical, recorded online tutorials. The click-on-demand tutorials are designed to walk graduates through the portion of the Investools Online website that relates to the subject being covered.

thinkorswim paperMoney ® This application became available to Investools' graduates after our merger announcement with thinkorswim in September 2006. It replicates the live online trading platform available to thinkorswim account holders. paperMoney provides the student with a "paper" $100,000 portfolio they can use to learn how to execute trades online and test strategies. paperMoney includes additional charting and tools for analyzing options strategies. All students have access to weekly online tutorials on the paperMoney platform.

The different course offerings are as follows:

Investing Foundation Course The foundation course covers the 7-Step Investing Formula® and is designed to teach both experienced and beginning investors how to approach the market, streamline the stock selection process and actively manage their investment portfolios. The 7 steps are (1) Prepare to be an investor (2) Protect your investment capital (3) Start analyzing from the top down (4) Conduct a thorough fundamental analysis (5) Search for additional strong stocks (6) Conduct a thorough technical analysis (7) Manage your portfolio.

Additional courses include Basic Options, Advanced Technical Analysis, Advanced Options, Forex and Advanced Forex. The course content ranges from strategies to provide the online investor with a number of investment strategies to help create additional profits and cash flows, to instruction around advanced option and spot currency trading strategies.

Investools Online Our proprietary Investools Online website houses our education curriculum, Investor Toolbox® tools and online community. Investools Online is the source of all educational content and analytical tools that enable students to study, review and analyze the seven steps of the Foundation Course as well as advanced investment strategies and provide students the investment tools needed to execute the strategies taught in our investor education programs. The website has proprietary features that are not accessible on other financial websites, including more than 200 pre-built stock searches and 9 customizable search engines, comparative analyst reports, over 130 market indicators, intra-day market commentary, portfolio tracking features, industry leading advanced charting tools, audio and video commentary broadcasts and account management features.

Continuing Education Programs

Designed for the advanced student, our continuing education programs offer students comprehensive access to a multitude of products and services at a bundled price. Typically included in the continuing education bundles are additional curriculum, online courses, live workshops, coaching services and extended access to Investools Online.

Pre-bundled continuing education programs offered in our workshop events include: Trading Rooms, Associate Investor Program, Master Investor Program and Program of High Distinction. In addition, the Company offers additional continuing education including: Active Investing Workshops, Interactive Stock and Options, High Probability Trading, and Capital Markets. Programs range from six months to 24 months and are priced between approximately $800 and $25,000. Students also have the option of purchasing products and services a la carte or bundled from our telesales organizations.

Brokerage Services Business Strategy

We have created a suite of award-winning trading products that harness the latest technology to allow our customers to securely trade stocks, options, bonds, mutual funds, futures and forex with easy-to-use interfaces. Our brokerage products are targeted to both novice investors and active traders, both large and small. We believe that the level of our customer support, educational materials, professional-level trade analysis tools and order execution capabilities differentiate us from our competitors, and give us a customer retention rate significantly higher than industry averages. We are committed to building better products for our customers through tighter integration of content and technology.

Brokerage Services Platform / Products

The different brokerage platforms are as follows:

thinkDesktop Our flagship trading platform is a technology leader in the online brokerage industry. Real-time streaming quotes, single-click order execution, live position updates and risk metrics, live account balances and margin requirements, profit/loss figures, charts, live CNBC Plus streaming video and a broad range of advanced trading tools are designed to assist the educated investor be an effective trader.

Web-based trading Our comprehensive browser-based trading platform allows customers to access our powerful trade execution, position monitoring and account management functionality from almost any computer. thinkorswim's web-based trading is fully synchronized with thinkDesktop, has real-time streaming data and information, and eliminates page refreshes to make it one of the fastest of the browser-based platforms.

thinkMicro Our application for non-stylus mobile devices offers customers stock, option and futures trading functionality with real-time streaming quotes, charts and account management features.

thinkMobile Our platform for Wireless Application Protocol (WAP) enabled devices and cell phones with Internet access and mini-browsers provides trade execution, account and position information, and real-time quotes to customers with easy-to-use navigation.

thinkAnywhere Our wireless trading application gives customers full trading and position monitoring functionality on pocket PC devices. It has a fully configurable layout, real-time streaming stock, option and futures quotes, and single-click order entry.

thinkPod Our portable, light-weight applet for trade execution, position management, charts and real-time streaming quotes allows customers to access thinkorswim technology directly from any website, and soon via the iPhone, through a streamlined interface.

thinkPipes Our professional trade execution, order management and direct market access (DMA) platform is designed for institutional money managers, hedge funds, market makers, regional and tier 1 broker/dealers and equity specialists with automated trade routing and execution functionality, an open API and customizable analytics.

We schedule approximately 12 releases each year with multiple new features and enhancements. Recent developments include:

Portfolio Margining We introduced portfolio margining to give qualified accounts the benefits of more efficient use of trading capital as defined by new regulations that allow margin to be determined by the risk of a portfolio.

Forex Trading thinkorswimFX is our new forex interface which allows customers to trade 123 different spot currency pairs.

paperMoney Traders who want to practice executing orders and managing positions can do so on paperMoney, which is a virtual trading application that replicates the thinkorswim desktop platform. Users are provided a "paper" portfolio they can use to learn how to execute trades and test strategies. paperMoney is free and accessible simply by registering for a username and password.

thinkScript We created a proprietary programming language that lets technologically advanced customers code their own technical studies and trade indicators on our charting package.

thinkBack thinkBack is our option strategy back testing feature. Powered by five years of historical option data, thinkBack gives customers the ability to track simple and complex simulated option trades over time with real option prices.

thinkMoney Our quarterly magazine delivers articles on topics for beginners to advanced traders and showcases new products, market commentary, trading tips and platform "How-To's".

Advanced Order Execution We redesigned our order routing architecture to give customers greater control and flexibility when routing orders. With the ability to control the sequence of executions, order trigger prices, and the time of executions and cancels, customers can implement their trading strategies without being tied to a computer.

Marketing

We engage in a broad range of activities that include:

Direct Response Television We run various long form and short form direct response television advertisements on network cable and local and national television for the Investor Education segment.

Internet Marketing We advertise extensively on the Internet using search placement, banners and advertisements on targeted sites, such as financial portals for education and brokerage prospects. We also benefit from an increasing number of non-paid Internet referrals, including leads directed to our domain names as a result of Web searches using Internet search engines.

Direct Mail Direct mail is effective at reaching individuals that express an interest in investor education and self-improvement. We can also reach specific metro areas for local marketing efforts in connection with our live preview events.

Print and Broadcast We rely on print and broadcast advertising to target new education prospects and to assist with building brand recognition.

Re-Marketing Re-marketing efforts include direct mail, telephone and e-mail sent to existing students in our education database. Re-marketing is an important part of our marketing campaign given our growing database of qualified prospects.

Referrals Referrals continue to be an important source of new students and brokerage customers.

We track leads for every direct mail campaign and direct response television campaign by allowing potential students the opportunity to respond using the following methods:

Calling us at a specific toll-free number or

Directing the potential student to one of our specific URL addresses on the Internet that are used to track individual marketing campaigns for reach and effectiveness.

Competition

We are aware of several companies that offer competing educational products or services. While these companies may have greater resources, we believe that: (i) the depth and quality of our curriculum and training, (ii) the range of our foundation and continuing education course offerings, from beginner to advanced, (iii) our portfolio of channel partners, (iv) the quality of our instructors and coaches, (v) our database of prospects and students, and (vi) our focus on improved learning formats such as online and on-demand access to expert instructors provide us with a considerable competitive advantage compared to other investor education providers.

The online brokerage market is rapidly evolving and highly competitive. Our direct competitors in this market include broker-dealers that offer online services, "niche-market" online or licensed software-based brokers, full commission brokerage firms as well as mutual fund sponsors, banks and other organizations that provide online brokerage services. A representative list of competitors includes

Charles Schwab & Co., Inc., Fidelity Brokerage Services, LLC, E*TRADE Group, Inc., TD Ameritrade, Inc., TradeStation Group, Inc., OptionsXpress, Inc., TradeKing, Interactive Brokers Group, Inc., Merrill Lynch & Co. Inc. and Scottrade, Inc.

In the Investor Education segment and Brokerage Services segment, we attribute our competitive success to the overall quality of our education and trading products, leading edge technology and superior customer service. Although competition may increase in either segment, we believe we will maintain our competitive advantage as the online broker for the educated investor.

Intellectual Property

Our success and ability to compete are dependent on our intellectual property, which includes our proprietary technology, trademarks, trade secrets, tradenames and client base. We rely on a combination of patent, trademark, copyright, contract provisions, licensing agreements, nondisclosure agreements with employees and contractors, unfair competition and trade secret laws in the United States and other jurisdictions to protect our proprietary technology and other intellectual property.

We have registered and received approval for a number of trademarks in the United States and foreign countries that are important to our future success. Of critical importance to us is the Investools trademark. The Investools trademark is a widely recognized, adopted and endorsed approach to investor education and is associated with quality and reliable service. In addition, as a result of various mergers or acquisitions, we have acquired the trademarks and tradenames of:

Prophet Financial Systems, Inc. ("Prophet"). Prophet's website is a widely recognized charting tool that has won various awards and been recognized as a leader in online financial charting applications by Barron's (2006).

thinkorswim, Inc. ("thinkorswim®"). thinkorswim is a leading online brokerage and technology provider for self-directed options traders. thinkorswim has been recognized as the top rated software-based online broker and best for options traders by Barron's (2006 and 2007).

MyTrade, Inc. ("mytrade") is an online social-networking content platform for investors of all experience levels.

We have registered and maintain a multitude of domain names to ensure continuity of delivery for all of our websites. Management believes that our products, trademarks and other proprietary rights do not infringe on the proprietary rights of third parties, and management is not aware of any current infringement claims against us.

Regulatory Compliance

Overview

Our products and services offered through our Investor Education segment are not currently subject to the prior approval of any government regulatory body. However, certain foreign countries require that we register with their respective securities commissions before conducting investment-related workshops; for example, we are registered with the Australian Securities and Investment Commission ("ASIC").

Our brokerage subsidiary, thinkorswim, Inc., is subject to extensive securities and futures industry regulation under both federal and state laws as a broker-dealer with respect to its equities and equity options business and as an introducing broker with respect to its futures and forex business. In general, broker-dealers that conduct retail business are required to register with the SEC and to be members of FINRA. thinkorswim Inc. is registered as a broker-dealer in every U.S. state and the District of Columbia, and is subject to regulation under the laws of those jurisdictions. thinkorswim Inc. is registered through the NFA as an introducing broker. thinkorswim is also a member of the Securities Investor Protection Corporation.

As a registered broker-dealer and a member of FINRA, thinkorswim is subject to the requirements of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder relating to broker-dealers and to the membership and Conduct Rules of FINRA. These regulations establish, among other things, categories of persons that must be registered, standards of conduct for dealing with customers and minimum net capital requirements. These laws, rules and regulations affect all facets of thinkorswim Inc.'s securities business, including trading practices, risk disclosure, marketing activities and record-keeping practices. thinkorswim, Inc. is also subject to regulation under various state laws, including registration requirements. thinkorswim Canada Inc., our Canadian subsidiary, is registered with the IDA.

thinkorswim also provides futures brokerage services and is subject to regulation by the Commodity Futures Trading Commission ("CFTC"), NFA and other self-regulatory organizations ("SROs"), such as the futures exchanges. The regulation of futures transactions in the United States is an extensive and rapidly changing area of law and is subject to modification by government and judicial action. thinkorswim is also subject to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the Patriot Act.

Our investment advisory subsidiary, Advisors, is registered with and regulated by the SEC and is subject to the regulations of the states in which it does business. Such regulations include, among other things, disclosure requirements, books and record keeping requirements, and rules governing advertising.

thinkorswim Canada Inc., our Canadian subsidiary, is a registered investment dealer subject to regulation by Investment Dealers Association ("IDA") and Ontario Securities Commission ("OSC") in Canada.

Net Capital Rule and Marketing Material Rules

thinkorswim has net capital requirements under SEC, CFTC and NFA regulations, which require minimum net capital requirements. Because it is an introducing broker in the futures business and its net capital requirements under the SEC rules are greater than its net capital requirements would be if it were only registered as an introducing broker, the SEC net capital rule governs our capital requirements on the futures side as well.

thinkorswim is required to maintain net capital of the greater of $6^2/_3$% of aggregate indebtedness, or $0.25 million and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. thinkorswim is also subject to the CTFC Regulation 1.17 ("Reg 1.17") under the Commodity Exchange Act, administered by the Commodity Futures Trading Commission and the National Futures Association, which also requires the maintenance of minimum net capital to be the greater of its SEC and FINRA net capital requirement or $45,000. At December 31, 2007, the Company had net capital of $37.6 million which was $36.2 million in excess of its required net capital of $1.4 million. The Company's net capital ratio was 0.55 to 1.

Marketing campaigns by thinkorswim Inc. to bring brand name recognition to its services and to promote the benefit of those services are regulated by FINRA and NFA. All marketing materials are reviewed by an appropriately-licensed thinkorswim securities principal prior to release and must conform to standards articulated by the SEC, FINRA and NFA.

Foreign Jurisdictions and Regulation

thinkorswim has a Canadian subsidiary that began operations in mid-December 2007, and provides brokerage services to self-directed traders and is therefore subject to that country's laws, rules and regulations. Foreign laws, rules and regulation differ from jurisdiction to jurisdiction.

Customers can access thinkorswim's services through the Internet, including in foreign jurisdictions. It is possible that foreign authorities in jurisdictions where we are not registered could attempt to assert jurisdiction over our activities or that such authorities could require thinkorswim to become registered, be subject to regulation and enforcement action, or require thinkorswim to cease activities in those jurisdictions.

Human Resources

At December 31, 2007, we had a total of 653 employees, of which 513 were employed by the Investor Education segment and 140 were employed by the Brokerage Services segment.

Our key personnel are covered by employment and confidentiality agreements. No person employed by us, either full-time, part-time or on a contract basis, is covered by a collective bargaining agreement or represented by a union, and we have never experienced a work stoppage due to a protest or related activities. Management considers relations with our personnel to be good.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations, cash flows, and trading price of our common stock. The risks and uncertainties described below are not the only ones we face. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations and financial condition.

Risks Related to Our Business

If we do not successfully introduce new programs, products and services, our growth rate and revenue will be reduced.

Our growth strategy for the educational segment of our business is dependent on our ability to sell existing training programs, products and services to new students, to open new markets and to develop and introduce new educational programs, products and services. If we are unable to expand our markets and products, our growth rate and revenue will be reduced. Market conditions and the level of customer interest may be different for our current products than for new products and marketing costs and methods may differ in new markets, and there can be no assurance that we will be able to compete favorably with, and obtain market acceptance for, any such new programs, products or services. thinkorswim's growth strategy also is dependent upon the development of new and the enhancement of existing products and services. The financial services industry involves rapid technological change and continually evolving industry standards and practices. Our failure to keep abreast of such changes could result in our technology and systems and our product offerings becoming obsolete. The development of new products involves significant risks. We may not be able to adapt our new products or services to new standards in the marketplace. In addition, changes in technologies could force us to incur substantial expenditures to appropriately modify our infrastructure and our products and services.

If we are not able to continually enhance our web-based products and services and adapt them to changes in technology, our future revenue growth could be adversely affected.

If our improvement and adaptation of our web-based products and services is delayed, results in systems interruptions or is not aligned with market expectations or preferences, our revenue growth could be adversely affected. The online environment is rapidly evolving, and the technology used in web-based products changes quickly. We must therefore be able to quickly modify our solutions to adapt to emerging online standards and practices, technological advances, and changing user and sponsor preferences. Ongoing enhancement of our web site, web-based products and related technology will entail significant expense and technical risk. We may use new technologies ineffectively or fail to adapt our web site, web-based products and related technology on a timely and cost-effective basis.

Our corporate debt levels may limit our ability to obtain additional financing.

At December 31, 2007, we had an outstanding balance of $117.5 million in senior secured term loans and $25 million in available senior secured revolving loan facilities. Our ratio of debt (our senior secured term loans and capital lease obligations) to equity (expressed as a percentage) was 73% at December 31, 2007.

Our loan agreements, which contain a number of restrictive covenants that affect our business, restrict our ability to, among other things, sell or lease assets, pay dividends or other distributions to stockholders, engage in mergers or consolidations, create liens on assets, and borrow money or issue guarantees.

In addition, as a result of the covenants and restrictions contained in our loan agreements, we are limited in how we conduct our business and we may be unable to raise additional debt or equity financing to compete effectively or to take advantage of new business opportunities either through acquisitions or internal expansion. The terms of any future indebtedness could include more restrictive covenants.

We cannot assure you that we will be able to remain in compliance with these covenants in the future and, if we fail to do so, that we will be able to obtain waivers from the appropriate parties and/or amend the covenants.

We may incur additional indebtedness in the future, including in connection with future acquisitions. Our level of indebtedness, among other things could:

- make it more difficult or costly for us to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes;
- limit our flexibility in planning for, or reacting to, changes in our business; or
- make us more vulnerable in the event of a downturn in our business.

We may desire or need to raise additional capital in the future, which may not be available on terms acceptable to us.

If we need, but are unable to obtain, additional capital to expand our operations and invest in new products and services, our business may be adversely affected. In the future we may require substantial additional capital to finance ongoing operations or the growth of our business. To the extent that our existing sources of liquidity and cash flow from operations are insufficient to fund our activities, we may need to raise additional funds. We cannot be certain that we will be able to obtain additional financing on favorable terms. If we fail to raise additional funds, we may need to sell debt or additional equity securities or to reduce our growth to a level that can be supported by our cash flow. Without additional capital, we may not be able to: further develop or enhance our services and products; acquire necessary technologies, products or businesses; expand operations in the United States or internationally; make acquisitions; hire, train and retain employees; market our services and products; or respond to competitive pressures or unanticipated capital requirements.

We may experience difficulties integrating recent and future acquisitions.

As a result of recent acquisitions and as part of our general business strategy, we expect to make more acquisitions and to experience significant growth, and expect such growth to continue into the future. There are numerous risks involved in the acquisition of other businesses, including difficulties in the integration of acquired companies and their operations, products and services; failure to achieve projected synergies; requiring the focus of management to the detriment of other aspects of our business; possible assumption of unknown liabilities; loss of customers or employees of acquired businesses; dilution to our shareholders and the reduction of our reported earnings as a result of the amortization of intangible assets acquired. This growth is expected to place a significant strain on our management, financial, operating and technical resources. Failure to manage this growth effectively could have a material adverse effect on our financial condition or results of operations. There can be no assurance that we will be able to effectively integrate the acquired companies, including thinkorswim and mytrade, with our own operations. Expansion will place significant demands on our marketing, sales, administrative, operational, financial and management information systems, controls and procedures. Accordingly, our performance and profitability will depend on the ability of our officers and key employees to (i) manage our business and our subsidiaries as a cohesive enterprise, (ii) manage expansion through the timely implementation and maintenance of appropriate administrative, operational, financial and management information systems, controls and procedures, (iii) add internal capacity, facilities and third-party sourcing arrangements as and when needed, (iv) maintain service quality controls, and (v) attract, train, retain, motivate and manage effectively our employees. There can be no assurance that we will integrate and manage successfully new systems, controls and procedures for our business, or that our systems, controls, procedures, facilities and personnel, even if successfully integrated, will be adequate to support our projected future operations. Any failure to implement and maintain such systems, controls and procedures, add internal capacity, facilities and third-party sourcing arrangements or attract, train, retain, motivate and manage effectively our employees could have a material adverse effect on our business, financial condition and results of operations.

thinkorswim operates in a highly regulated industry and compliance failures could adversely affect our business.

Our securities broker-dealer operates under extensive regulation, which increases our cost of doing business and may be a limiting factor on the operations and development of our business. Our securities broker-dealer business and operations are subject to regulation by the SEC, FINRA f/k/a NASD, IDA and OSC in Canada, national security exchanges and state securities commissions. We also may be subject to regulation by securities regulatory authorities in foreign countries where our customers are located. The securities industry in the United States covers all aspects of the securities business, including:

- sales and marketing methods;
- trade practices;
- use and safekeeping of customer funds and securities;
- capital structure;
- record-keeping;
- financing of customers' purchases; and
- conduct of directors, officers and employees.

Our securities broker also provides futures brokerage services and is registered through the NFA as an introducing broker. The futures industry is also subject to comprehensive statutes, rules and regulations, including margin requirements, trading restrictions, customer regulations and net capital requirements. Participants in the futures industry are subject to regulation by the CFTC, NFA or other SROs, including futures exchanges and boards of trade. The regulation of futures transactions in the United States is an extensive and rapidly changing area of law and is subject to modification by government and judicial action.

Our investment advisory subsidiary is registered with and regulated by the SEC and is subject to the regulations of the states in which it does business.

As thinkorswim grows, it is subject to increasing attention from regulators, even for routine audits and examinations. This higher level of scrutiny requires that thinkorswim's management devote more time to regulatory matters.

Failure to comply with any of the laws, rules or regulations applicable to us, even inadvertently, could lead to adverse consequences including investigation, censure, fine, the issuance of cease-and-desist orders, other penalties from regulatory agencies, criminal penalties, civil lawsuits, or the suspension or disqualification of our subsidiaries, directors, officers or employees. Any of these consequences could adversely affect our securities broker-dealer business, our futures business and/or our advisory business.

If we fail to attract students and brokerage customers in a cost-effective manner, our financial position may be negatively impacted.

Our profitability and growth depends on increasing our student base and our brokerage customer base in a cost-effective manner. We incur significant marketing expenses in connection with our educational operations. Although we have spent significant financial resources on advertising and related expenses and plan to continue to do so, there can be no assurance that these efforts will be cost-effective at increasing our student base and that our students and their contacts will continue to open brokerage accounts at thinkorswim. Advertising and marketing costs are likely to increase in the foreseeable future, and we may not have the same ability to expand our advertising and marketing budgets as our larger competitors. Finally, the advertising and marketing activities of thinkorswim are subject to regulation by FINRA and the NFA. These SROs impose limitations on our sales methods and our ability to make payments to third party marketers. Our failure to successfully market our products and services to student and brokerage customers can negatively impact our business and financial condition.

We rely on our strategic partners to provide us with access to leads and customers.

We currently access approximately 43 percent of our Investor Education sales transaction volume through co-marketing relationships. Our strategic partners may enter into identical or similar relationships with our competitors, which could diminish the value of the partners for customer acquisition. Our strategic partners could terminate their relationship with us. The businesses of our strategic partners could contract or such strategic partners could experience financial difficulties. If any of our strategic partners, and in particular Success Magazine Investor Education, LLC, were to terminate their relationship with us or were to decrease operations or experience serious financial difficulties, our ability to distribute our educational products and services could be materially impaired. In addition, since our merger with thinkorswim, our educational subsidiaries have been the referral source for a substantial percentage of thinkorswim's new customers. Any reduction in our sales of education products and services are likely to decrease our referral of new customers to thinkorswim. We may not be able to maintain our existing relationships or enter into new strategic relationships with co-marketing partners.

Changes in legislation or regulations may affect our ability to conduct our business or reduce our profitability.

The regulatory environment in which we operate may change. These changes may affect our ability to conduct our business or reduce our profitability. Our activities may be affected not only by legislation or regulations of general applicability, but also by industry-specific legislation or regulations. Our brokerage customers may also be affected by changes in rules and regulations that could negatively impact us. The SEC, other U.S. or foreign governmental authorities, FINRA, the NFA or other SROs may adopt new or revised regulations which affect our business. Changes in the interpretation or enforcement of existing laws and rules by those entities may also affect our business.

In addition, we use the Internet as the distribution channel to provide services to our customers. We must comply with a variety of federal and state laws affecting the content of materials distributed over the Internet, as well as regulations and other laws restricting the collection, use and disclosure of personal information that we may obtain in the course of providing our online services. As online advertising becomes more popular and more complex, it is possible that such activities will become more tightly regulated. Any new law or regulation pertaining to the Internet, or the application or interpretation of existing laws, could increase our cost of doing business, decrease the demand for our products and services, or otherwise harm our business. A number of regulatory agencies have recently adopted regulations regarding customer privacy and the use of customer information by service providers. Additional laws and regulations relating to the Internet may be adopted in the future, including regulations regarding the pricing, privacy, taxation, content and quality of products and services delivered over the Internet. Compliance with future laws and regulations, or existing laws as they may be interpreted in the future, could be expensive, time consuming, impractical or impossible.

Failure to comply with any of the laws, rules or regulations applicable to us, even inadvertently, could lead to adverse consequences including censure, fine, the issuance of cease-and-desist orders or the suspension or disqualification of directors, officers or employees. It is also possible that any noncompliance could subject us to criminal penalties and civil lawsuits. An adverse ruling against us or our officers or other employees could cause us or our subsidiaries or our officers and other employees to pay a substantial fine or settlement, and could result in their suspension or expulsion. Any of these consequences or events could have a material adverse effect on our business and financial condition.

Our broker-dealer subsidiary has experienced substantial growth.

thinkorswim has experienced substantial growth over the past year and its rate of growth has increased significantly since our merger with them. Such rapid growth has placed significant demands on thinkorswim's management and other resources. As a result, thinkorswim will need to attract, hire and retain highly skilled and motivated officers and employees. We cannot assure you that we will be able to attract or retain the officers and employees necessary to manage this growth effectively.

Many of our competitors have greater financial, technical, marketing and other resources.

Many of our competitors have longer operating histories and greater resources than we do and offer a wider range of brokerage, brokerage related and educational products and services. Many also have greater name recognition, greater market acceptance and larger customer bases. These competitors may conduct extensive promotional activities and offer better terms, lower prices and/or different products and services than we do. Moreover, some of our competitors have established relationships among themselves or with third parties to enhance their products and services. This means that our competitors may be able to respond more quickly to new or changing opportunities and demands and withstand changing market conditions better than we can.

The market for electronic brokerage services is rapidly evolving and intensely competitive. We expect the competitive environment to continue in the future. Our brokerage operations face direct competition from numerous online and software-based brokerage firms, including Charles Schwab & Co., Inc., E*TRADE Group, Inc., Fidelity Brokerage Services, LLC, OptionsXpress, Inc., TD Ameritrade, Inc., TradeKing, and TradeStation Group, Inc. Our brokerage operations also encounter competition from the broker-dealer affiliates of established full commission brokerage firms as well as from mutual fund sponsors, banks and other organizations that provide online brokerage services. Many of our competitors in the brokerage industry have greater financial, technical, marketing and other resources, and have greater name recognition and a more extensive customer base than we do.

This intense competition in the brokerage industry has resulted in several trends that may adversely affect our financial condition and results of operations, including the implementation of new pricing strategies; the development by our competitors of products and services and enhancements; consolidation in the industry and increased emphasis on advertising and promotional efforts. In addition, some of our competitors are actively pursuing a larger share of the options trading market.

We believe that the general financial success of brokerage operations within the online brokerage industry will continue to attract new competitors to the industry, such as banks, software development companies, insurance companies, providers of online financial information and others. These companies may provide a more comprehensive suite of services than we do. We may not be able to compete effectively with our current or future competitors.

Downturns or disruptions in the securities markets could reduce trade volumes and margin borrowing and increase our dependence on our more active customers who receive lower pricing.

A significant portion of our revenues now comes from online investing services; we expect this business to continue to account for an increasingly significant portion of our revenues in the foreseeable future. Like other financial services firms, we are affected directly by national and global economic, political and market conditions, broad trends in business and finance, distributions to the securities markets and changes in volume and price levels of securities and futures transactions. Historically, securities trading volume in the United States has fluctuated considerably. We expect our revenues to be adversely affected by periods of low trading volume. Decreases in trade volume may be more significant for us with respect to our less active customers, increasing our dependence on our more active trading customers who receive more favorable pricing based on their trade volume. Decreases in volumes, as well as securities prices, are also typically associated with a decrease in margin borrowing. Because we receive a portion of the revenue our clearing firms generate from interest charged on margin borrowing by our customers, such decreases result in a reduction of revenue. When transaction volume is low, our operating results may suffer in part because some of our overhead costs may remain relatively fixed.

We are subject to various forms of credit risk, and those risks could have a material adverse effect on our financial situation.

Our brokerage operations are subject to substantial credit risk. Credit risk may arise, for example, from holding securities of third parties; executing securities or futures trades that fail to settle at the required time due to non-delivery by the counterparty or systems failure by clearing agents, exchanges, clearing houses or other financial intermediaries; and extending credit to our clients through margin loans or other arrangements, including forex transactions.

Many of the customer accounts of our brokerage business are margin accounts. Our customer futures accounts trade on margin as well. In margin transactions, we may be obligated for credit extended to our customers by our clearing firms, because we indemnify our clearing firms for our customers' debits and defaults. Margin credit is collateralized by cash and securities in the customers' accounts. We also execute customer transactions involving the sale of securities not yet purchased which result in our clearing firms extending leverage to our customers for which we may be ultimately responsible. Leverage involves securing a large potential future obligation with a proportional amount of cash or securities. We introduce forex transactions to Penson Financial Services, Inc. ("Penson"), which involve substantial amounts of leverage. The risks associated with margin credit and leverage increase during periods of fast market movements or in cases where leverage or collateral is concentrated and market movements occur. During such times, customers who utilize margin credit or leverage and who have collateralized their obligations with securities may find that the securities have a rapidly depreciating value and may not be sufficient to cover their obligations in the event of liquidation. When our clearing firms extend margin or our customers use leverage, our clearing firms may be exposed to significant off-balance-sheet credit risk in the event customer collateral is not sufficient to fully cover losses that customers may incur. In the event customers fail to satisfy their obligations, our clearing firms may be required to purchase or sell financial instruments at prevailing market prices to fulfill the customers' obligations.

We expect this kind of exposure to increase with growth in our overall securities broker-dealer and other brokerage business. Because we indemnify and hold harmless our clearing firms from certain liabilities or claims, the use of margin credit, leverage and short sales may expose us to significant off-balance-sheet risk in the event that collateral requirements are not sufficient to fully cover losses that customers may incur and those customers fail to satisfy their obligations. The amount of risk to which we are exposed from the leverage our clearing firms extend to our customers and from short sale transactions by our customers is unlimited and not quantifiable as the risk is dependent upon analysis of a potential significant and undeterminable rise or fall in stock prices.

Our exposure to litigation could adversely affect our business and results of operations.

We are from time to time involved in various lawsuits and legal proceedings. Although we currently are not a defendant in any material legal proceedings, any claim, with or without merit, could result in costly litigation, subject us to undetermined penalties, or require us to modify or cease sales of our products or services, any of which could have a material adverse effect on our business and results of operations.

The loss of or change in our third-party vendors may adversely affect our business.

We rely on a number of third parties for various services. These include the services of other broker-dealers, market makers and exchanges to execute customer orders and other third parties for clearing and related back-office services and other information necessary to run our business, including transaction summaries, data feeds for compliance and risk management, execution reports and trade confirmations. Third-party content providers provide us with all of the financial information, market news, charts, option and stock quotes, research reports and other fundamental data that we offer to customers. Furthermore, we have offsite third-party data center operations that are critical to our business.

We cannot assure you that any of these providers will be able to continue to provide these services in an efficient, cost-effective manner or that they will be able to adequately expand their services to meet our needs. An interruption in or the cessation of service by any third-party service provider as a result of systems failures, capacity constraints, financial constraints or problems, unanticipated trading market closures or for any other reason, and our inability to make alternative arrangements in a smooth and timely manner, if at all, may impact our ability to process trades and have other material adverse effects on our business, financial condition and operating results.

We rely on a few key employees whose absence or loss could disrupt our operations or be adverse to our business.

We are highly dependent on the experience of our senior management team in the continuing development of our operations. The loss of the services of certain of these individuals would have a material adverse effect on our business. Although we have employment and non-competition agreements with certain of our key employees, as a practical matter, those agreements will not assure the retention of our employees. We currently do not maintain key man insurance on any member of our senior management team.

We are subject to interest rate risk exposure.

thinkorswim's clearing firms pay us a portion of the revenue they generate from the difference between the interest they earn by investing our customer cash and the interest they pay to our customers on such cash. A rising interest rate environment will generally result in an increase in the spread our clearing firms generate and a corresponding increase in the amounts of that spread that is paid to us. A declining interest rate environment will generally result in a decrease in the spread our clearing firms generate and a corresponding decrease in the amounts of that spread that is paid to us.

Our risk management policies and procedures may not be effective and may leave us exposed to unidentified or unexpected risks.

Our policies, procedures and practices used to identify, monitor and control a variety of risks may fail to be effective. thinkorswim is particularly dependent upon risk management systems because it has indemnified its clearing firms for any losses incurred by its clearing firms from thinkorswim's customers. As a result, we face the risk of losses, including losses resulting from firm errors, customer defaults, market movements, fraud and money laundering. Our risk management methods rely on a combination of technical and human controls and supervision that are subject to error and failure. Some of our methods of managing risk are based on internally developed controls and observed historical market behavior, and also involve reliance on industry standard practices. These methods may not adequately prevent futures losses, particularly when there are extreme market movements that exceed historical precedent. These methods may not adequately prevent losses due to technical errors or the failure of our software or systems.

Systems failures and delays could harm our business.

We deliver educational products and services and receive and process trade orders through a variety of electronic channels. Our online services are heavily dependent on the integrity of the systems supporting them. Our systems and operations, including our Web servers and those of our third-party service providers, are vulnerable to damage or interruption from human error, sabotage, encryption failures, break-ins, intentional acts of vandalism, earthquakes, terrorist attacks, floods, fires, power loss, telecommunications failures, computer viruses, computer denial of service attacks or other attempts to harm our systems and operations, and similar events. Our disaster recovery planning cannot account for all eventualities. In addition, unusually high trading volumes could cause our computer systems to operate at an unacceptably low speed or even fail. While we have invested significant amounts to upgrade the reliability and scalability of our systems, there can be no assurance that our systems will be sufficient to handle such extraordinary trading volumes.

Systems failures or delays may occur in the future and could cause, among other things, unanticipated disruptions in service to our customers, slower system response time resulting in transactions not being processed as quickly as our customers desire, decreased levels of customer service and customer satisfaction and harm to our reputation. If any of these events were to occur, we could lose customers, incur additional expenses or financial losses, become involved in customer litigation or become subject to regulatory sanctions.

Our business also depends on the continued reliability of the Internet infrastructure. Internet infrastructure may be unable to support the demands placed on it if the number of Internet users continues to increase or if existing or future Internet users access the Internet more often or increase their bandwidth requirements. In addition, viruses, worms and similar programs may harm the performance of the Internet. The Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage and our business could be materially adversely affected.

Our business may suffer if we are not successful in developing, maintaining and defending proprietary aspects of technology used in our products and services.

Our success and ability to compete are dependent on our ability to develop and maintain the proprietary aspects of our technology. Litigation may be necessary in the future to enforce our intellectual property rights, to protect trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement or invalidity. Any such litigation, even if we prevailed, could be costly, divert resources and could have a material adverse effect on our business, operating results and financial condition. We can give no assurance that our means of protecting our proprietary rights will be adequate, or that our competitors will not independently develop similar technology. Any failure by us to protect our intellectual property could have a material adverse effect on our business, operating results and financial condition. We integrate third-party software into code creating and supporting some of our products and services. This third-party software may not continue to be available on commercially reasonable terms. If we are unable to maintain licenses to the third-party software included in the code supporting our product services, features of our products or services could be unavailable, until equivalent software could be developed or licensed and integrated. This delay could adversely affect our business, operating results and financial condition.

We depend on continued growth in use of the Internet and online commerce.

Our ability to expand our delivery platforms and penetrate new markets could be stagnated without continued growth in the use and efficient operation of the Internet. Web-based markets for information, products and services are new and rapidly evolving. If Internet usage does not continue to grow or grows slower than anticipated, we may be unable to secure new sponsorship and subscription arrangements for our offerings. To the extent the investor education portion of our business relies on web-based delivery platforms, our operations will also be dependent on adequate network infrastructure, consistent quality of service and availability to customers of cost-effective, high-speed Internet access. Our brokerage business is online and is entirely dependent on the Internet. If our systems cannot meet customer demand for access and reliability, these requirements will not be satisfied, and customer satisfaction could degrade substantially, adversely affecting our prospects for market penetration and profitability.

Our inability to protect our intellectual property rights or our infringement of the intellectual property rights of others could adversely affect our business.

Patents of third parties may have an important bearing on our ability to offer certain of our products and services. Our major competitors as well as other companies and individuals may obtain and may have obtained patents related to the educational tools and the technologies for trading the types of products and providing the services we offer or plan to offer. We cannot assure you that we are or will be aware of all patents containing claims that may pose a risk of infringement by our products and services. In addition, some patent applications in the United States are confidential until a patent is issued and, therefore, we cannot evaluate the extent to which technology concerning our products and services may be covered or asserted to be covered by claims contained in pending patent applications. In general, if one or more of our products or services were found by a court to infringe patents held by others, we may be required to stop developing or marketing the products or services, to obtain licenses to develop and market the services from the holders of the patents or to redesign the products or services in such a way as to avoid infringing those patents. An adverse ruling arising out of any intellectual property dispute could also subject us to significant liability for damages.

We cannot assess the extent to which we may be required in the future to obtain licenses with respect to patents held by others, whether such license would be available or, if available, whether we would be able to obtain such licenses on commercially reasonable terms. If we are unable to obtain licenses with respect to patents held by others, and are unable to redesign our products or services to avoid infringement of any such patents, this could materially adversely affect our business, financial condition and operating results.

Also, protection may not be available for our intellectual property. Although we have numerous registered trademarks in the United States and other countries, we do not have any patents on our educational tools or trading related technology and there can be no assurance that we will be able to secure significant protection for any of this intellectual property. It is possible that our competitors will adopt technology or product or service names similar to ours, thereby impeding our ability to distinguish our technology and build brand identity, possibly leading to customer confusion. Our inability to adequately protect our marks could have material adverse effect on our business, financial condition and operating results.

Requirements associated with being a public company require significant company resources and management attention.

As a public company, we are subject to the reporting requirements of the Exchange Act and the other rules and regulations of the SEC and the NASDAQ Global Market. We continue to work with our independent legal, accounting and financial advisors to identify those areas in which changes should be made to our financial and management control systems to manage our growth and our obligations. These areas include corporate governance, internal controls, disclosure controls and procedures and financial reporting and accounting systems. We have made, and will continue to make, changes in these and other areas, including our internal control over financial reporting. However, we cannot assure you that these and other measures we may take will be sufficient to allow us to satisfy our obligations as a public company on a timely basis. In addition, compliance with reporting and other requirements applicable to public companies, including under the Sarbanes-Oxley Act of 2002, as well as rules and regulations adopted by the SEC and the Public Company Accounting Oversight Board, create additional costs for us and require substantial amounts of time and attention of our management. We cannot predict or estimate the future amount of the costs we may incur, the timing of such costs or the degree of impact that our management's attention to these matters will have on our business.

Failure to maintain adequate internal controls could adversely affect our business.

We are subject to internal control requirements under the Sarbanes-Oxley Act of 2002, as well as rules and regulations adopted by the SEC and the Public Company Accounting Oversight Board. These laws, rules and regulations continue to evolve and could become increasingly stringent in the future. We have undertaken actions to enhance our ability to comply with the requirements of the Sarbanes-Oxley Act of 2002, including, but not limited to, the increased allocation of the accounting department resources, documentation of existing controls and implementation of new controls or modification of existing controls as deemed appropriate. Control deficiencies have been identified from time to time, and we have undertaken actions to remediate them.

We continue to devote substantial time and resources to the documentation and testing of our controls, and to planning for and implementation of remedial efforts in those instances where remediation is indicated. If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time; we could be subject to regulatory actions, civil or criminal penalties or shareholder litigation. In addition, failure to maintain adequate internal controls could result in financial statements that do not accurately reflect our financial condition, results of operations and cash flows.

We may be liable for invasion of privacy or misappropriation by others of our users' information, which could adversely affect our reputation and financial results.

Some of our services require the disclosure of sensitive information by the user. We rely on a number of security systems for our services to protect this information from unauthorized use or access. We cannot predict whether new technological developments could circumvent these security measures. If the security measures that we use to protect personal information or credit card information are ineffective, we may be subject to liability, including claims for invasion of privacy, impersonation, unauthorized purchases with credit card information or other similar claims. In addition, the Federal Trade Commission and several states have investigated the use of personal information by certain Internet companies. We could incur significant expenses if new regulations regarding the use of personal information are introduced or if our privacy practices are investigated.

Downturns in the securities markets increase the credit risk associated with margin.

We permit customers to purchase securities on margin. Our clearing firms provide margin financing to our customers. Under the terms of our clearing agreements, we indemnify our clearing firms for our customer debit balances. When the market declines rapidly, there is an increased risk that the value of the collateral our clearing firms hold in connection with these transactions could fall below the amount of a customer's indebtedness, which increases the risk of customer debit balances.

Reduced spreads in securities pricing and reduced levels of trading activity could harm our business.

In addition to commissions, we generate a portion of our brokerage revenue from payment for order flow. As is customary in the industry, our payment for order flow arrangements are not subject to written agreements. Consequently, they could be adjusted or terminated at any time. If these payments were reduced or eliminated, our business could be adversely affected. The increase in computer generated buy/sell programs in the marketplace has continued to tighten spreads, resulting in reduced revenue capture per share by the specialist and market-making community and reduced payment for order flow revenues for a brokerage firm like us. Any changes in the marketplace, such as quoting of options in smaller increments, that reduce the spread available for market makers and other liquidity providers, who are the parties that pay us for order flow, could negatively impact our cash flow from these sources.

Losses due to employee or customer fraud could have an adverse effect on our business.

We are exposed to potential losses resulting from fraud and other misconduct by employees, customers or third parties. Employees may bind us to transactions that exceed authorized limits or present unacceptable risks, hide from us unauthorized or unsuccessful activities or improperly use confidential information. Third parties may engage in fraudulent activities, including fraudulent access to legitimate customer accounts, the use of false identities to open accounts, or the use of forged or counterfeit checks for payment. Such types of fraud may be difficult to prevent or detect, and we may not be able to recover the losses caused by such activities. Any such losses could have a material adverse effect on our business, financial condition and operating results.

Servicing customers outside the United States involves special challenges that we may not be able to meet, which could negatively impact our financial results.

Since our services are available over the Internet in foreign countries and we have customers residing in foreign countries, foreign jurisdictions may claim that we are required to qualify to do business in their country. We believe that the number of our customers residing outside of the United States will increase over time. We may be required to comply with the laws and regulations of each country in which we conduct business, including laws and regulations currently in place or which may be enacted related to Internet services available to their citizens from service providers located elsewhere. Any failure to develop effective compliance and reporting systems could result in regulatory penalties in the applicable jurisdiction, which could have a material adverse effect on our business, financial condition and operating results.

Our operations outside of the United States are subject to political, investment and local business risks.

In 2007, thinkorswim organized Canadian and Australian subsidiaries. The Canadian subsidiary is currently operating as a registered brokerage firm, and the Australian subsidiary is in the process of registering as a brokerage firm. While the amount of revenues from such operations are not currently material to the Company, operations outside of the United States are subject to a variety of risks which are different from or additional to the risks we face within the United States. Among others, these risks include:

- imposition of limitations on the remittance of dividends and payments by foreign subsidiaries;
- adverse currency exchange rate fluctuations, including significant devaluations of currencies;
- tax-related risks, including the imposition of taxes and the lack of beneficial treaties, that result in a higher effective tax rate for us;
- difficulties in enforcing agreements and collecting receivables through certain foreign local systems;
- domestic and foreign customs, tariffs and quotas or other trade barriers;
- difficulties in protecting intellectual property;
- hiring and retaining qualified management personnel for our overseas operations; and
- required compliance with a variety of local laws and regulations which may be materially different than those to which we are subject in the United States.

The occurrence of one or more of the foregoing factors could have a material adverse effect on our international operations.

Failure to comply with net capital requirements could adversely affect our business.

The SEC and the NASD have strict rules with respect to the maintenance of specific levels of net capital by securities broker-dealers and introducing brokers. thinkorswim is required to comply with these net capital requirements. If it fails to maintain the required net capital, the SEC could fine thinkorswim or even suspend or revoke its registration, or FINRA could sanction thinkorswim, including by limiting its growth or expelling it from membership. Any of these actions could have a material adverse effect on our securities broker-dealer business. If such net capital rules are changed or expanded, or if there is an unusually large charge against our net capital, operations that require the use of capital would be restricted. A large operating loss or charge against net capital could adversely affect our ability to expand or even maintain our then present levels of business, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

thinkorswim has net capital requirements under CFTC and NFA regulations; however, because it is an introducing broker and its net capital requirements under the SEC rules are greater than its net capital requirements would be if it were only registered as an introducing broker, the SEC net capital rule governs our capital requirements on the futures side as well.

As a holding company, we access the earnings of our broker-dealer subsidiary through the receipt of dividends from that subsidiary. Net capital requirements may limit our ability to access those earnings.

We are dependent on clearing agents, including Penson Financial Services, Inc., and any failures by them or difficulties in our relationships could materially harm our business.

Our securities broker-dealer business and our futures brokerage business is dependent on Penson and certain other clearing agents, including Merrill Lynch, Pierce, Fenner & Smith Incorporated ("ML"), for the clearing and orderly processing of our transactions and the holding of our customers accounts and securities and futures positions. Our clearing agreements with Penson, ML, and our other clearing firms may be terminated by any of the parties upon prior written notice. Breaches or termination of these agreements or the clearing firms' agreements with their third-party suppliers and sources of financing could harm our securities broker-dealer business and our futures business.

Termination of our relationship with Penson, ML, or any of our other clearing firms could have a material adverse effect on our business. We would have to enter into agreements with other clearing firms and there is no assurance we could enter into agreements on favorable or satisfactory terms. Moreover, we have agreed to indemnify and hold harmless our clearing firms from certain liabilities or claims, including claims arising from the transactions of our customers, and may incur significant costs as a result of customer losses.

Any negative changes in economic conditions, significant price increases, inflation or adverse events related to various industries, or the willingness of investors to trade could harm discretionary spending and have a material adverse effect.

We believe that the level of public interest in investing, particularly in the securities and option markets as well as electronic trading has significantly influenced the market for these products and services. The securities markets have experienced substantial volatility in recent periods. Sharp drops or sustained or gradual declines in securities prices or other developments in the securities markets typically could cause individual investors to be less inclined to invest in the securities markets, which would be likely to result in reduced interest in our investor educational products and services.

Laws and regulations can affect the operations of the education segment of our business and may limit our ability to operate in certain jurisdictions.

Federal, state and international laws and regulations impact our operations and may limit our ability to obtain authorization to operate in some states or countries. Many federal, state and international governmental agencies assert authority to regulate providers of investment education programs. Although we believe that we are currently in compliance with all such regulations, there can be no assurance that the federal, state or international regulatory structure will not change. For example, if we were required to comply with, or found to be in violation of, a regulatory body's current or future licensing or regulatory requirements, we could be subject to civil or criminal sanctions, including monetary penalties. Additionally, we could be required to incur significant on-going expenses to comply with regulatory requirements or, conceivably, could be barred from providing investment education services in that jurisdiction. If any of these things occur, it could have a material adverse effect on our business and results of operations and may cause our stock price to decline.

Our ability to offer courses may be affected by natural disaster, strikes and other unpredictable events.

Natural disasters, external labor disruptions and other adverse events may affect our ability to conduct our business, resulting in loss of revenue. Severe blizzards or floods may reduce the ability of our course participants to travel to our courses. These natural disasters may also disrupt the printing and transportation of the materials used in our direct mail campaigns. Furthermore, postal strikes could occur in the countries where we operate which could delay and reduce delivery of our direct mail marketing materials. Transportation strikes could also occur in the countries where we operate, adversely affecting course attendance. The future occurrence of any of these events could have a material adverse effect on our business and results of operations and may cause our stock price to decline.

We may suffer losses if our reputation is harmed.

Our ability to attract and retain customers and employees may be adversely affected to the extent our reputation is damaged. If we fail, or appear to fail, to deal with various issues that may give rise to reputational risk, we could harm our business prospects. These issues include, but are not limited to, appropriately dealing with potential conflicts of interest, legal and regulatory requirements, ethical issues, money-laundering, privacy, record-keeping, marketing and sales practices, delivering products and services of high quality and the proper identification of the legal, credit, liquidity, and market risks inherent in our business. Failure to appropriately address these issues could also give rise to additional legal risk to us, which could, in turn, increase the size and number of claims and damages asserted against us or subject us to regulatory enforcement actions, fines, and penalties.

Risks Related to Our Common Stock

The market price of our common stock is subject to significant fluctuations due to a number of factors that are beyond our control.

The market price of our common stock has experienced, and may continue to experience, substantial volatility. During the twelve-month period ended December 31, 2007, the close price of our common stock on the NASDAQ Global Market has ranged from a low of $9.36 to a high of $18.15 per share. We expect our common stock to continue to be subject to fluctuations. Factors that could cause fluctuation in the stock price may include, among other things:

- actual or anticipated variations in quarterly operating results;
- changes in our relationships with our strategic partners;
- acquisitions and the operating results of the businesses we acquire;
- the sale of shares of our common stock by our significant stockholders;
- announcements of technological advances by us or our competitors;
- conditions or trends in our industry, including demand for our products and services, technological advances and governmental regulations;
- litigation involving or affecting us;
- changes in financial estimates by us or by any securities analysts who might cover our stock; and
- additions or departures of our key personnel.

Broad market and industry factors could also adversely affect the market price of our common stock, regardless of our actual operating performance. The realization of any of these risks and other factors beyond our control could cause the market price of our common stock to decline significantly.

If a large number of shares of our common stock are sold in the public market, the sales could reduce the trading price of our common stock and impede our ability to raise future capital.

We cannot predict what effect, if any, future issuances by us of our common stock will have on the market price of our common stock. We issued approximately 19.1 million shares of our common stock in connection with our merger with thinkorswim. We have registered approximately 10.3 million shares of such common stock for resale under a registration statement effective August 7, 2007. In addition we are obligated to file a shelf registration statement for approximately 3 million shares of common stock in the aggregate on or before April 14, 2008 and effect a shelf registration for an additional approximately 3 million shares of common stock in the aggregate on or before February 15, 2009, for the benefit of Tom Sosnoff and Scott Sheridan; provided, that upon the termination of their employment for other than cause, death or disability, such registration statement for the terminating employee's shares must be filed within thirty days of the terminating event. The market price of our common stock could drop significantly if certain large holders of our common stock, or recipients of our common stock in connection with an acquisition, including thinkorswim, sell all or a significant portion of their shares of common stock or are perceived by the market as intending to sell these shares other than in an orderly manner. In addition, these sales could impair our ability to raise capital through the sale of additional common stock in the capital markets.

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Our ability to issue preferred stock could adversely affect the rights of holders of our common stock.

Our certificate of incorporation authorizes us to issue up to 1,000,000 shares of preferred stock in one or more series on terms that may be determined at the time of issuance by our Board of Directors. Accordingly, subject to any contractual limitation, we may issue shares of any series of preferred stock that would rank senior to the common stock as to voting or dividend rights or rights upon our liquidation, dissolution or winding up without the consent of the holders of common stock.

Certain provisions in our charter documents have anti-takeover effects.

Certain provisions of our certificate of incorporation and bylaws may have the effect of delaying, deferring or preventing a change in control of us. Such provisions, including those limiting who may call special stockholders' meetings, the possible issuance of our preferred stock without stockholder approval, and a classified Board of Directors with staggered three year terms, may make it more difficult for other persons, without the approval of our Board of Directors, to make a tender offer or otherwise acquire substantial amounts of our common stock or to launch other takeover attempts that a stockholder might consider to be in such stockholder's best interest.

Because we have no plans to pay any dividends for the foreseeable future, investors must look solely to stock appreciation for a return on their investment in us.

We have never paid cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain any future earnings to support our operations and growth. Any payment of cash dividends in the future will be dependent on the amount of funds legally available, our earnings, financial condition, capital requirements and other factors that our Board of Directors may deem relevant. Additionally, our credit facility restricts the payment of dividends. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

ITEMS 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate headquarters are located in New York, NY and occupy approximately 700 square feet. The Investor Education segment operates its sales, service and operations out of Draper, UT and has a technology center in Palo Alto, CA, together utilizing approximately 70,000 total square feet between these two locations. The Brokerage Services segment operates primarily out of a facility in Chicago, IL, with approximately 23,000 square feet. We also lease office space in other cities throughout the United States.

While we believe our existing facilities are adequate to meet our immediate needs, it may become necessary to lease or acquire additional or alternative space to accommodate future growth.

ITEM 3. LEGAL PROCEEDINGS

From time to time we are involved in certain legal actions arising in the ordinary course of business, including inquiries, investigations and proceedings with government agencies and other regulators. We believe that such litigation and proceedings will be resolved without a material adverse effect to our liquidity, financial position or results of operations.

We have applied for rulings from various states on the taxability of our products to determine if our sales tax policy is supported by the various state taxing jurisdictions. During 2006, we received rulings from a majority of the states to which we applied. Based on these rulings, we adjusted amounts owing to various states, which aggregated to $0.8 million of additional accrued sales taxes payable. These amounts are included in selling expenses.

We are not aware of any material pending legal proceedings that may have a material adverse impact on our liquidity, financial position or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of 2007, there were no matters submitted to a vote of the stockholders.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES

Price Range of Common Stock

Our common stock is traded on the Nasdaq Global Market. Effective February 21, 2007, our common stock is traded under the symbol SWIM. The following table sets forth, for the periods indicated, the high and low closing sales prices for our common stock based on actual transactions on the Nasdaq Global Market. The prices do not include retail markups, markdowns or commissions.

	Company Common Stock Closing Sales Prices	
	High	Low
2007		
Quarter ended March 31	$ 17.11	$ 12.92
Quarter ended June 30	16.01	9.90
Quarter ended September 30	14.09	9.36
Quarter ended December 31	18.15	12.44
2006		
Quarter ended March 31	$ 8.78	$ 5.35
Quarter ended June 30	9.70	7.79
Quarter ended September 30	10.64	7.03
Quarter ended December 31	13.96	11.01

On March 12, 2008, the closing price of our common stock as reported by the Nasdaq Global Market was $10.35. As of March 12, 2008, we had 679 stockholders of record based on information provided by our transfer agent. The number of stockholders of record does not reflect the actual number of individual or institutional stockholders that own our stock because most stock is held in the name of nominees. Based on information previously provided to us by depositories and brokers, we believe there are more than 6,000 beneficial holders.

Dividend Policy

We have never declared a cash dividend on our common stock. The Board of Directors currently intends to retain any earnings for use in our business, and therefore, does not anticipate paying any cash dividends on our common stock in the foreseeable future.

Recent Sales of Unregistered Securities; Use of Proceeds from Registered Shares

In connection with the definitive agreement to enter into a long-term relationship with and acquisition of certain exclusive rights and intellectual property of a group of active option traders on February 27, 2007, we issued 650,000 unregistered common shares. Subject to meeting certain thresholds over annual and cumulative three-year periods, we will issue an additional 950,000 contingent shares of unregistered common shares. On February 27, 2008, we issued 200,000 of the contingent shares as they were earned during the fiscal year ended December 31, 2007.

In connection with our acquisition of mytrade on December 10, 2007, we issued 145,160 unregistered shares of our common stock to the prior owners of mytrade and paid approximately $1.0 million in cash. We relied on Section 4(2) of the Securities Act of 1933 as amended, and Regulation D promulgated thereunder to issue such shares of common stock.

Equity Compensation Plan Information

The following table sets forth information about the total number of outstanding options and shares available for future issuance under all of our existing equity plans as of December 31, 2007 including our Telescan and Ziasun Stock Option Plans, our 2001 Investools Stock Option Plan and our 2004 Restricted Stock Plan.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by stockholders	6,129,122	$ 9.05	5,513,410
Total	6,129,122	$ 9.05	5,513,410

Performance Measurement Comparison

The Company performance information shall not be deemed "soliciting material" or be deemed to be "filed" with the SEC nor shall such information be incorporated by reference into any prior or subsequent filing by the Company under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that we specifically incorporate it by reference into such filing.

The graph below shows the cumulative total stockholder return on an investment of $100.00 over the last five years for Investools. The return is compared to the Russell 2000 Stock Index and a peer group which represents both the brokerage industry and the education industry, assuming in each case dividend reinvestment. The peer group is comprised of the following companies:

Charles Schwab & Co., Inc.

E*TRADE Group, Inc.

OptionsXpress Inc.

TD Ameritrade, Inc.

TradeStation Group, Inc.

Apollo Group, Inc.

Career Education Corp.

Corinthian Colleges, Inc.

DeVry Inc.

ITT Educational Service, Inc. and

Strayer Education, Inc.

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The stockholder return shown on the graph below is not necessarily indicative of future performance.

	2002	2003	2004	2005	2006	2007
Investools Inc	$ 100	$ 700	$ 1,478	$ 2,348	$ 5,996	$ 7,713
Russell 2000 Index	$ 100	$ 145	$ 170	$ 176	$ 206	$ 200
Peer group	$ 100	$ 179	$ 178	$ 166	$ 166	$ 233

Issuer Purchases of Equity Securities

There were no stock repurchases during the year ended December 31, 2007.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data presented below should be read in conjunction with the Consolidated Financial Statements of Investools and related footnotes included elsewhere in this annual report on Form 10-K and the discussion under Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations." The selected consolidated financial data has been derived from the Consolidated Financial Statements of Investools. The historical financial and operating information may not be indicative of our future performance.

Results of Operations

(in thousands, except for per share data)

	Years Ended December 31,				
	2007	2006	2005	2004	2003
Revenue	$ 318,009	$ 170,330	$ 138,621	$ 97,169	$ 69,802
Cost of revenue	143,511	121,270	92,161	65,659	41,921
Selling expense	70,860	52,947	37,332	24,493	20,669
General and administrative expense	69,574	32,646	24,275	17,843	12,388
Net income (loss)	22,435	(40,732)	(15,742)	(11,727)	(7,301)
Net income (loss) per common share:					
Basic	$ 0.36	$ (0.90)	$ (0.35)	$ (0.26)	$ (0.17)
Diluted	$ 0.34	$ (0.90)	$ (0.35)	$ (0.26)	$ (0.17)
Weighted average shares outstanding:					
Basic	62,942	45,042	44,933	45,045	43,692
Diluted	65,790	45,042	44,933	45,045	43,692

Balance Sheet Data

(in thousands)

	Years Ended December 31,				
	2007	2006	2005	2004	2003
Cash, cash equivalents and marketable securities	$ 63,080	$ 75,064	$ 28,337	$ 24,576	$ 12,266
Total assets	509,330	131,637	72,699	49,778	26,551
Deferred revenue	161,870	159,575	77,516	40,378	14,520
Total liabilities	347,435	195,288	96,438	57,010	23,367
Total stockholders' equity/(deficit)	161,895	(63,651)	(23,739)	(7,232)	3,184

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Business Overview

Investools Inc. offers market-leading investor education and brokerage and related financial products and services for self-directed investors. Our Investor Education segment offers a full range of investor education products and services that provide lifelong learning in a variety of interactive delivery formats. Our educational products and services cover a broad range of financial products, including equity securities, options, fixed income, index products, futures, other derivatives and foreign exchange. We have more than 337,000 graduates of our foundation courses and 102,800 active subscribers to our websites.

On February 15, 2007, we merged with thinkorswim Group, Inc., a leading online brokerage firm and provider of related technology-based financial services to self-directed options traders and retail investors. thinkorswim® offers customers a broad range of products including equity securities, index products, exchange traded options, futures, mutual funds, bonds and foreign exchange. All securities transactions are cleared on a fully disclosed basis pursuant to a clearing agreement with our primary clearing broker, Penson Financial Services.

See Note 3 to the Consolidated Financial Statements for a discussion regarding Business Acquisitions that took place during 2007.

Segment Summary Results of Operations

During 2007, the operations of thinkorswim have been included in the Company's operations since the date of the merger. Previously reported amounts reported by the Company do not include the consolidated results of thinkorswim. As a result of the merger, we operate in the following two principal business segments:

Investor Education segment This business segment provides a full range of investor education products and services that provide lifelong learning and support to self-directed investors. The Company has more than 337,000 graduates of our Foundation course and 102,800 paid subscribers to our websites. The investor education products and services are offered in a variety of learning formats with courses ranging from beginning to advanced, to address the needs of students on all investor levels.

Brokerage Services segment This business segment is a leading online brokerage firm specializing in options and offers customers a broad range of products including equities, futures, mutual funds and bonds. The Company supports retail and active traders through its own trading platforms and is widely recognized as a premier option software for order entry, professional analytical tools and real-time position management. thinkorswim was ranked by Barron's as its top rated software-based online broker and best for options traders for 2006 and 2007.

See Note 17 to the Consolidated Financial Sheets for additional disclosure regarding Segment Reporting.

Consolidated Revenue

Investor Education segment sales transaction volume ("STV"), a non-GAAP measure, represents sales transactions generated in each period before the impact of recognition of deferred revenue from prior periods, for services performed in the current period, and the deferral of current period sales for services to be performed in the future. We believe that STV is an important measure of business performance for the Investor Education segment.

The following table sets forth our total consolidated revenues and segment operating data for the periods presented (in thousands):

	Years Ended December 31, 2007	2006	2005
Investor Education segment revenue			
Workshop	$ 40,667	$ 54,903	$ 47,646
Coaching services	80,387	89,034	69,124
Home study/Online courses	56,706	68,046	27,732
Webtime renewals	30,632	33,243	25,941
Other revenue	2,263	7,576	5,727
Total Investor Education sales transaction volume ("STV")	210,655	252,802	176,170
Change in deferred revenue	(3,528)	(82,472)	(37,549)
Investor Education segment revenue	207,127	170,330	138,621
Brokerage Services segment revenue			
Commissions	67,734		
Interest and dividends	20,961		
Other & brokerage related revenue	22,187		
Brokerage Services segment revenue	110,882		
Total Consolidated Revenue	$ 318,009	$ 170,330	$ 138,621

Cost of Revenue

(in thousands)

Cost of Revenue	2007	% of STV	% of Revenue	2006	% of STV	% of Revenue	2005	% of STV	% of Revenue
Partner Commissions	$ 33,468	10%	10%	$ 48,477	19%	29%	$ 30,688	17%	22%
Payroll cost	40,234	13%	13%	39,838	16%	23%	32,858	19%	24%
Brokerage, clearing and other related fees	17,361	5%	5%						
Depreciation and amortization	15,572	5%	5%	2,278	1%	1%	1,534	1%	1%
Other	36,876	12%	12%	30,677	12%	18%	27,081	15%	20%
Cost of Revenue	$ 143,511	45%	45%	$ 121,270	48%	71%	$ 92,161	52%	67%

Selling Expense

(in thousands)

	2007	% of Revenue	2006	% of Revenue	2005	% of Revenue
Marketing	$ 53,211	16%	$ 38,109	23%	$ 26,510	19%
Payroll	8,522	3%	5,781	3%	4,512	3%
Other	9,127	3%	9,057	5%	6,310	5%
Total selling expense	$ 70,860	22%	$ 52,947	31%	$ 37,332	27%

General and Administrative Expense
(in thousands)

	2007	% of Revenue	2006	% of Revenue	2005	% of Revenue
Payroll	$ 38,554	12%	$ 15,318	9%	$ 12,723	9%
Other	$ 0		$ 3,617		$ 297,742	

Officer, Senior Vice President, and Chief Financial Officer (5)	2008	$ 227,214	$ 450,000	$ 225,000	$ 52,664
Charles W. Olson, *Vice President and*	2010	$ 217,500	$ 100,000	$ 111,343	$ 0
General	2009	$ 204,750	$ 56,250	$ 0	$ 0
Manager, Cardiovascular Business Unit	2008	$ 204,805	$ 450,000	$ 225,000	$ 49,153
Eugene C. Rusch, *Vice President of Manufacturing*	2010	$ 130,001	$ 110,550	$ 211,750	$ 0
Arthur J. Tipton, Ph.D,	2010	$ 280,000	$ 0	$ 111,343	$ 0
Senior Vice President and General Manager,	2009	$ 273,000	$ 56,250	$ 0	$ 0
Pharmaceuticals	2008	$ 275,000	$ 595,906	$ 159,502	$ 65,302
Bruce J Barclay,	2010	$ 274,430	$ 0	$ 346,399	$ 0
Former President and	2009	$ 374,585	$ 175,000	$ 0	$ 0
Chief Executive Officer (5)	2008	$ 379,080	$ 1,400,000	$ 700,000	$ 172,955
Paul A. Lopez, *Former Vice President,*	2010	$ 141,166	$ 0	$ 111,343	$ 0
President,	2009	$ 273,000	$ 56,250	$ 0	$ 0
Ophthalmology Business Unit (6)	2008	$ 263,330	$ 112,500	$ 0	$ 58,459

(1) Reflects the aggregate grant date fair value of options, restricted stock and performance shares in accordance with Accounting Standards Codification Topic 718 (ASC 718), but disregarding estimates of forfeitures related to service-based vesting conditions. The value of performance shares assumes a 100% achievement level. The amounts reported do not match the amounts reported in last year s proxy statement due to new reporting requirements adopted by the SEC, which require the Company to restate the amounts for these years applying the new grant date fair value methodology. Because the grant dates cover the date on which the compensation was granted and not the performance period over which the compensation would be earned, the compensation is recorded in the fiscal year in which the award was approved rather than in the year to which the performance relates. The ultimate payout value may be significantly more or less than the amounts shown, and could be zero, depending on the outcome of the performance criteria (in the case of performance shares) and the price of our common stock at the end of the performance or restricted period or the expiration of stock options. For a description of the performance criteria applicable to the performance shares, see Compensation Discussion and Analysis Elements of Executive Compensation; Equity Elements of Compensation Performance Share Awards.

(2) Represents the aggregate grant date fair value of restricted stock and performance shares awarded to each named executive officer in fiscal 2010 under ASC 718 for restricted stock grants and performance share awards. With respect to performance share awards, amounts represent achievement at the Target Level. The table below shows the aggregate grant date fair value of performance share awards based on both Target levels of achievement and Maximum levels of achievement.

Name	Fiscal Year	ASC 718 Value of Performance Shares at Target	ASC 718 Value of Performance Shares at Maximum
Philip D. Ankeny	2010	$ 0	$ 0
	2009	$ 56,250	$ 112,500
	2008	$ 450,000	$ 900,000
Charles W. Olson	2010	$ 0	$ 0
	2009	$ 56,250	$ 112,500
	2008	$ 450,000	$ 900,000
Eugene C. Rusch	2010	$ 0	$ 0
Arthur J. Tipton, Ph.D.	2010	$ 0	$ 0
	2009	$ 56,250	$ 112,500
	2008	$ 431,500	$ 863,000
Bruce J Barclay	2010	$ 0	$ 0
	2009	$ 175,000	$ 350,000
	2008	$ 1,400,000	$ 2,800,000
Paul A. Lopez	2010	$ 0	$ 0
	2009	$ 56,250	$ 112,500
	2008	$ 112,500	$ 225,000

(3) Represents amounts earned under the annual incentive plan in each applicable period, which is discussed in detail in Compensation Discussion and Analysis above.

(4) Represents matching contributions to our 401(k) Plan, for which the employer match was discontinued effective April 1, 2009 and resumed effective April 1, 2010. Dr. Tipton s fiscal 2009 compensation includes $43,481 paid in lieu of vacation under the vacation policy existing at SurModics Pharmaceuticals, Inc. (formerly Brookwood Pharmaceuticals, Inc.) at the time of the Company s acquisition of it in July 2007. That policy was integrated into the Company s vacation policy on January 1, 2009. Mr. Lopez s 2010 compensation includes $280,000 paid pursuant to the terms of his offer letter. Mr. Rusch s 2010 compensation includes $19,439 in expenses related to Mr. Rusch s temporary living and relocation and a $5,000 payment pursuant to the terms of his offer letter.

(5) On June 1, 2010, Mr. Barclay resigned his position as the Company s President and Chief Executive Officer, and Mr. Ankeny was appointed as the Company s Chief Executive Officer on an interim basis. In recognition of the additional responsibilities assumed by him in connection with his role as the Company s interim Chief Executive Officer, Mr. Ankeny s base salary was increased by $10,000 per month for the period during which he served as interim CEO.

(6) Mr. Lopez s employment with the Company ended March 15, 2010.

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GRANTS OF PLAN-BASED AWARDS IN FISCAL 2010

The following table sets forth certain information concerning grants of plan-based awards to each of our named executive officers during fiscal 2010. You should refer to the sections of Compensation Discussion and Analysis above relating to the annual incentive plan and the officer performance share program to understand how plan-based awards are determined.

		Committee	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards(1)			All Other Stock Awards: Number of Shares of Stock or Units	All Other Option Awards: Number of Securities Underlying Options	Exercise or Base Price of Option Awards	Grant Date Fair Value of Stock and Option Awards
	Grant Date	Approval Date (if different)	Threshold ($)	Target ($)	Maximum ($)	(#)(2)	(#)(3)	($/sh)	($)(4)
Philip D. Ankeny			$ 0	$ 73,500	$ 147,000				
	02/8/10	09/21/09					18,283	$ 24.30	$ 168,750
	06/28/10					5,980			$ 100,000
Charles W. Olson			$ 0	$ 63,000	$ 126,000				
	02/8/10	09/21/09					18,283	$ 24.30	$ 168,750
	06/28/10					5,980			$ 100,000
Eugene C. Rusch			$ 0	$ 69,000	$ 138,000				
	03/15/10						25,000	$ 22.11	$ 211,750
	03/15/10					5,000			$ 110,550
Arthur J. Tipton, Ph.D.			$ 0	$ 84,000	$ 168,000				
	02/8/10	09/21/09					18,283	$ 24.30	$ 168,750
Bruce J Barclay			$ 0	$ 197,150	$ 394,300				
	02/8/10	09/21/09					56,880	$ 24.30	$ 525,000
Paul A. Lopez			$ 0	$ 84,000	$ 168,000				
	02/8/10	09/21/09					18,283	$ 24.30	$ 168,750

(1) Represents the potential cash payments under the Company s annual incentive plan at threshold, target and maximum performance. Under the terms of our annual cash incentive plan, results at the threshold level of performance would receive no award, however any result above that minimum would result in a proportional

level of award. For a further discussion of these awards, see Compensation Discussion and Analysis Elements of Executive Compensation Cash Elements of Compensation.

(2) Represents (i) restricted stock awards granted on June 28, 2010 to Messrs. Ankeny and Olson, for which each award has a two-year cliff vesting, except that in the event that the recipient is terminated other than for Cause (as defined in the award), or the recipient terminates his employment for Good Reason (as defined in the award), the entire award will immediately vest, and (ii) a restricted stock award granted to Mr. Rusch in March 2010 in connection with the commencement of his employment with the Company.

(3) Represents the number of stock options granted to each named executive officer (except Mr. Rusch) as a component of such officer s equity-based compensation on September 21, 2009 pursuant to the 2009 Equity Incentive Plan. These awards were granted subject to shareholder approval of the 2009 Equity Incentive Plan, which was obtained at the Company s 2010 Annual Meeting of Shareholders. Although these awards were priced on the date of grant and disclosed in our proxy for the 2010 Annual Meeting of Shareholders, for accounting purposes the grant date is deemed to be February 8, 2010, the date that the plan was approved by shareholders, and consequently we are disclosing the grants again as an award made in fiscal 2010. Mr. Rusch s award was granted at the commencement of his employment in March 2010.

(4) The grant date fair value calculations for performance share and option awards were made in accordance with ASC 718.

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OUTSTANDING EQUITY AWARDS AT 2010 FISCAL YEAR-END

The table below reflects all outstanding equity awards made to each of the named executive officers that are outstanding on September 30, 2010. The market or payout value of unearned shares, units or other rights that have not vested equals $11.92 per share, which was the closing price of the Company s common stock as listed on The NASDAQ Global Select Market on September 30, 2010.

	Option Awards(1)					Stock Awards				
							Shares or Units of Stock That Have Not Vested		Equity Incentiv Plan Awards: Unearne Shares, Units or Other Rights That Hav Not Vested	
ame	Option Grant Date	Number of Securities Underlying Unexercised Options (#)(1) Exercisable	Unexercisable	Option Exercise Price ($)	Option Expiration Date	Award Grant Date	Number (#)	Market Value ($)	Number (#)	Marke or Payou Value ($)
ilip D. nkeny	01/26/04	15,000	0	$ 21.36	01/26/11	05/19/08			510(3)	$ 6,079
	01/31/05	60,000	0	$ 29.37	01/31/12	09/15/08			599(4)	$ 7,140
	05/19/08	4,144	4,146	$ 44.09	05/19/15	09/21/09			463(4)	$ 5,519
	09/15/08	5,072	5,072	$ 37.51	09/15/15	6/28/10	5,980	$ 71,282		
	02/08/10	4,570	13,713	$ 24.30	09/21/16					
harles W. son	01/31/05	60,000	0	$ 29.37	01/31/12	05/19/08			510(3)	$ 6,079
	05/17/04	5,000	0	$ 21.82	05/17/11	09/15/08			599(4)	$ 7,140
	05/19/08	4,144	4,146	$ 44.09	05/19/15	09/21/09			463(4)	$ 5,519
	09/15/08	5,072	5,072	$ 37.51	09/15/15	6/28/10	5,980	$ 71,282		
	02/08/10	4,570	13,713	$ 24.30	09/21/16					
ugene C. usch	03/15/10	0	25,000	$ 22.11	03/15/17	03/15/10	5,000	$ 59,600		
rthur J. pton, Ph.D.	05/19/08	5,876	5,878	$ 44.09	05/19/15	05/19/08			724(3)	$ 8,630
	02/08/10	4,570	13,713	$ 24.30	09/21/16	09/15/08			599(4)	$ 7,140
						09/21/09			463(4)	$ 5,519
ruce J rclay(2)										
ul A. opez(2)										

(1)

Options granted prior to May 1, 2008 generally become exercisable with respect to 20% of the shares on each of the first five anniversaries following the grant date such that the entire option is fully vested five years after the grant date, and options granted subsequent to May 1, 2008 generally become exercisable with respect to 25% of the shares on each of the first four anniversaries following the grant date such that the entire option is fully vested four years after the grant date.

(2) In accordance with the terms of their equity awards, unexercised awards made to Mr. Barclay and Mr. Lopez were forfeited following the termination of their respective employment with the Company, and therefore were not outstanding as of September 30, 2010.

(3) On May 19, 2008, each of our named executive officers was issued a three-year performance share award enabling each such officer to receive the specified number of shares of our common stock to the extent predefined performance objectives were achieved during fiscal 2008-2010 period. Because minimum performance targets for this period were not met, none of the performance shares awarded to our named executive officers under that program vested, and the awards lapsed. Nevertheless, since the performance awards were outstanding at 2010 fiscal year end, pursuant to SEC rule, the value of these performance shares is disclosed at the threshold level.

(4) Because cumulative performance for the three-year performance period applicable to these performance shares is below threshold, number of shares and payout value are reported at threshold.

2010 OPTION EXERCISES AND STOCK VESTED

The table below includes information related to options exercised by each of the named executive officers during fiscal 2010 and restricted stock awards that vested during fiscal 2010. The value realized for such options and restricted stock awards is also provided. For options, the value realized on exercise is equal to the difference between the market price of the underlying shares at exercise and the exercise price of the options. For stock awards, the value realized on vesting is equal to the market price of the underlying shares at vesting.

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)
Philip D. Ankeny			10,000	233,800
Charles W. Olson			5,000	116,900
Eugene C. Rusch				
Arthur J. Tipton, Ph.D.			13,433	176,241
Bruce J Barclay			25,000	584,500
Paul A. Lopez			7,200	160,920

Employment Arrangements with Gary R. Maharaj

On December 14, 2010, we announced the hiring of Mr. Gary R. Maharaj as our President and Chief Executive Officer, effective as of December 27, 2010. In connection with his hiring, Mr. Maharaj entered into an Offer Letter and a Severance Agreement. Pursuant to the Offer Letter, Mr. Maharaj s annual salary will be $425,000, and he will be eligible for an annual target incentive award equal to 50% of his base salary (pro-rated for fiscal 2011). Mr. Maharaj s incentive award, if any, will be based on achievement of the Company s fiscal 2011 corporate and business objectives as approved by the Committee. The Company also agreed to pay up to $10,000 in legal fees incurred by Mr. Maharaj in connection with negotiating his employment offer, and to provide him with certain payments in the event the Company rescinds his offer of employment prior to his start date.

Additionally, pursuant to the Offer Letter, Mr. Maharaj was granted the following three stock awards on December 27, 2010: (1) a restricted stock award having a value equal to $250,000, half of which vested on December 27, 2010, and half of which will vest on December 27, 2011; (2) a 7 year non-qualified option to purchase shares of the Company s common stock having a value of $325,000, which will vest in four equal annual increments of twenty-five percent beginning on December 27, 2011; (3) a performance share award under the Company s fiscal 2011 officer performance share plan, the target number of shares provided in such award having a value equal to $325,000. Vesting of the performance shares will be determined based on the achievement of corporate performance objectives, as approved by the Committee, over a three-year period consisting of the Company s fiscal years 2011 through 2013. Each of the foregoing stock awards will be non-cancelable (except upon payment), and will otherwise be granted in accordance with the SurModics 2009 Equity Incentive Plan and the terms of the Severance Agreement.

Consistent with the Company s compensation philosophy and the design of the Company s executive compensation programs, a significant portion of Mr. Maharaj s compensation is tied to the Company s performance and is, therefore, at risk.

Pursuant to the Severance Agreement, Mr. Maharaj will be eligible for certain severance benefits in the event that his employment is terminated by the Company without cause, or by him for good reason. In particular, in the event his employment is terminated without cause, Mr. Maharaj will receive (1) a severance payment equal to twelve months of his then-current annual base salary, and (2) continuation coverage of life, health or dental benefits for up to 18 months. Further, in the event that Mr. Maharaj s employment is terminated by the Company without cause and he is unable to secure subsequent employment primarily because of his obligations under the Non-Competition, Invention, Non-Disclosure Agreement, the Company will extend his base salary severance payments so long as he is able to demonstrate that he is diligently seeking alternate employment. Additionally, any remaining forfeiture provisions on the initial restricted stock award provided to him in connection with his hiring will immediately lapse.

Additionally, pursuant to the Severance Agreement, Mr. Maharaj will be provided with severance benefits in the event his employment with the Company is terminated following a change in control of the Company. If, within twelve months following the occurrence of a change of control, Mr. Maharaj s employment with the Company is terminated either by the Company without cause, or by him for good reason, then Mr. Maharaj will receive: (1) a severance payment equal to two and one-half times the average cash compensation paid to him during the three most recent taxable years, and (2) continuation coverage of life, health or dental benefits for up to 18 months. In addition, any unvested portions of Mr. Maharaj s outstanding options or stock appreciation rights will immediately vest and become exercisable, any remaining forfeiture provisions on his outstanding restricted stock awards will immediately lapse, and the target number of shares subject to his outstanding performance awards will immediately vest and become payable. If the severance benefits payable to Mr. Maharaj would constitute an excess parachute payment under Section 280G of the Internal Revenue Code, and such benefits arise out of a change of control that occurs on or before the first anniversary of the Agreement, then Mr. Maharaj will receive a tax gross-up payment sufficient to pay the initial excise tax applicable to such excess parachute payment. The Board determined that it was appropriate to provide Mr. Maharaj with this benefit given the circumstances facing the Company at the time of his appointment, including the potential election contest and the Company s announcement on December 14, 2010, that it is exploring strategic alternatives for its SurModics Pharmaceuticals business, including a potential sale of that business.

Potential Payouts Upon Termination or Change of Control

The Company entered into a Change of Control Agreement with Philip D. Ankeny, Senior Vice President, Interim Chief Executive Officer and Chief Financial Officer, in April 2006 (which was amended in April 2009). The agreement was approved by the Organization and Compensation Committee of the Board of Directors. In addition, as described above, the Company entered into certain arrangements with Gary R. Maharaj on December 14, 2010. Because this agreement was entered into after September 30, 2010, potential benefits to Mr. Maharaj are not included in the table below.

Following its amendment in 2009, the agreement with Mr. Ankeny will be in effect until April 2012 unless a change of control (as such term is defined in the agreements) occurs within such period, in which case the agreement will terminate twelve months following the occurrence of such a change of control. Mr. Ankeny s agreement provides that the Company may terminate the employment of the executive, for any reason or no reason, at any time prior to the earlier of a change of control or the expiration of the agreement without obligation for severance benefits.

If within twelve months following the occurrence of a change of control, Mr. Ankeny s employment with the Company is terminated either by the Company without cause or by Mr. Ankeny for good reason, then Mr. Ankeny is entitled to receive a severance payment equal to two times the average cash compensation paid to him during the three most recent taxable years and to continue coverage under life, health and dental benefit plans for up to eighteen months. In addition, any unvested portions of Mr. Ankeny s outstanding options or stock appreciation rights will immediately vest and become exercisable, any remaining forfeiture provisions on his outstanding restricted stock awards will immediately lapse, and a portion of the shares subject to his outstanding performance awards (excluding those awards not subject to the achievement of corporate or business objectives) will immediately vest and become payable. If any change of control benefit payable to the executive would constitute an excess parachute payment under Section 280G of the Internal Revenue Code, the executive will receive a tax gross-up payment sufficient to pay the initial excise tax applicable to such excess parachute payment.

In addition, in June 2010, the Company issued restricted stock awards to certain executive officers, including Messrs. Ankeny and Olson. Each award has a two-year cliff vesting, except that in the event that the recipient is terminated other than for Cause (as defined in the award), or the recipient terminates his employment for Good Reason (as defined in the award), the entire award will immediately vest.

Compensation paid to Mr. Lopez in fiscal 2010 pursuant to the terms of his offer letter is disclosed above in the Summary Compensation Table. Other than with respect to that compensation, the arrangements with Mr. Maharaj

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described above, and as contained in the table below, no executive officer has any contractual right to severance or other termination benefits. The table below reflects estimated benefits for Mr. Ankeny under the existing Change of Control Agreement, and for Messrs. Ankeny and Olson under the terms of their restricted stock agreements described above, in each case assuming that the change of control occurred on September 30, 2010.

		Accelerated Vesting					
Name	**Severance Amounts(1)**	**Performance Shares(2)**	**Stock Options(3)**	**Stock Awards(4)**	**Other Benefits(5)**	**Estimated Tax Gross-Up(6)**	**Total**
Philip D. Ankeny	$ 551,491	$ 63,343	$ 0	$ 71,282	$ 21,071	$ 0	$ 707,186
Charles W. Olson	n/a	n/a	n/a	$ 71,282	n/a	n/a	$ 71,282

(1) This amount is equal to two times the average cash compensation paid to Mr. Ankeny during the three most recent taxable years. The average cash compensation means the executive s annual base salary and cash incentive payments.

(2) Represents the value of outstanding and unearned performance share awards, excluding those awards not subject to the achievement of corporate or business objectives.

(3) Represents the market gain (intrinsic value) of unvested options as of September 30, 2010 at the closing price on that date of $11.92.

(4) Represents the value of unvested restricted stock awards as of September 30, 2010 at the closing price on that date of $11.92. With respect to Messrs. Ankeny and Olson, this amount reflects the vesting of the restricted stock awards granted in June, 2010 which pursuant to their terms vest in the event of a termination by the Company other than for Cause, or in the event of a termination by the executive for Good Reason, in each case as defined in the restricted stock agreement.

(5) Represents the estimated value of the continuation of coverage under life, health, and dental benefit plans for up to eighteen months.

(6) This amount represents the estimated 280(G) tax gross-up payment.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires the Company s executive officers, directors and persons who own more than 10% of the Company s common stock (Insiders) to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of common stock and other equity securities of the Company. Insiders are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms they file.

To the Company s knowledge, based on a review of the copies of such reports furnished to the Company, for the fiscal year ended September 30, 2010, all Section 16(a) filing requirements applicable to Insiders were complied with, except that a Form 4 filed by Bryan Phillips reporting the withholding of 654 shares to satisfy tax liability incident to a vesting of restricted stock was not filed on a timely basis.

AUDIT COMMITTEE REPORT

The Board of Directors maintains an Audit Committee comprised of five of the Company s outside directors listed below. The Board of Directors and the Audit Committee believe that the Audit Committee s current member composition satisfies the rules of The NASDAQ Stock Market that governs audit committee composition, including the requirement that audit committee members all be independent directors as that term is defined by the rules of The NASDAQ Stock Market. Additionally, the Board of Directors has determined that Mr. Gerald B. Fischer and Ms. Susan E. Knight qualify as audit committee financial experts under federal securities laws.

In accordance with the written charter adopted by the Board of Directors, the Audit Committee assists the Board of Directors with fulfilling its oversight responsibility regarding the quality and integrity of the accounting, auditing and financial reporting practices of the Company. In discharging its oversight responsibilities regarding the audit process, the Audit Committee:

(1) reviewed and discussed the audited financial statements with management;

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(2) discussed with the Company s independent registered public accounting firm the matters required to be discussed by Statement on Auditing Standards No. 61, *Communications with Audit Committees*, as amended (AICPA, *Professional Standards*, Vol. 1. AU section 380), as adopted by the Public Company Accounting Oversight Board in Rule 3200T; and

(3) received the written disclosures and the letter from the independent registered public accounting firm required by the applicable requirements of the Public Company Accounting Oversight Board regarding the independent registered public accounting firm s communications with the audit committee concerning independence, and has discussed with the independent registered public accounting firm the firm s independence.

Based upon the review and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2010, as filed with the Securities and Exchange Commission.

Members of the Audit Committee:

Gerald B. Fischer, Chairman
José H. Bedoya
Mary K. Brainerd
Susan E. Knight
John A. Meslow

Audit Fees. The aggregate fees billed by Deloitte & Touche LLP for professional services rendered in connection with the audit of the Company s annual financial statements and reviews of the financial statements included in the Company s Forms 10-Q for the fiscal years ended September 30, 2010 and September 30, 2009 were $350,000, and $358,227, respectively. The fees for the fiscal year ended September 30, 2010 included amounts related to consents issued in connection with the filing of the Company s registration statements in connection with its equity plans.

Audit-Related Fees. The aggregate fees billed by Deloitte & Touche LLP for audit-related services rendered to the Company during fiscal 2010 and 2009 were $132,212 and $40,052, respectively. The audit-related fees in fiscal 2010 were related to analysis of the Company s license and development agreement with F. Hoffmann-La Roche, Ltd. (Roche) and Genentech, Inc., a wholly owned member of the Roche Group as well as consultations with the SEC regarding the accounting treatment. The fees in fiscal 2009 were related to consultation on the Company s SEC comment letter and the PR Pharmaceuticals acquisition.

Tax Fees. The aggregate fees billed by Deloitte & Touche LLP for tax-related services (tax compliance, tax planning, and tax advice) in fiscal 2010 and 2009 were $0 and $25,000, respectively. The fees in fiscal 2009 related to analysis of the termination of the Company s collaborative research and license agreement with Merck & Co., Inc.

All Other Fees. Deloitte & Touche Products Company LLC, an affiliate of Deloitte & Touche LLP billed during fiscal 2010 and 2009 that were $2,200 and $2,000, respectively for training materials.

The Company s Audit Committee pre-approved all of the services described in each of the items above. In addition, the Audit Committee considered whether provision of the above non-audit services was compatible with maintaining Deloitte & Touche LLP s independence and determined that such services did not adversely affect Deloitte & Touche LLP s independence.

RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

(Proposal #3)

The Audit Committee of the Board of Directors of the Company has appointed the firm of Deloitte & Touche LLP to serve as the independent registered public accounting firm of the Company for the fiscal year ending September 30, 2011, subject to ratification of this appointment by the shareholders of the Company. Deloitte &

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Touche LLP has acted as the Company s independent registered public accounting firm since fiscal 2002, and it is expected that at an Audit Committee meeting to be held prior to the Annual Meeting, such firm will be formally selected by the Audit Committee to serve as the Company s independent registered public accounting firm for the current fiscal year ending September 30, 2011. In the event that shareholders do not ratify the selection of Deloitte & Touche LLP, the Audit Committee will reevaluate their selection as the Company s independent registered public accounting firm for fiscal 2011.

Representatives of Deloitte & Touche LLP are expected to be present at the Annual Meeting, will be given an opportunity to make a statement regarding financial and accounting matters of the Company if they so desire, and will be available to respond to appropriate questions from the Company s shareholders.

The Board of Directors recommends that you vote **FOR** the ratification of the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of the Company for the fiscal year ending September 30, 2011.

ADVISORY VOTE ON EXECUTIVE COMPENSATION
(Proposal #4)

The Company is presenting the following proposal, which gives you as a shareholder the opportunity to endorse or not endorse the compensation of our named executive officers as described in this proxy statement by voting for or against the following resolution. This resolution is required pursuant to Section 14A of the Securities Exchange Act. While our Board of Directors intends to carefully consider the shareholder vote resulting from the proposal, the final vote will not be binding on us and is advisory in nature.

RESOLVED, that the shareholders approve the compensation of the Company s named executive officers, as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosure contained in the proxy statement set forth under the caption Executive Compensation and Other Information of this proxy statement.

The Board of Directors recommends that you vote **FOR** approval of the compensation of our named executive officers as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosure contained in the proxy statement set forth under the caption Executive Compensation and Other Information of this proxy statement. Proxies will be voted **FOR** approval of the proposal unless otherwise specified.

ADVISORY VOTE ON FREQUENCY OF SHAREHOLDER ADVISORY VOTES ON EXECUTIVE COMPENSATION
(Proposal #5)

The Company is presenting the following proposal, which gives you as a shareholder the opportunity to inform the Company as to how often you wish the Company to include a proposal, similar to Proposal #4, in our proxy statement. In connection with recently enacted legislation, companies are required to provide a separate shareholder advisory vote once every six years to determine whether the shareholders say-on-pay vote should occur every year, every two years or every three years. We believe that approval of executive compensation should occur every year because the Company believes that an annual advisory vote would allow our shareholders to provide us with their direct input on our compensation philosophy, policies and practices as disclosed in our proxy statement every year.

The Company is asking shareholders to vote on whether the say-on-pay vote should occur every year, every two years or every three years. As an advisory vote, this proposal is non-binding on the Company. If none of the options (i.e. year, two years or three years) receives a majority vote, the Board will consider the option receiving the most votes to have received the advisory approval of the shareholders.

The Board of Directors unanimously recommends that you vote to hold an advisory vote on executive compensation every **YEAR**.

SHAREHOLDER PROPOSALS

Any appropriate proposal submitted by a shareholder of the Company and intended to be presented at the 2012 annual meeting of shareholders must be received by the Company by September , 2011, to be considered for inclusion in the Company s Proxy Statement and related Proxy for the 2012 annual meeting. Any other shareholder proposal intended to be presented at the 2012 annual meeting, but not included in the Company s Proxy Statement and Proxy must be received by the Company on or before November 9, 2011.

ANNUAL REPORT

A copy of the Company s Annual Report to Shareholders, including its Annual Report on Form 10-K containing financial statements for the fiscal year ended September 30, 2010, accompanies this Notice of Meeting and Proxy Statement. No part of the Annual Report, including any portion of the Annual Report on Form 10-K, is incorporated herein and no part thereof is to be considered proxy soliciting material.

EXHIBITS TO FORM 10-K

The Company will furnish to each person whose Proxy is being solicited, upon written request of any such person, a copy of any exhibit described in the exhibit list accompanying the Form 10-K, upon the payment, in advance, of reasonable fees related to the Company s furnishing such exhibit(s). Requests for copies of such exhibit(s) should be directed to Mr. Philip D. Ankeny, Senior Vice President and Chief Financial Officer, at the Company s principal address.

OTHER BUSINESS

Neither management nor the Board knows of any matters to be presented at the Annual Meeting other than the matters described above. If any other matter properly comes before the Annual Meeting, the appointees named in the Proxies will vote the Proxies in accordance with their best judgment.

Your vote is very important no matter how many shares you own. You are urged to read this proxy statement carefully and, whether or not you plan to attend the Annual Meeting, to promptly submit a proxy by signing, dating and returning the enclosed Proxy in the postage paid envelope.

BY ORDER OF THE BOARD OF DIRECTORS

Robert C. Buhrmaster
Chairman of the Board

Dated: January , 2011
Eden Prairie, Minnesota

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PRELIMINARY COPY SUBJECT TO COMPLETION VOTE BY INTERNET www.proxyvote.com Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and SURMODICS, INC. follow the instructions to obtain your records and to create an electronic voting 9924 WEST 74TH STREET instruction form. EDEN PRAIRIE, MN 55344-3523 ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years. VOTE BY PHONE 1-800-690-6903 Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions. VOTE BY MAIL Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717. TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS: M28710-P04148 KEEP THIS PORTION FOR YOUR RECORDS THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED. DETACH AND RETURN THIS PORTION ONLY SURMODICS, INC. For Withhold For All To withhold authority to vote for any individual All All Except nominee(s), mark For All Except and write the The Board of Directors recommends you vote number(s) of the nominee(s) on the line below. FOR the following: Vote on Directors 0 0 0 1. Election of Directors Nominees: 01) Robert C. Buhrmaster 02) Jeffrey C. Smith 03) Susan E. Knight Vote on Proposals For Against Abstain The Board of Directors recommends you vote FOR the following proposals: 2. To set the number of directors at ten (10); 0 0 0 3. Ratify the appointment of Deloitte & Touche LLP as SurModics independent registered public accounting firm for fiscal year 2011; 0 0 0 4. Cast a non-binding advisory vote on executive compensation; and 0 0 0 The Board of Directors recommends you vote 1 year on the following proposal: 1 Year 2 Years 3 Years Abstain 5. Cast a non-binding advisory vote regarding the frequency of non-binding shareholder advisory votes on executive compensation; 0 0 0 0 PRELIMINARY COPY SUBJECT TO COMPLETION Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name, by authorized officer. Signature [PLEASE SIGN WITHIN BOX] Date Signature (Joint Owners) Date

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Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting: The Notice and Proxy Statement and Annual Report are available at www.proxyvote.com. M28711-P04148 PRELIMINARY COPY SUBJECT TO COMPLETION SURMODICS, INC. Annual Meeting of Shareholders February 7, 2011 4:00 PM This proxy is solicited by the Board of Directors The shareholder(s) hereby appoint(s) Gary R. Maharaj and Philip D. Ankeny, or either of them, as proxies, each with the power to appoint his substitute, and hereby authorizes them to represent and to vote, as designated on the reverse side of this ballot, all of the shares of Common stock of SURMODICS, INC. that the shareholder(s) is/are entitled to vote at the Annual Meeting of shareholders to be held at 4:00 PM, CST on February 7, 2011 at the offices of Faegre & Benson LLP located at 90 South Seventh Street in Minneapolis, Minnesota, and any adjournment or postponement thereof. This proxy, when properly executed, will be voted in the manner directed herein. If no such direction is made, this proxy will be voted in accordance with the Board of Directors recommendations. Continued and to be signed on reverse side