

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

- QUARTERLY** report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2007

OR

- TRANSITION** report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____.

Commission file number 0-26420

AMBASSADORS GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware

*(State or Other Jurisdiction of
Incorporation or Organization)*

91-1957010

*(I.R.S. Employer
Identification No.)*

Dwight D. Eisenhower Building

2001 South Flint Road

Spokane, WA

(Address of Principal Executive Offices)

99224

(Zip Code)

Registrant's Telephone Number, Including Area Code: (509) 568-7800

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 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
- No

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

- Large Accelerated filer
- Accelerated filer
- Non-Accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

- Yes
- No

The number of shares outstanding of the registrant's Common Stock, \$0.01 par value, as of October 30, 2007 was 19,486,043.

AMBASSADORS GROUP, INC.
FORM 10-Q QUARTERLY REPORT

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**PART I
FINANCIAL INFORMATION**

Item 1. FINANCIAL STATEMENTS

AMBASSADORS GROUP, INC.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
September 30, 2007 and December 31, 2006
(dollars in thousands, except share and per share data)

	September 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,382	\$ 36,784
Available-for-sale securities	71,791	96,350
Foreign currency exchange contracts	2,929	2,571
Prepaid program costs and expenses	6,527	3,786
Other assets	550	675
Total current assets	96,179	140,166
Property and equipment, net	27,895	12,267
Deferred tax asset	1,743	1,328
Other long-term assets	171	192
Total assets	<u>\$ 125,988</u>	<u>\$ 153,953</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 8,779	\$ 2,941
Accrued expenses	8,031	3,922
Deferred tax liability	705	737
Other liabilities	—	1,268
Participants' deposits	21,624	60,651
Capital lease	199	191
Total current liabilities	39,338	69,710
Long term liabilities:		
Capital lease	46	196
Total liabilities	<u>39,384</u>	<u>69,906</u>
STOCKHOLDERS' EQUITY		
Preferred stock, \$.01 par value; 2,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$.01 par value; 50,000,000 shares authorized; 19,593,843 and 20,599,170 shares issued and outstanding, respectively	195	205
Additional paid-in capital	6,091	15,619
Retained earnings	78,359	66,587
Accumulated other comprehensive income	1,959	1,636
Total stockholders' equity	<u>86,604</u>	<u>84,047</u>
Total liabilities and stockholders' equity	<u>\$ 125,988</u>	<u>\$ 153,953</u>

The accompanying notes are an integral part of the consolidated financial statements.

AMBASSADORS GROUP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
For the three and nine months ended September 30, 2007 and 2006
(dollars in thousands, except per-share amounts)

	Nine months ended September 30,		Three months ended September 30,	
	2007	2006	2007	2006
Net revenue, non-directly delivered programs	\$ 80,997	\$ 65,222	\$ 42,571	\$ 33,174
Gross revenue, directly delivered programs	27,185	17,789	9,567	5,532
Total Revenue	108,182	83,011	52,138	38,706
Cost of sales, directly delivered programs	15,916	10,233	6,169	3,613
Gross Margin	92,266	72,778	45,969	35,093
Operating Expenses:				
Selling and marketing	29,066	22,925	10,185	9,176
General and administrative	9,503	6,707	3,479	2,399
Total Operating Expenses	38,569	29,632	13,664	11,575
Operating Income	53,697	43,146	32,305	23,518
Other income:				
Interest income	3,337	3,626	1,000	1,263
Income before income taxes	57,034	46,772	33,305	24,781
Income tax provision	18,565	14,654	10,801	7,682
Net income	\$ 38,469	\$ 32,118	\$ 22,504	\$ 17,099
Net income per share — basic	\$ 1.98	\$ 1.56	\$ 1.16	\$ 0.83
Weighted-average common shares outstanding — basic	19,423	20,559	19,394	20,609
Net income per share — diluted	\$ 1.91	\$ 1.50	\$ 1.12	\$ 0.80
Weighted-average common shares outstanding — diluted	20,172	21,390	20,125	21,418

The accompanying notes are an integral part of the consolidated financial statements.

AMBASSADORS GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
For the three and nine months ended September 30, 2007 and 2006
(dollars in thousands)

	Nine months ended		Three months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Net income	\$ 38,469	\$ 32,118	\$ 22,504	\$ 17,099
Unrealized gain (loss) on foreign currency exchange contracts, net of income tax benefit (provision) of \$(125), \$(908), \$(565), and \$14	233	1,675	1,049	(25)
Unrealized gain (loss) on available-for-sale securities, net of income tax (provision) of \$(49), \$(42), \$(86), and \$(86)	90	95	159	160
Comprehensive income	<u>\$ 38,792</u>	<u>\$ 33,888</u>	<u>\$ 23,712</u>	<u>\$ 17,234</u>

The accompanying notes are an integral part of the consolidated financial statements.

AMBASSADORS GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
For the nine months ended September 30, 2007 and 2006
(dollars in thousands)

	2007	2006
Cash flows from operating activities:		
Net income	\$ 38,469	\$ 32,118
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,632	1,083
Stock-based compensation	1,450	1,561
Write-down of property and equipment	336	—
Excess tax benefit from stock-based compensation	(2,696)	(1,703)
Change in assets and liabilities:		
Prepaid program costs and expenses	(2,741)	(4,331)
Accounts payable and accrued expenses	12,128	3,537
Participants' deposits	(39,027)	(17,946)
Other current assets	(98)	(699)
Net cash provided by operating activities	9,453	13,620
Cash flows from investing activities:		
Net change in available-for-sale securities	24,698	(4,593)
Purchase of property and equipment and other	(18,726)	(4,318)
Net cash provided by (used in) investing activities	5,972	(8,911)
Cash flows from financing activities:		
Dividend payment to shareholders	(6,712)	(5,278)
Repurchase of common stock	(35,621)	(2,984)
Proceeds from exercise of stock options	1,952	1,397
Excess tax benefit from stock-based compensation	2,696	1,703
Capital lease payments and other	(142)	(134)
Net cash used in financing activities	(37,827)	(5,296)
Net decrease in cash and cash equivalents	(22,402)	(587)
Cash and cash equivalents, beginning of period	36,784	26,916
Cash and cash equivalents, end of period	\$ 14,382	\$ 26,329

The accompanying notes are an integral part of the consolidated financial statements.

AMBASSADORS GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Basis of Presentation

Ambassadors Group, Inc. is a leading educational travel company that organizes and promotes international and domestic educational travel and sports programs for youth, athletes and professionals. These consolidated financial statements include the accounts of Ambassadors Group, Inc. and our wholly owned subsidiaries.

We have a single operating segment consisting of the educational travel and sports programs for students, athletes and professionals. These programs have similar economic characteristics, offer comparable products to participants and utilize similar processes for program marketing.

Revenue from non-directly delivered programs is presented as net revenue and recognized as the program convenes. For these non-directly delivered programs, we do not actively manage the operations of each program, and our remaining performance obligation for these programs after they convene is perfunctory. For directly delivered programs, however, we organize and operate all activities including speakers, facilitators, events, accommodations and transportation. As such, we recognize the gross revenue and cost of sales of these directly delivered programs over the period the programs are being delivered.

In our opinion, the consolidated financial statements contain all adjustments necessary to present fairly our financial position at September 30, 2007 and December 31, 2006, our results of operations for the three and nine months ended September 30, 2007 and 2006, and our cash flows for the nine months ended September 30, 2007 and 2006.

2. Income Per Share

Net income per share — basic is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Net income per share — diluted is computed by increasing the weighted-average number of common shares outstanding by the additional common shares that would have been outstanding if the dilutive potential common shares had been issued.

The following table presents a reconciliation of basic and diluted earnings per share (“EPS”) computations and the number of dilutive securities (stock options and grants) that were not included in the dilutive EPS calculation because they were anti-dilutive (in thousands, except per-share amounts):

	Nine months ended September 30,		Three months ended September 30,	
	2007	2006	2007	2006
Numerator:				
Net income for basic and diluted earnings per share	\$ 38,469	\$ 32,118	\$ 22,504	\$ 17,099
Denominator:				
Weighted-average shares outstanding – basic	19,423	20,559	19,394	20,609
Effect of dilutive common stock options	665	781	638	753
Effect of dilutive common stock grants	84	50	93	56
Weighted average shares outstanding – diluted	20,172	21,390	20,125	21,418
Net income per share – basic	\$ 1.98	\$ 1.56	\$ 1.16	\$ 0.83
Net income per share - diluted	\$ 1.91	\$ 1.50	\$ 1.12	\$ 0.80

AMBASSADORS GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the three months ended September 30, 2007 and 2006, and for the nine months ended September 30, 2007 the effects of a negligible number of stock options have been excluded from the calculation of diluted earnings per share because their effect would be anti-dilutive. For the nine months ended September 30, 2006, the effects of approximately 116,000 stock options have been excluded from the calculation of diluted earnings per share because their effect would be anti-dilutive.

3. Accounting for Stock-Based Compensation

Effective November 2001, we adopted our 2001 Equity Participation Plan (the "Plan"). The Plan provides for the grant of stock options, awards of restricted stock, performance or other awards or stock appreciation rights to our directors, key employees and consultants. The maximum number of shares which may be awarded under the Plan is 3.6 million shares, and approximately 0.8 million shares remain available for future issuance as of September 30, 2007.

Under the terms of the Plan, restricted stock grants follow the same grant price parameters as options. The Compensation Committee of the Board of Directors (the "Compensation Committee") also establishes the vesting period of the grants, which is generally set at 100 percent at the conclusion of one to four years. Our key employees who have been awarded stock grants and are full time employees are subject to a four year vesting period, while members of our Board of Directors who have been awarded stock grants are subject to a one year vesting period. During the three months ended September 30, 2007 and 2006, 1,400 and no restricted stock grants were granted to our Board of Directors or key employees, and during the nine months ended September 30, 2007 and 2006, approximately 3,900 and 3,100 restricted stock grants were granted to our Board of Directors or key employees, respectively.

Under the terms of the Plan, options to purchase shares of our common stock are granted at a price set by the Compensation Committee, not to be less than the par value of a share of common stock and if granted as performance-based compensation or as incentive stock options, not to be less than the fair market value of the stock on the date of grant. The Compensation Committee establishes the vesting period of the awards, which is generally set at 25 percent per year for four years. Options may be exercised any time after they vest for a period up to 10 years from the grant date. The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model. The assumptions used to calculate the fair value of options granted are evaluated and revised, as necessary, to reflect market conditions and our experience as of the date of grant.

Total stock-based compensation expense recognized in the consolidated statement of operations for the quarter ended September 30, 2007 was \$0.5 million before income taxes. Of the total stock-based compensation expense during the quarter, stock option expense was \$0.2 million, restricted stock grant expense was \$0.2 million, and the related total tax benefit was \$0.1 million. Total stock-based compensation expense recognized in the consolidated statement of operations for the nine months ended September 30, 2007 was \$1.4 million before income taxes. Of the total stock-based compensation expense during this time period, stock option expense was \$0.7 million, restricted stock grant expense was \$0.7 million, and the related total tax benefit was \$0.4 million.

AMBASSADORS GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in the nine months ending September 30, 2007 and 2006. No stock options were granted during the three months ended September 30, 2007 or 2006.

	<u>Nine months ended September 30, 2007</u>	<u>Nine months ended September 30, 2006</u>
Expected dividend yield	1.47 %	1.23 %
Expected stock price volatility	37.70 %	37.09 %
Risk-free interest rate	4.63 %	5.11 %
Expected life of options	4.55 years	8.89 years
Estimated fair value per option granted	\$11.01	\$12.99

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, giving consideration to the contractual terms, vesting schedules and expectations of future employee behavior. Expected stock price volatility is based on historical volatility of our stock. The risk-free interest rate is based on the implied yield available on U.S. Treasury zero-coupon issues with an equivalent remaining term. We have also included our anticipated dividend yield based on quarterly cash dividends paid to our shareowners during 2007 and 2006. Additionally, an annualized forfeiture rate of 8.0 percent is used as a best estimate of future forfeitures based on our historical forfeiture experience. Under the true-up provisions of Statement of Financial Accounting Standard No. 123, "Share-Based Payment" ("SFAS 123(R)"), the stock-based compensation expense will be adjusted in later periods if the actual forfeiture rate is different from the estimate.

The Black-Scholes option-pricing model was developed for use in estimating the fair value of options. In addition, option valuation models require the input of highly subjective assumptions, particularly for the expected term and stock price volatility. Our employee stock options do not trade on a secondary exchange, therefore employees do not derive a benefit from holding stock options unless there is an appreciation in the market price of our stock above the grant price. Such an increase in stock price would benefit all shareholders commensurately.

Stock option and restricted stock transactions during the nine months ended September 30, 2007 were as follows:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Aggregate Intrinsic Value (in thousands)</u>
Outstanding, December 31, 2006	1,753,363	\$ 9.79		
Granted	33,586	28.69		
Exercised	(289,483)	6.74		
Canceled	(11,491)	26.68		
Outstanding, September 30, 2007	<u>1,485,975</u>	<u>\$ 10.70</u>	<u>5.22</u>	<u>\$ 40,722</u>
Exercisable, September 30, 2007	940,293	\$ 7.96	4.73	\$ 28,345

The aggregate intrinsic value in the table above is before applicable income taxes, based on our \$38.10 closing stock price at September 30, 2007, which would have been received by the optionees had all options been exercised on that date. As of September 30, 2007, total unrecognized stock-based compensation expense related to non-vested stock options and restricted stock grants was approximately \$3.4 million, which is expected to be recognized over a period of approximately 3.7 years. During the three and nine months ended September 30, 2007, the total intrinsic value of stock options exercised was \$2.0 million and \$7.9 million, and the total fair value of options vested was \$0.2 million and \$0.4 million, respectively.

AMBASSADORS GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents information about our common stock options and restricted grants as of September 30, 2007:

Range of Exercise Prices	Options and Grants Outstanding			Options Exercisable	
	Shares	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$0.00 - \$3.47	172,066	1.79	\$ -	2,566	\$ 3.11
3.48 - 6.93	688,143	4.07	5.62	688,143	5.62
6.94 - 10.40	134,885	5.80	9.20	101,035	9.02
10.41 - 13.86	51,575	6.19	11.76	31,875	11.82
13.87 - 17.33	149,292	7.21	16.65	70,299	16.65
20.80 - 24.26	53,000	7.87	21.09	17,500	21.09
24.27 - 27.72	207,746	8.59	27.11	27,411	26.80
27.73 - 31.19	15,609	9.06	29.48	1,464	27.89
31.20 - 34.65	13,659	9.60	34.65	-	-
	<u>1,485,975</u>	<u>5.22</u>	<u>\$ 10.55</u>	<u>940,293</u>	<u>\$ 7.96</u>

4. Uncertainty of Income Taxes

In June 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement 109, Accounting for Income Taxes* (“FIN 48”). This statement clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company’s financial statements. FIN 48 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. Effective January 1, 2007, we adopted the provisions of FIN 48. There was no material effect on the financial statements, and as a result, there was no cumulative effect related to adopting FIN 48. However, certain amounts have been reclassified in the statement of financial position in order to comply with the requirements of the statement.

As of January 1, 2007, we provided a liability for approximately \$164,000 of unrecognized tax benefits, of which \$163,000 was interest, related to various federal and state income tax matters. The majority of unrecognized tax benefits consisted of items that are offset by deferred tax assets and the federal tax benefit of state income tax items. Thus, the amount that would impact our effective tax rate, if recognized, is insignificant. The liability decreased to zero and an insignificant amount of additional interest was recognized during the quarter ended June 30, 2007 due to a settlement with the Internal Revenue Service. No interest was recognized during the quarter ended September 30, 2007. No penalties were recognized during the three and nine months ended September 30, 2007. Our policy is to account for interest and penalties related to uncertain tax positions as part of income tax expense.

We file tax returns in the U.S. federal jurisdiction and various state jurisdictions. We are currently open to audit under the statute of limitations by the Internal Revenue Service for the year ending December 31, 2006. Our state income tax returns are open to audit under the statute of limitations for the years ending December 31, 2002 through 2006.

5. Recently Issued Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements. Rather, it applies under other accounting pronouncements that require or permit fair value

AMBASSADORS GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS 157 are effective for the fiscal years beginning after November 15, 2007. Therefore, we anticipate adopting this standard as of January 1, 2008. We have not determined the effect, if any, the adoption of this statement will have on our financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, *Fair Value Option for Financial Assets and Financial Liabilities* (“SFAS 159”). SFAS 159 gives entities the option to measure eligible financial assets and liabilities at fair value on an instrument by instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election to use the fair value option is available when an entity first recognizes a financial asset or financial liability. Subsequent changes in fair value must be recorded in earnings. This statement is effective as of the beginning of a company’s first fiscal year after November 15, 2007. Therefore, we anticipate adopting this standard as of January 1, 2008. We have not determined the effect, if any, the adoption of this statement will have on our financial condition or results of operations.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our consolidated financial statements and the notes thereto included in this Quarterly Report on Form 10-Q.

Statements contained in this Quarterly Report on Form 10-Q, which are not historical in nature, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These forward-looking statements include, without limitation, statements in Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations, regarding matters which are not historical fact, including our intent, belief or current expectations of our Company or our officers with respect to, among other things, trends in the travel industry, business and growth strategies, use of technology, ability to integrate acquired businesses, future actions, future performance or results of operations, the outcome of contingencies such as legal proceedings.

Forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from anticipated results. These risks and uncertainties include factors affecting the travel industry generally, competition, our ability to successfully integrate the operations of existing or acquired companies, and a variety of factors such as conflict in Iraq and the Middle East, periods of international unrest, the outbreak of disease, changes in the direct-mail environment, recession, weather conditions and concerns for passenger safety that could cause a decline in travel demand, as well as the risk factors, and other factors as may be identified from time to time in our Securities and Exchange Commission filings or in our press releases. For a more complete discussion of these risks, please refer to Item 1A Risk Factors disclosure in our Annual Report on Form 10-K filed on March 9, 2007 and those factors set forth under Part II, Item 1A Risk Factors set forth in this Quarterly Report on Form 10-Q.

Executive Overview

We are a leading educational travel company that organizes and promotes international and domestic programs for students, athletes and adults. Youth programs provide opportunities for grade school, middle school and high school students to learn about the history, government, economy and culture of the foreign and domestic destinations they visit as well as for athletes to participate in international sports challenges. Our student leadership programs provide educational opportunities for grade school, middle school and high school students to learn leadership, government, college admissions and community involvement skills at domestic and international destinations. Our adult programs emphasize meetings and seminars between delegates and persons in similar professions abroad.

We were founded in 1967, were reincorporated in Delaware in 1995, and operated as Ambassadors Education Group, a wholly owned subsidiary of Ambassadors International, Inc. until February 2002, at which time we spun off to operate as an independent stand-alone company beginning in March, 2002. Since then, our common stock has traded on The NASDAQ Stock Market under the ticker symbol “EPAX”. The consolidated financial statements include the accounts of Ambassadors Group, Inc. and our wholly owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

We have a single operating segment consisting of educational travel and sports programs for students, athletes and professionals. These programs have similar economic characteristics, offer comparable products to delegates, and utilize similar processes for program marketing.

Our Seasonality

Our business is seasonal. The majority of our travel programs occur in June and July of each year. We have historically earned more than 85 percent of our annual revenues in the second and third quarters, which we anticipate will continue for the foreseeable future. Historically, these seasonal revenues have more than offset operating losses incurred during the rest of the year. Our annual results would be adversely affected if our revenues were to be substantially below seasonal norms during these periods.

Our Foreign Currency Exposure

The majority of our programs take place outside the United States and most foreign suppliers require payment in local currency rather than in U.S. dollars. Accordingly, we are exposed to foreign currency risks in certain countries as foreign currency exchange rates between those currencies and the U.S. dollar fluctuate. We generally hedge against certain of these foreign currency risks. We use forward contracts and options that allow us to acquire the foreign currency at a fixed price for a specified period of time. Some of our forward contracts and options include a variable component if a pre-determined trigger occurs during the term of the contract.

These foreign exchange contracts and options are entered into in order to support normal anticipated recurring purchases and, accordingly, are not entered into for speculative purposes.

Program Revenue and Accounting Structure

The majority of our revenue is from non-directly delivered programs and is presented as net revenue and recognized as the program convenes. For these programs, we do not actively deliver the operations of each program, and our remaining performance obligation for these programs after they convene is perfunctory. For directly delivered programs, however, we organize and operate all activities including speakers, facilitators, events, accommodations and transportation. As such, we present gross revenue and cost of sales, and we recognize the gross revenue and cost of sales of these directly delivered programs over the period the programs are being delivered.

Our policy is to obtain payment for substantially all travel services prior to entering into commitments for incurring expenses relating to such travel. Program pass-through and direct delivery expenses include all direct costs associated with our programs, including, but not limited to, costs related to airfare, hotels, meals, ground transportation, guides, presenters, facilitators, professional exchanges and changes in currency exchange rates.

Operating expenses, which are expensed as incurred, are the costs related to the creation of programs, promotional materials and marketing costs, salaries, rent, other general and administrative expenses and all ordinary expenses.

Comparison of the Three Months Ended September 30, 2007 to the Three Months Ended September 30, 2006

Total revenue increased 35 percent to \$52.1 million from \$38.7 million, and gross margin increased 31 percent to \$46.0 million from \$35.1 million during the third quarter 2007 in comparison to the third quarter 2006. The increase in total revenue and gross margin was a direct result of traveling 24,475 delegates in the third quarter 2007 in comparison to 19,500 delegates in the third quarter 2006.

Selling and marketing expenses were \$10.2 million and \$9.2 million during the third quarters of 2007 and 2006, respectively. The \$1.0 million increase was spent primarily toward increased personnel to support higher business volumes during 2007 compared to 2006, as well as additional marketing expenses during 2007 for our 2008 travel programs. General and administrative expenses increased \$1.1 million to \$3.5 million from \$2.4 million as a result of higher business volumes, increased personnel to support the increased delegates traveling on our programs, and planned investments in our organizational and technical capabilities.

Other income consists primarily of interest income generated by cash, cash equivalents and available-for-sale securities. Interest income recognized decreased \$0.3 million to \$1.0 million from \$1.3 million during the quarters ended September 30, 2007 and 2006, respectively. This decreased interest income was primarily due to interest income on lower cash, cash equivalents and available-for-sale security balances held during the quarter ended September 30, 2007 than those held during the quarter ended September 30, 2006. These decreased balances were a result of \$35.6 million expenditures on share repurchases and \$18.7 million on capital expenditures primarily relating to our new office facility and new equipment.

The income tax provision has been recorded based on a 32.5 percent and 31.3 percent estimated annual effective income tax rate, applied to the pre-tax income for the quarters ended September 30, 2007 and 2006, respectively. The difference from the statutory rate of 35 percent is primarily due to tax exempt interest.

This resulted in net income of \$22.5 million and \$17.1 million, and \$1.12 and \$0.80 earnings per share being recorded during the third quarters of 2007 and 2006, respectively.

Comparison of the Nine Months Ended September 30, 2007 to the Nine Months Ended September 30, 2006

Total revenue increased to \$108.2 million from \$83.0 million, and gross margin increased to \$92.3 million from \$72.8 million in the first nine months of 2007 versus the same time period in 2006. The 27 percent increase in gross margin was a direct result of traveling 23 percent more delegates in the first nine months of 2007 than the same period of 2006. We traveled 49,900 delegates year to date in 2007 in comparison to 40,600 delegates year to date in 2006.

Selling and marketing expenses were \$29.1 million and \$22.9 million year to date 2007 and 2006, respectively. The \$6.1 million increase was spent primarily toward increased personnel to support higher business volumes during 2007 compared to 2006, as well as additional marketing expenses during 2007 for our 2008 travel programs. General and administrative expenses were \$9.5 million and \$6.7 million year to date 2007 and 2006, respectively. The \$2.8 million increase resulted from additional expenses supporting the increased number of delegates traveling during 2007 and planned investments in our organizational and technical capabilities.

Other income in the first nine months of 2007 and 2006 consists primarily of interest income generated by cash, cash equivalents and available-for-sale securities. Interest income decreased to \$3.3 million from \$3.6 million when comparing the nine months ending September 30, 2007 and 2006, due to lower cash, cash equivalents and available-for-sale security balances held during the period ended September 30, 2007.

The income tax provision has been recorded based on a 32.5 percent and 31.3 percent estimated annual effective income tax rate, applied to the pre-tax income as of the nine months ended September 30, 2007 and 2006, respectively.

This resulted in net income of \$38.4 million and \$32.1 million, and \$1.91 and \$1.50 earnings per share being recorded during the nine months ended September 30, 2007 and 2006, respectively.

Liquidity and Capital Resources

Net cash provided by operations for the nine months ended September 30, 2007 and 2006 was \$9.5 million and \$13.6 million, respectively. The \$4.2 million decrease in cash flow from operations primarily resulted from the net effect of \$6.4 million increased year over year net income, \$21.1 million decreased participant's deposits for future travel, and \$8.7 million increased accounts payable and accrued expenses.

Net cash provided by investing activities for the nine months ended September 30, 2007 was \$6.0 million and the net cash used by investing activities for the nine months ended September 30, 2006 was \$8.9 million. The \$14.9 million fluctuation was primarily related to the timing of available-for-sale security purchases and expenditures in 2007 related to the construction of a new office facility.

Net cash used in financing activities for the nine months ended September 30, 2007 and 2006 was \$37.8 million and \$5.3 million, respectively. The net change in financing activities primarily resulted from \$1.4 million increased cash dividends to our shareholders and \$32.6 million increased activity in our share repurchase plan. During 2007, we paid \$6.7 million in cash dividends and \$35.6 million in stock repurchases.

At September 30, 2007, we had \$86.2 million of cash, cash equivalents and available-for-sale securities, including program participant funds of \$21.6 million. At September 30, 2006, we had \$120.7 million of cash, cash equivalents, restricted cash and available-for-sale securities, including program participant funds of \$29.5 million.

Net Enrollments

Net enrollments consist of all individuals traveled year to date as of the most recent quarter end plus those actively enrolled for future travel.

Net Enrollments for 2007

As of October 16, 2007, we had 52,600 net enrolled participants for our 2007 travel programs compared to 43,100 net enrolled participants as of the same date last year for our 2006 travel programs.

Net Enrollments for 2008

As of October 16, 2007, we had 26,200 net enrolled participants for our 2008 travel programs compared to 37,300 net enrolled participants as of the same date last year for our 2007 travel programs. The decrease in enrollments is believed to be caused by inflationary pressures on 2008 program costs, an underperforming name source used to identify potential delegates, and the current economic uncertainty. We believe the decrease in net enrollments for our 2008 programs will negatively impact 2008 earnings; however, it is too early to assess the full extent of this impact. We have taken, and will continue to take, measures to mitigate these negative impacts. However, there can be no assurances that any of these measures will have any success, and if so, to what extent.

Under our cancellation policy, a program delegate may be entitled to a refund of a portion of his or her deposit, less certain fees, depending on the time of cancellation. Should a greater number of delegates cancel their travel in comparison to that which is part of our ongoing operations, due to circumstances such as international or domestic unrest, terrorism or general economic downturn, our cash balances could be significantly reduced. Cash balances could also be reduced significantly if the financial institutions, which held balances beyond that federally insured, were to become insolvent.

Deployable Cash

Deployable cash is a non-GAAP (generally accepted accounting principles) liquidity measure. Deployable cash is calculated as the sum of cash and cash equivalents, available for sale securities and prepaid program costs and expenses less the sum of accounts payable, accrued expenses and other short-term liabilities (excluding deferred taxes), participant deposits and the current portion of long-term capital lease. We believe this non-GAAP measure is useful in understanding the cash available to deploy for future business opportunities and is presented as

supplementary information to enhance your understanding of, and highlight trends in, our financial position. Any non-GAAP financial measure used should not be considered in isolation or as a substitute for measures of performance or liquidity prepared in accordance with GAAP.

Deployable Cash Reconciliation

(in thousands)

	<u>September 30,</u> <u>2007</u>	<u>September 30,</u> <u>2006</u>	<u>December 31,</u> <u>2006</u>
Cash, cash equivalents and available-for-sale securities	\$ 86,173	\$ 120,747	\$ 133,134
Prepaid program cost and expenses	6,527	5,927	3,786
Less: Participants' deposits	(21,624)	(29,517)	(60,651)
Less: Accounts payable/accruals/other liabilities	(16,810)	(10,955)	(8,131)
Less: Current portion of long term capital lease	(199)	(188)	(191)
Deployable cash	<u>\$ 54,067</u>	<u>\$ 86,014</u>	<u>\$ 67,947</u>

Our business is not capital intensive. However, we do retain funds for operating purposes in order to conduct sales and marketing efforts for future programs. We continue to consider acquisitions of educational, travel and youth businesses that may require the use of cash and cash equivalents. No such acquisitions are currently pending and no assurance can be given that definitive agreements for any such acquisitions will be entered into, or, if they are entered into, that they will be on terms favorable to us.

We do not have any material capital expenditure commitments for 2007, not already presented within our September 30, 2007 financial statements. We believe that existing cash and cash equivalents and cash flows from operations will be sufficient to fund our anticipated operating needs and capital expenditures through 2007 and 2008. For a more complete discussion of these and other contractual factors, please refer to our Annual Report on Form 10-K for the year ended December 31, 2006, along with our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K filed during 2007.

Foreign Currency – Hedging Policy

A majority of our travel programs take place outside of the United States and most foreign suppliers require payment in currency other than in U.S. dollars. Accordingly, we are exposed to foreign currency risks relative to changes in foreign currency exchange rates between those currencies and the U.S. dollar. We have a program to provide a hedge against certain of these foreign currency risks with less than two years maturity, and we use forward contracts and options that allow us to acquire the foreign currency at a fixed price for a specified period of time. All of our derivatives are designated as cash-flow hedges of forecasted transactions.

We account for these foreign exchange contracts and options in accordance with the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133"). The statement requires that all derivative instruments be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction. For qualifying cash-flow hedge transactions in which we are hedging the variability of cash flows related to a forecasted transaction, changes in the fair value of the derivative instrument are reported in other comprehensive income. The gains and losses on the derivative instruments that are reported in other comprehensive income are reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges is recognized in current period earnings. Unrealized gains and losses on foreign currency exchange contracts that are not qualifying cash-flow hedges as defined by SFAS 133 are recorded in the statement of operations.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and

liabilities. We consider our policies associated with cash and cash equivalents, available-for-sale securities, income taxes, derivative financial instruments, stock-based compensation and contingencies and litigation to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements. With the adoption of FIN 48 at the beginning of 2007, we have added to our existing income tax accounting policy, as follows:

Uncertainty in Income Taxes

For discussion of the uncertainty in income taxes critical accounting policies and estimates, please refer to footnote 4 in the Notes to the Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Recently Issued Accounting Pronouncements

For discussion of the recently issued accounting pronouncements, please refer to footnote 5 in the Notes to the Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

A majority of our travel programs take place outside of the United States and most foreign suppliers require payment in currency other than the U.S. dollar. Accordingly, we are exposed to foreign currency risk relative to changes in foreign currency exchange rates between those currencies and the U.S. dollar. We have a program to provide a hedge against certain of these foreign currency risks with less than two years' maturity. Currently, the U.S. dollar has significantly weakened against the major currencies that we pay most foreign suppliers including the Euro, British pound, Australian dollar and New Zealand dollar. If the U.S. dollar continues to weaken against these four major currencies, we face increased costs to travel a delegate abroad and therefore increased pressure on the gross margin percent (gross margin as a percentage of gross program receipts). We are not able to determine whether the impact of the weakening U.S. dollar will be material on our business, financial condition, cash flows and results of operations. See further discussion of these market risks in Item 2, *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

As of September 30, 2007, the end of the period covered by this report, our chief executive officer and chief financial officer reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)), which are designed to ensure that material information we must disclose in our report filed or submitted under the Exchange Act is recorded, processed, summarized, and reported on a timely basis, and have concluded, based on that evaluation, that as of such date, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to our chief executive officer and chief financial officer as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting

In the three months ended, September 30, 2007, there has been no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1A. Risk Factors

We consider our risk factors to include risks within the travel industry, international operations and natural occurrences, terrorism, seasonality and fluctuation in quarterly results, competition, dependence on People to People International, dependence on travel suppliers, dependence on key personnel, marketing, government regulation and taxation, fluctuation of currency exchange rates and increased costs, casualty losses, growth, acquisitions, and alliances, concentration of credit risk, and risks relating to the securities markets and ownership of our common stock, as discussed in further detail in Item 1A Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 and our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2007 and June 30, 2007.

Marketing

A portion of our marketing performance is dependent upon the success of names sources used to identify potential participants for our programs. Failure or underperformance of a names source, in conjunction with our performance in the direct mail and local informational meetings, could materially and adversely affect the number of participants who enroll for travel.

Travel Industry; Fluctuation of Currency Exchange Rate; Increased Costs

The success of our enrollment volume may be affected by the inflationary pressures of increased costs. The weakening dollar value within the global market and increased fuel prices may affect the pricing of our travel programs, which in turn could have a material adverse affect on our business, financial condition, cash flows, and results of operations.

The risk factors discussed in Item 1A Risk Factors section of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2007 and June 30, 2007, and those discussed in this Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2007 could materially and adversely affect our future operating results and could cause actual results to differ materially from those predicated in forward-looking statements we make about our business.

Item 6. Exhibits

- 31.1 Certification under Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification under Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification under Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification under Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, we have duly caused this report to be signed on our behalf by the undersigned thereunto duly authorized.

AMBASSADORS GROUP, INC.

Date: November 8, 2007

By: /s/ CHADWICK J. BYRD
Chadwick J. Byrd
Chief Financial Officer

EXHIBIT INDEX

31.1 Certification under Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification under Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification under Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification under Section 906 of the Sarbanes-Oxley Act of 2002

EXHIBIT 31.1

Certification required by Rule 13a-14(a) or Rule 15d-14(a) and under Section 302 of the Sarbanes-Oxley Act of 2002.

I, Jeffrey D. Thomas, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ambassadors Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a – 15(f) and 15d – 15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2007

/s/ Jeffrey D. Thomas

Jeffrey D. Thomas
Chief Executive Officer

EXHIBIT 31.2

Certification required by Rule 13a-14(a) or Rule 15d-14(a) and under Section 302 of the Sarbanes-Oxley Act of 2002.

I, Chadwick J. Byrd, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Ambassadors Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a – 15(f) and 15d – 15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2007

/s/ Chadwick J. Byrd

Chadwick J. Byrd
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Ambassadors Group, Inc., (the "Company") on Form 10-Q for the period ending September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Jeffrey D. Thomas, chief executive officer of the Company, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 8, 2007

/s/ Jeffrey D. Thomas

Jeffrey D. Thomas

Chief Executive Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Ambassadors Group, Inc., (the "Company") on Form 10-Q for the period ending September 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Chadwick J. Byrd, chief financial officer of the Company, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 8, 2007

/s/ Chadwick J. Byrd

Chadwick J. Byrd

Chief Financial Officer