



**CENGAGE LEARNING HOLDINGS II L.P.**  
(Formerly TL Holdings II L.P.)

(As successor to Thomson Learning,  
a combination of certain assets and liabilities of The Thomson Corporation)

**Transition Report for The Six Months Ended June 30, 2007  
And Annual Report for The Years Ended  
December 31, 2006, 2005 and 2004**

Audited Combined Financial Statements,  
Management's Discussion and Analysis of Financial Condition and Results of Operations,  
Quantitative and Qualitative Disclosures about Market Risk,  
Selected Financial Data and  
Ratio of Earnings to Fixed Charges

As of June 30, 2007, the end of the period to which this transition and annual report relates, Thomson Learning (predecessor to Cengage Learning) was comprised of wholly-owned indirect subsidiaries and divisions of The Thomson Corporation (“TOC”), representing the assets, liabilities, revenues and expenses directly attributed to TOC’s Domestic Higher Education and Domestic Library Reference businesses as well as certain international businesses, managed together by a single management team (hereinafter collectively referred to as “Thomson Learning” or “the Company” for the six month period ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004). The financial statements of Thomson Learning are combined on the basis of common control.

On July 5, 2007, Cengage Learning Holdings II L.P. (i) acquired the stock of certain companies and certain assets; and (ii) assumed certain liabilities, of Thomson Learning from TOC in exchange for cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments (the “Acquisition”). Accordingly, except as otherwise noted, this transition and annual report does not reflect the impact of the Acquisition.

As of the end of the period covered by this report, Cengage Learning Holdings II L.P. was not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended. Consequently, this report has not and will not be filed with the Securities and Exchange Commission (“SEC”). However, Cengage Learning Holdings II L.P. is obligated pursuant to the indentures, dated as of July 5, 2007, among Cengage Learning Acquisitions, Inc. (formerly TL Acquisitions, Inc. and a wholly owned subsidiary of Cengage Learning Holdings II L.P.), the guarantors named therein and The Bank of New York as trustee, and other agreements relating to Cengage Learning’s debt and securities, to post, on a publicly accessible page on the Cengage Learning website and make otherwise available, financial information that the would be required to file with the SEC were it subject to Sections 13 or 15(d) of the Securities Exchange Act of 1934, as amended, subject to exceptions consistent with the presentation of financial information in the TL Acquisitions, Inc. Offering Memorandum, dated June 22, 2007, relating to the \$1,215,600,000 10.50% Senior Notes due 2015 and the \$519,000,000 13.25% Senior Subordinated Discount Notes due 2015 (the “Offering Memorandum”). This report is made available pursuant to such obligations and is presented on the basis of Cengage Learning Holdings II L.P. and its consolidated subsidiaries, as successor to Thomson Learning.

**“Safe Harbor” Statement Under the  
Private Securities Litigation Reform Act of 1995**

This transition and annual report contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are not based on historical facts, but rather reflect our current expectations concerning future results and events. These forward-looking statements generally can be identified by the use of statements that include phrases such as “believe,” “expect,” “anticipate,” “intend,” “estimate,” “plan,” “project,” “foresee,” “likely,” “will” or other words or phrases with similar meanings. Similarly, statements that describe our objectives, plans or goals are, or may be, forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be different from any future results, performance and anticipated achievements expressed or implied by these statements. Except as required by law, we do not intend to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In addition, forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. These risks and uncertainties include, but are not limited to, those described in the Offering Memorandum.

**CENGAGE LEARNING HOLDINGS II L.P.  
(AS SUCCESSOR TO THOMSON LEARNING)**

**Transition and Annual Report  
For the six-month transition period ended June 30, 2007  
and the years ended December 31, 2006, 2005 and 2004  
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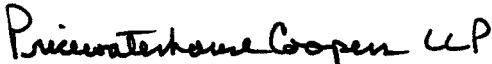
**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and management of Cengage Learning Holdings II L.P. (successor to Thomson Learning, a combination of certain assets and liabilities of The Thomson Corporation):

In our opinion, the accompanying combined balance sheets and the related combined statements of operations, cash flows and owners' equity and comprehensive income (loss), present fairly, in all material respects, the financial position of Cengage Learning Holdings II L.P. (successor to Thomson Learning, a combination of certain assets and liabilities of The Thomson Corporation) (the "Company") at June 30, 2007 and December 31, 2006 and 2005, and the results of its operations and its cash flows for the six months period ended June 30, 2007 and each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As disclosed in Note 15, the Company and The Thomson Corporation ("TOC") and its subsidiaries engaged in extensive intercompany transactions, and the Company relied on TOC for a significant portion of its administrative support, for which it was allocated costs on a basis that management believe is appropriate under the circumstances. The amounts recorded for these transactions and allocations are not necessarily representative of the amounts that would have been reflected in the financial statements had the Company been an entity operated independently of TOC.

As discussed in Note 1 to the financial statements, the Company adopted FIN 48, "Accounting for Uncertainty in Income Taxes", effective January 1, 2007.

  
PricewaterhouseCoopers LLP  
New York, New York  
November 14, 2007

**CENGAGE LEARNING HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**Combined Balance Sheets**  
(In thousands of U.S. dollars unless otherwise indicated)

	<u>June 30,</u> <u>2007</u>	<u>December 31,</u>	
		<u>2006</u>	<u>2005</u>
<b>Assets</b>			
Cash and cash equivalents	\$ 18,774	\$ 36,056	\$ 30,731
Accounts receivable, net	236,693	354,396	303,608
Notes receivable from TOC	23,820	37,187	28,111
Inventories	185,476	161,152	167,889
Deferred tax assets	57,461	93,585	94,380
Prepaid expenses and other current assets	40,611	35,990	30,116
Total current assets	<u>562,835</u>	<u>718,366</u>	<u>654,835</u>
Property, equipment and capitalized software for internal use, net	150,306	147,956	159,305
Pre-publication costs, net	233,862	218,583	222,662
Author advances	24,809	32,053	31,512
Identifiable intangible assets, net	572,325	585,428	601,903
Goodwill	1,387,943	1,366,996	1,345,302
Deferred tax assets	4,760	4,760	5,682
Other non-current assets	17,817	12,508	14,275
Total assets	<u>\$ 2,954,657</u>	<u>\$ 3,086,650</u>	<u>\$ 3,035,476</u>
<b>Liabilities and Owners' Equity</b>			
Accounts payable and accrued expenses	\$ 241,186	\$ 347,468	\$ 371,888
Deferred revenue	133,694	157,232	140,466
Current portion of long-term debt	35,000	35,000	35,000
Capital lease obligation	26,022	26,040	-
Notes payable to TOC	693,877	466,809	1,393,992
Current taxes payable	12,355	11,722	6,820
Other current liabilities	22,136	18,219	10,379
Total current liabilities	<u>1,164,270</u>	<u>1,062,490</u>	<u>1,958,545</u>
Long-term debt	14,915	34,831	69,617
Capital lease obligation	-	-	26,077
Deferred tax liabilities	310,949	301,031	259,450
Other non-current liabilities	10,760	13,850	16,859
Total liabilities	<u>1,500,894</u>	<u>1,412,202</u>	<u>2,330,548</u>
Commitments, contingencies and guarantees (Note 16)			
Net investment of TOC	1,402,513	1,628,724	671,947
Accumulated other comprehensive income	51,250	45,724	32,981
Total liabilities and owners' equity	<u>\$ 2,954,657</u>	<u>\$ 3,086,650</u>	<u>\$ 3,035,476</u>

The accompanying notes are an integral part of these Combined Financial Statements

**CENGAGE LEARNING HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**Combined Statements of Operations**  
(In thousands of U.S. dollars unless otherwise indicated)

	<b>Six Months Ended</b>	<b>Years Ended December 31,</b>		
	<b>June 30, 2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Revenues:				
Products	\$ 399,114	\$ 1,275,640	\$ 1,244,803	\$ 1,203,921
Services and other	177,767	394,673	334,010	275,859
Total revenues	<u>576,881</u>	<u>1,670,313</u>	<u>1,578,813</u>	<u>1,479,780</u>
Cost of revenues, excluding depreciation stated below:				
Products	259,286	626,302	608,052	575,615
Services and other	47,680	94,086	88,877	74,740
Amortization of pre-publication costs	46,951	124,897	119,977	115,732
Total cost of revenues, excluding depreciation stated below	<u>353,917</u>	<u>845,285</u>	<u>816,906</u>	<u>766,087</u>
Selling, general & administrative, excluding depreciation stated below	250,929	423,331	389,683	367,720
Allocation of management costs from TOC (Note 15)	25,274	47,691	41,033	34,081
Depreciation and impairment	30,227	53,848	48,091	41,158
Amortization and impairment of identifiable intangible assets	22,473	43,571	39,247	38,247
Total costs and expenses	<u>682,820</u>	<u>1,413,726</u>	<u>1,334,960</u>	<u>1,247,293</u>
Operating (loss) income	(105,939)	256,587	243,853	232,487
Gain on nonmonetary transaction	-	1,289	-	-
Interest expense with TOC	(9,380)	(35,743)	(87,220)	(74,246)
Interest expense	(2,167)	(5,479)	(5,792)	(2,056)
(Loss) income before taxes	<u>(117,486)</u>	<u>216,654</u>	<u>150,841</u>	<u>156,185</u>
Benefit from (provision for) income taxes	40,929	(85,542)	(60,662)	(64,515)
Equity losses of investee, net of taxes	(4,851)	(6,930)	(7,907)	(7,595)
Net (loss) income	<u>\$ (81,408)</u>	<u>\$ 124,182</u>	<u>\$ 82,272</u>	<u>\$ 84,075</u>

The accompanying notes are an integral part of these Combined Financial Statements

**CENGAGE LEARNING HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**Combined Statements of Cash Flows**  
**(In thousands of U.S. dollars unless otherwise indicated)**

	Six Months Ended	Years Ended December 31,		
	<u>June 30, 2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
<b>Cash Flows from Operating Activities</b>				
Net (loss) income	\$ (81,408)	\$ 124,182	\$ 82,272	\$ 84,075
Adjustments to reconcile net (loss) income to net cash provided by operating activities:				
Amortization of pre-publication costs	46,951	124,897	119,977	115,732
Depreciation and impairment	30,227	53,848	48,091	41,158
Amortization and impairment of identifiable intangible assets	22,473	43,571	39,247	38,247
Provision for (benefit from) deferred taxes	38,248	29,363	8,984	18,973
Gain on nonmonetary transaction	-	(1,289)	-	-
Equity losses of investee, net of taxes	4,851	6,930	7,907	7,595
Changes in working capital and other items, net of acquisitions	(46,305)	(52,253)	55,986	44,426
Decrease (increase) in author advances	6,849	(315)	(1,474)	(42)
Other, net	2,323	3,237	1,743	3,481
Net cash provided by operating activities	<u>24,209</u>	<u>332,171</u>	<u>362,733</u>	<u>353,645</u>
<b>Cash Flows from Investing Activities</b>				
Acquisitions of businesses, less cash therein	(27,534)	(25,600)	(33,779)	(63,720)
Capital infusion into equity investee	(5,224)	(5,222)	(7,484)	-
Additions to pre-publication costs	(61,279)	(119,611)	(126,195)	(142,566)
Additions to property, equipment and capitalized software for internal use	(26,786)	(43,720)	(48,170)	(48,253)
Proceeds from disposition of property, equipment and capitalized software for internal use	651	544	188	3,696
Other investing, net	(1,178)	(1,245)	3,054	-
Net cash used by investing activities	<u>(121,350)</u>	<u>(194,854)</u>	<u>(212,386)</u>	<u>(250,843)</u>
<b>Cash Flows from Financing Activities</b>				
Repayments of long-term debt	(20,018)	(35,037)	(35,037)	(20,033)
Proceeds from issuance of long-term debt	-	-	-	160,000
Increase (decrease) in cash overdrafts	3,917	6,757	(4,317)	14,640
Proceeds (repayments) from notes payable/receivable to TOC, net	240,435	(936,259)	44,366	202,763
Repayment of term loan with TOC	-	-	(93,880)	(85,083)
(Decrease) increase in net investment of TOC	(145,323)	831,071	(66,274)	(354,533)
Net cash provided (used) by financing activities	<u>79,011</u>	<u>(133,468)</u>	<u>(155,142)</u>	<u>(82,246)</u>
<b>Impact on Cash and Cash Equivalents from</b>				
<b>Change in Foreign Currency</b>	<u>848</u>	<u>1,476</u>	<u>(1,542)</u>	<u>1,218</u>
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	(17,282)	5,325	(6,337)	21,774
<b>Cash and Cash Equivalents</b>				
Beginning of period	36,056	30,731	37,068	15,294
End of period	<u>\$ 18,774</u>	<u>\$ 36,056</u>	<u>\$ 30,731</u>	<u>\$ 37,068</u>

The accompanying notes are an integral part of these Combined Financial Statements

**CENGAGE LEARNING HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**Combined Statements of Owners' Equity and Comprehensive Income (Loss)**  
**(In thousands of U.S. dollars unless otherwise indicated)**

	Net investment of TOC	Accumulated other comprehensive income	Total owners' equity	Comprehensive Income (Loss)
December 31, 2003	\$ 925,041	\$ 31,269	\$ 956,310	
Decrease in net investment of TOC	(353,984)		(353,984)	
Net income	84,075		84,075	\$ 84,075
Foreign currency translation adjustment		9,749	9,749	9,749
Comprehensive income				<u>\$ 93,824</u>
December 31, 2004	655,132	41,018	696,150	
Decrease in net investment of TOC	(65,457)		(65,457)	
Net income	82,272		82,272	\$ 82,272
Foreign currency translation adjustment		(8,037)	(8,037)	(8,037)
Comprehensive income				<u>\$ 74,235</u>
December 31, 2005	671,947	32,981	704,928	
Increase in net investment of TOC	832,595		832,595	
Net income	124,182		124,182	\$ 124,182
Foreign currency translation adjustment		12,519	12,519	12,519
Unrealized gains on derivative instruments		224	224	224
Comprehensive income				<u>\$ 136,925</u>
December 31, 2006	1,628,724	45,724	1,674,448	
Opening balance adjustment for income tax accounting change (Note 1):				
Adjustment to retained earnings	(2,125)		(2,125)	
Adjustment to net investment of TOC	2,125		2,125	
Decrease in net investment of TOC	(144,803)		(144,803)	
Net loss	(81,408)		(81,408)	\$ (81,408)
Foreign currency translation adjustment		5,750	5,750	5,750
Unrealized gains on derivative instruments		(224)	(224)	(224)
Comprehensive loss				<u>\$ (75,882)</u>
June 30, 2007	<u>\$ 1,402,513</u>	<u>\$ 51,250</u>	<u>\$ 1,453,763</u>	

The accompanying notes are an integral part of these Combined Financial Statements

**CENGAGE LEARNING HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**Notes to Combined Financial Statements**  
**(In thousands of U.S. dollars unless otherwise indicated)**

**1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Description of the Business**

Cengage Learning Holdings II L.P. and its consolidated subsidiaries (collectively, "Cengage Learning"), as successor to Thomson Learning, which is comprised of wholly-owned indirect subsidiaries and divisions of The Thomson Corporation ("TOC") managed together by a single management team (hereinafter collectively referred to as "Thomson Learning" or "the Company" for the six month period ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004), is a global print and electronic publisher of textbooks, reference materials and other educational resources for the higher education, professional training and library reference markets.

**Basis of Presentation**

The accompanying financial statements of Thomson Learning reflect the assets, liabilities, revenues and expenses directly attributed to TOC's Domestic Higher Education and Domestic Library Reference businesses as well as certain international businesses. The financial statements for the periods presented herein are combined on the basis of common control. Thomson Learning owns 50% of Universitas 21 Global ("U21"), a joint venture between Thomson Learning and a consortium of 19 universities from around the world, which it accounts for using the equity method.

The Combined Financial Statements of Thomson Learning are prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The Combined Financial Statements have been derived from the accounting records of TOC using the historical results of operations and the historical basis of assets and liabilities of Thomson Learning adjusted as necessary to conform to GAAP. All significant transactions between Thomson Learning and other entities of TOC are included in these Combined Financial Statements. Certain prior period amounts have been reclassified to conform to the current period presentation. Management believes the assumptions underlying the Combined Financial Statements are reasonable. However, the Combined Financial Statements included herein may not necessarily reflect Thomson Learning's results of operations, financial position and cash flows in the future or what its results of operations, financial position and cash flows would have been had the Company operated independently of TOC during the periods presented.

As described in Note 15, "Related Party Transactions", Thomson Learning and other subsidiaries of TOC engage in extensive intercompany transactions, and the Company relies on TOC for some of its administrative support for which it is allocated costs using methodologies that management believes are reasonable. The amounts recorded for these transactions and allocations are not necessarily representative of the amounts that would have been reflected in the Combined Financial Statements had Thomson Learning been an entity operated independently of TOC. Other than those reflected as notes payable to or receivable from TOC, these transactions are presented in the Combined Financial Statements as related party transactions, the net effect of which is presented within "Net investment of TOC" on the Combined Balance Sheets. All transactions recorded through the "Net investment of TOC" are reflected as financing activities in the accompanying Combined Statements of Cash Flows.

**CENGAGE LEARNING HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**Notes to Combined Financial Statements**  
**(In thousands of U.S. dollars unless otherwise indicated)**

**Change of Fiscal Year End**

On October 18, 2007, the Company changed its fiscal year end from December 31 to June 30. Certain financial information for the resulting six-month period ended June 30, 2007 and the six-month period ended June 30, 2006 (unaudited) is presented below:

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>
		<b>(unaudited)</b>
Revenues	\$ 576,881	\$ 550,159
Cost of revenues, excluding depreciation stated below	\$ 353,917	\$ 339,203
Selling, general & administrative, excluding depreciation stated below	250,929	206,700
Allocation of management costs from TOC (Note 15)	25,274	21,804
Depreciation and impairment	30,227	25,864
Amortization and impairment of identifiable intangible assets	22,473	20,099
Total costs and expenses	<u>\$ 682,820</u>	<u>\$ 613,670</u>
Operating loss	<u>\$ (105,939)</u>	<u>\$ (63,511)</u>
Loss before taxes	\$ (117,486)	\$ (86,244)
Benefit from income taxes	\$ 40,929	\$ 33,087
Net loss	<u>\$ (81,408)</u>	<u>\$ (57,154)</u>
Net cash provided (used) by operating activities	\$ 24,209	\$ (42,208)
Net cash used by investing activities	(121,350)	(78,737)
Net cash provided by financing activities	79,011	115,050
Impact on cash and cash equivalents from change in foreign currency	848	114
Net decrease in cash and cash equivalents	<u>(17,282)</u>	<u>(5,781)</u>
Cash and cash equivalents		
Beginning of period	36,056	30,731
End of period	<u>\$ 18,774</u>	<u>\$ 24,950</u>

**Seasonality and Comparability**

Typically, a greater portion of the Company's revenue, operating profit and operating cash flow is derived in the second half of the calendar year because customer buying patterns are concentrated during this period, while expenses are incurred more evenly throughout the year. As a result, operating margins generally increase as the calendar year progresses. For these reasons, the performance of the businesses may not be comparable quarter to consecutive quarter and should be considered on the basis of results for the whole year or by comparing results in a quarter with results in the same quarter for the previous year.

In connection with TOC's sale of the Company to Cengage Learning Holdings II L.P. as discussed in Note 2, "Acquisition of Thomson Learning", Thomson Learning incurred costs of \$28,442 during the six month period ended June 30, 2007 relating to employee retention bonuses and professional services fees, which were recorded in "Selling, general & administrative, excluding depreciation stated below" on the Combined Statements of Operations.

**Income Taxes**

Thomson Learning accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". Income taxes are presented as if the subsidiaries were operated as separate stand-alone tax-paying entities (separate return basis). Current taxes payable attributable to divisions of TOC were \$44,928, \$128,128 and \$80,442 as of June 30, 2007,

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**(In thousands of U.S. dollars unless otherwise indicated)**

December 31, 2006 and 2005, respectively, and are included in “Net investment of TOC” on the Combined Balance Sheets. Income taxes payable by subsidiaries that file separate returns are included in “Current taxes payable” on the Combined Balance Sheets. TOC files individual and combined tax returns that include Thomson Learning as required within each jurisdiction.

The computation of the provision for income taxes requires certain estimates and significant judgment including, but not limited to, projections of the proportion of income earned and taxed in foreign jurisdictions, permanent and temporary differences, and the likelihood of recovering deferred tax assets generated. The accounting estimates used to compute the provision for income taxes may change as new events occur, more experience is acquired, additional information is obtained or as the tax environment changes.

Deferred income taxes are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse. A valuation allowance is recorded against deferred income tax assets if management determines that it is more likely than not that such deferred income tax assets will not be realized. The income tax provision for the period shown is the taxes payable or receivable for the period and the change during the period in deferred income tax assets and liabilities.

Thomson Learning recognizes interest and penalties related to income tax matters as a component of income tax expense.

#### **Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these Combined Financial Statements and accompanying notes. Although these estimates are based on management's best knowledge of current events and actions that Thomson Learning may undertake in the future, actual results could differ from those estimates. These estimates include, but are not limited to, reserve for sales returns, inventory obsolescence reserve, allowance for doubtful accounts, realization of deferred tax assets, the allocation of certain expenses to Thomson Learning and the determination of fair values used in the assessment of the realizability of long-lived assets, goodwill and identifiable intangible assets.

#### **Summary of Significant Accounting Policies**

**Revenue Recognition:** Thomson Learning delivers learning solutions for universities, students, professors, libraries, professionals and corporations around the world. These solutions are delivered through specialized content, applications and services. Although printed materials continue to be the most widely-sold learning resource, the Company is increasingly providing customers with electronic resources. Services and other revenues include revenues from the delivery of content in electronic format and administrative services (e.g., distribution, warehousing and payroll). Thomson Learning recognizes revenue when the following four criteria are met:

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the fee is fixed or determinable; and
- collectibility is probable.

*Print Products.* Revenue from the sale of print products, less estimated returns, is recognized when the product is shipped and title passes to the customer. Amounts billed to customers for shipping and handling are classified as revenue.

*Subscription-Based Products.* Revenues from sales of subscription-based products are recognized ratably over the term of the subscription. Subscription revenue received or receivable in advance of the delivery of services or publications is included in deferred revenue. Incremental costs that are directly related to the subscription revenue are deferred and amortized over the subscription period.

*Multiple Element Arrangements.* When a sales arrangement requires the delivery of more than one product or service, the individual deliverables are accounted for separately, if applicable criteria are met. Specifically, the revenue is allocated to

**CENGAGE LEARNING HOLDINGS II L.P.**  
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**Notes to Combined Financial Statements**  
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each deliverable if reliable and objective evidence of fair value for each deliverable is available. The amount allocated to each unit is then recognized when each unit is delivered, provided that all other relevant revenue recognition criteria are met with respect to that unit. If, however, evidence of fair value is only available for undelivered elements, the revenue is allocated first to the undelivered items, with the remainder of the revenue being allocated to the delivered items, according to a calculation known as the residual method. Amounts allocated to delivered items are deferred if there are further obligations with respect to the delivered items. If evidence of fair value is only available for the delivered items, but not the undelivered items, the arrangement is considered a single element arrangement and revenue is recognized as the relevant recognition criteria are met.

**Advertising Costs:** Costs incurred for producing and communicating advertising are expensed when incurred. Advertising expenses are included as a component of “Selling, general & administrative, excluding depreciation stated below” on the Combined Statements of Operations, and amounted to \$41,752, \$70,179, \$72,110 and \$71,919 for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

**Accumulated Other Comprehensive Income:** Other comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events or circumstances from non-owner sources. Accumulated other comprehensive income consisted of the following:

	<b>June 30,</b>	<b>December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Foreign currency translation adjustment	\$ 51,250	\$ 45,500	\$ 32,981	\$ 41,018
Unrealized gain on derivative instruments	-	224	-	-
Total accumulated other comprehensive income	<u>\$ 51,250</u>	<u>\$ 45,724</u>	<u>\$ 32,981</u>	<u>\$ 41,018</u>

**Allowance for Doubtful Accounts and Reserve for Sales Returns:** Most of Thomson Learning’s accounts receivable are due from universities, bookstores, students, libraries, professionals and corporations. Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Accounts receivable are reflected net of an allowance for doubtful accounts and sales returns. Management periodically assesses the allowance for doubtful accounts and estimates the amount of future returns by evaluating general factors such as the length of time individual receivables are past due, historical collection experience and sales returns experience, and the economic and competitive environment. Accounts receivable losses are charged against the allowance when management believes the uncollectibility of the receivable is confirmed. Subsequent recoveries, if any, are credited to the allowance. Sales returns are charged against the reserve as products are returned to inventory.

The aggregate allowance for doubtful accounts and sales returns reserve as of June 30, 2007, December 31, 2006 and December 31, 2005 was \$118,028, \$198,839 and \$202,459, respectively.

**Concentration of Credit Risk:** As of June 30, 2007, no customer accounted for more than 10% of Thomson Learning’s gross accounts receivable. No customer accounted for more than 10% of the Company’s revenue during the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004.

**Cash and Cash Equivalents:** The Company considers cash and cash equivalents to consist of cash on deposit in banks. Cash equivalents have original maturities of less than 90 days. Thomson Learning and TOC maintain an agreement whereby TOC periodically sweeps Thomson Learning’s cash receipts and funds Thomson Learning’s cash disbursements as necessary. With the exception of that which is included in “Notes receivable from TOC” and “Notes payable to TOC”, such activity is included in “Net investment of TOC” on the Combined Balance Sheets.

**Notes Receivable and Notes Payable with TOC:** Thomson Learning periodically lends to, or borrows money from, various subsidiaries of TOC as part of TOC’s overall cash management and capitalization program. These arrangements are subject to written loan agreements specifying repayment terms and interest payments. These notes are reflected separately in the Combined Balance Sheets based on their legal form. As the balances pursuant to these notes fluctuate on a frequent basis, Thomson Learning has classified both the “Notes receivable from TOC” and “Notes payable to TOC” as a current asset and a current liability, respectively. As these notes are part of TOC’s overall capitalization of the Company, changes in the

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notes' balances have been reflected as financing activities in the Combined Statements of Cash Flows. (See Note 2, "Acquisition of Thomson Learning".)

In March 2006, TOC contributed capital of \$906,000 which Thomson Learning used to reduce "Notes Payable to TOC". This contribution is included in "(Decrease) increase in net investment of TOC" on the accompanying Combined Statements of Cash Flows. In the United States of America, the agreements require interest to be paid or received at variable market rates of 5.3%, 3.9%, 6.3% and 5.6% for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively. Outside the United States of America, the agreements require interest to be paid or received at variable market rates of 5.4%, 4.2%, 4.0% and 3.6% for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively. Interest on all loans is reflected in "Interest expense with TOC" on the Combined Statements of Operations. Other intercompany activity with TOC is not subject to written loan agreements.

**Revolver:** Thomson Learning maintains a revolver facility with a wholly-owned subsidiary of TOC. The facility has a maximum borrowing of \$1 billion and expires in 2011. The Company has never drawn down on this facility.

**Term Loan with TOC:** During the years ended December 31, 2005 and 2004, Thomson Learning repaid a term loan in the amounts of \$93,880 and \$85,083, respectively, to a wholly-owned subsidiary of TOC. The loan carried an interest rate that varied based on the London Inter Bank Offered Rate ("LIBOR") plus a specified margin of 2.25%. The interest expense on such loan was \$1,542 and \$5,241 for the years ended December 31, 2005 and 2004, respectively and is included in "Interest expense with TOC" on the Combined Statements of Operations.

**Inventories:** Inventories, which are principally comprised of books, other print products and electronic media, are stated at lower of cost or market value, with cost determined generally using the weighted average method. Allowances are established to reduce the cost of excess and obsolete inventories to their estimated net realizable value.

**Pre-publication Costs:** Pre-publication costs are costs to create a book or other media, and include costs for the associated delivery method when such media is electronic. Pre-publication costs are amortized upon publication of the title over estimated economic lives of one to six years, being the estimated operating life cycle of the title, with a higher proportion of the amortization taken in the earlier years. The amortization method and periods chosen best reflect the expected sales generated from individual titles or programs.

**Capitalized Software:** Certain costs incurred in connection with software to be used internally are capitalized once a project has progressed beyond a conceptual, preliminary stage to that of application development. Costs which qualify for capitalization include both internal and external costs, but are limited to those that are directly related to a specific project. The capitalized amounts, net of accumulated depreciation, are included in "Property, equipment and capitalized software for internal use, net" on the Combined Balance Sheets. These costs are depreciated over their expected useful lives, which range from three to five years.

**Property, Equipment and Capitalized Software for Internal Use:** Property, equipment and capitalized software for internal use is stated at cost less accumulated depreciation.

Depreciation is computed on a straight-line basis over the following estimated useful lives:

Purchased and internally-developed software	3-5 years
Computer hardware	3-5 years
Buildings and building improvements	30-40 years
Machinery and equipment	7-10 years
Furniture and fixtures	5-10 years
Office equipment	3-5 years
Automobiles	4-7 years
Leasehold improvements	Lesser of lease term or estimated useful life

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**Identifiable Intangible Assets and Goodwill:** Upon acquisition, identifiable intangible assets are recorded at fair value. Identifiable intangible assets with finite lives are amortized over their estimated useful lives. The carrying values of these identifiable intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The initial test for impairment compares the carrying amounts with the sum of undiscounted cash flows related to the identifiable intangible asset. If the carrying value is greater than the undiscounted cash flows of the asset, the identifiable intangible asset is written down to its estimated fair value.

Goodwill represents the excess of the cost of acquired businesses over fair values attributed to underlying net tangible assets and identifiable intangible assets. The carrying value of goodwill is tested at least annually for impairment on a “reporting unit” level, using a two-step approach. In the first step, the fair value of each reporting unit is determined. If the fair value of a reporting unit is less than its carrying value, this is an indicator that the goodwill assigned to that reporting unit may be impaired. In this case, the second step is to allocate the fair value of the reporting unit to the assets and liabilities of the reporting unit as if it had just been acquired in a business combination, and as if the purchase price was equivalent to the fair value of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is referred to as the implied fair value of goodwill. The implied fair value of the reporting unit’s goodwill is then compared to the actual carrying value of goodwill. If the implied fair value is less than the carrying value, an impairment loss is recognized for that excess.

**Royalties and Author Advances:** Thomson Learning pays royalties to certain vendors and authors either as a lump-sum prepayment or as products are sold, in accordance with the respective contracts. Such payments are recognized as a component of “Cost of revenues, excluding depreciation stated below” on the Combined Statements of Operations as revenue from the associated products or services are recognized.

**Investments in Affiliates:** The equity method of accounting is used to account for investments in affiliated businesses over which Thomson Learning has the ability to exercise significant influence. Under the equity method, investments are initially recorded at cost and the carrying amounts are adjusted to reflect the Company’s share of net earnings or losses of the investee companies, and are reduced by dividends received. When the estimated fair values of investments fall below their carrying values, the investments are written down if such declines are considered to be other than temporary.

**Acquisitions:** Acquisitions are accounted for using the purchase method and the results of acquired businesses are included in the Combined Financial Statements from the dates of acquisition. Under the purchase method of accounting, the cost, including transaction costs, are allocated to the underlying net tangible and identifiable intangible assets, based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill.

**Impairment of Long-lived Assets:** Management evaluates the impairment of long-lived assets whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The initial test for impairment compares the carrying amounts with the sum of undiscounted cash flows related to the asset. If the carrying value is greater than the undiscounted cash flows of the asset, the asset is written down to its estimated fair value.

**Derivative Financial Instruments:** In the ordinary course of business, TOC enters into derivative financial instruments on behalf of Thomson Learning to hedge forecasted cash flows denominated in currencies other than the functional currency of a business for up to a one year period.

Thomson Learning identifies a risk management objective for each transaction. All derivatives are linked to specific assets and liabilities or to specific firm commitments or forecasted transactions. For derivatives designated as hedges, periodic assessments of each derivative’s effectiveness are performed by comparing actual cash receipts to the hedged amounts.

While the derivative financial instruments are subject to the risk of loss from changes in exchange rates, these losses are offset by gains on the exposures being hedged. Gains and losses on foreign exchange contracts designated as hedges for firm commitments or forecasted transactions are initially recorded in “Accumulated other comprehensive income” and are recorded in earnings when the related transaction is realized. All transactions related to the foreign exchange contracts are recorded in “Cash flows from operating activities” on the Combined Statements of Cash Flows. As of June 30, 2007, there are no outstanding foreign exchange contracts.

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**Fair Value of Financial Instruments:** The carrying amounts of Thomson Learning's financial instruments, which include accounts receivable, accounts payable and accrued expenses, approximate their fair values due to the short-term nature of these instruments. The fair value of derivatives is estimated based upon discounted cash flows using applicable current market rates. The carrying amounts of "Notes receivable from TOC" and "Notes payable to TOC" approximate their fair values as these notes bear floating rates of interest. The fair value of long-term debt is estimated based on either quoted market prices for similar issues or through the use of a discounted cash flow model using current rates available to TOC for debt of the same maturity.

**Stock-based Compensation Plans:** TOC administers all stock-based compensation plans on behalf of Thomson Learning and has applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123R "*Share-based Payment*" to calculate the effect of such compensation on Thomson Learning's net income for the six months ended June 30, 2007 and the year ended December 31, 2006, and SFAS No. 123 "*Accounting for Stock-based Compensation*" for the years ended December 31, 2005 and 2004. Stock-based compensation expense for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004 of \$520, \$1,300, \$817 and \$549, respectively, is included as a component of "Selling, general and administrative, excluding depreciation stated below" and \$323, \$2,645, \$2,181 and \$1,764, respectively, is included in "Allocation of management costs from TOC" on the Combined Statements of Operations. The income tax benefit of such expense was \$408, \$1,288, \$1,189 and \$998 for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

**Foreign Currency Translation:** The functional currencies of Thomson Learning's foreign operations are the local currencies of those foreign locations. Balance sheet accounts of the Company's foreign operations are translated from foreign currencies into the reporting currency (U.S. dollars) at period-end exchange rates while revenues and expenses are translated at average exchange rates during the period. Currency gains or losses arising from transactions denominated in a currency other than the functional currency are recorded in "Selling, general & administrative, excluding depreciation stated below" on the accompanying Combined Statements of Operations. Net (losses) gains were \$(7), \$414, \$49 and \$(207) for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

**Taxes Collected from Customers and Remitted to Governmental Agencies:** Thomson Learning records taxes on customer transactions but due to governmental agencies as a receivable and a liability on the Combined Balance Sheets.

#### **New Accounting Standards and Accounting Changes**

**Income Taxes:** Effective January 1, 2007, Thomson Learning adopted the provisions of the Financial Accounting Standards Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). As a result of this change in accounting policy, the Company recorded a non-cash charge of \$2,125 to its opening retained earnings as of January 1, 2007 with an offsetting increase to "Net investment of TOC".

Under its previous policy, Thomson Learning would reserve for tax contingencies if it was probable that an uncertain position would not be upheld. Under FIN 48, the Company evaluates a tax position using a two-step process. First, Thomson Learning determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, Thomson Learning presumes that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. Secondly, a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

**Stock-Based Compensation:** In December 2004, the FASB issued SFAS No. 123R, "*Share-based Payment*", which generally requires the recognition, at fair value, of all share-based payments to employees (e.g., stock options). This statement is effective as of the beginning of the first annual reporting period starting after June 15, 2005. Because Thomson Learning previously applied the fair value provisions in SFAS No. 123, "*Accounting for Stock Based Compensation*", the new standard did not materially impact the Company's Combined Financial Statements.

**Other Pronouncements:** In December 2004, the FASB issued SFAS No. 153, "*Exchanges of Nonmonetary Assets an Amendment of APB Opinion No. 29*". This guidance amends Accounting Principles Board Opinion No. 29 to eliminate the

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exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have a commercial substance; commercial substance being determined on the basis of whether the future cash flows of the entity are expected to change significantly as a result of the exchange. This statement is effective as of the beginning of the first annual reporting period starting after June 15, 2005. The new standard did not materially impact Thomson Learning's Combined Financial Statements.

In May 2005, the FASB issued SFAS No. 154, "*Accounting Changes and Error Corrections*". This guidance requires retrospective application of changes in accounting principles to all periods presented in the financial statements in the absence of explicit transition requirements specific to a newly adopted accounting principle. SFAS No. 154 also requires that any change in the method of depreciation or amortization of long-lived non-financial assets be accounted for prospectively as a change in accounting estimate, and corrections of errors in previously issued financial statements be termed a restatement. SFAS No. 154 is effective for changes in accounting principles and corrections of errors made in fiscal years beginning after December 15, 2005. The new standard did not materially impact Thomson Learning's Combined Financial Statements.

In September 2006, the Emerging Issues Task Force ("EITF") issued EITF 06-3, "*How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)*". This guidance requires the disclosure of a company's policy for presenting certain taxes (those assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer) as either gross (included in revenues and costs) or net (excluded from revenues). EITF 06-3 is effective the first fiscal year beginning after December 15, 2006, with retrospective application. The new standard did not materially impact Thomson Learning's Combined Financial Statements.

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*". This guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements, to be applied under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective the first fiscal year beginning after November 15, 2007. Thomson Learning is currently evaluating the impact of this standard on its Combined Financial Statements.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of SFAS No.115*". This guidance provides the option to measure and report certain assets and liabilities at their fair value. SFAS No. 159 is effective as of the beginning of the first fiscal year after November 15, 2007. Thomson Learning is currently evaluating the impact of this standard on its Combined Financial Statements.

## **2. ACQUISITION OF THOMSON LEARNING**

On May 11, 2007, certain indirect wholly-owned subsidiaries of TOC entered into a Stock and Asset Purchase Agreement (the "Acquisition Agreement") with Apax/TL Holdings LLC, an affiliate of funds managed by Apax Europe Managers Ltd. and Apax Partners L.P. and OMERS Capital Partners ("OMERS") and certain of their affiliates. Pursuant to the Acquisition Agreement, Apax/TL Holdings LLC assigned its rights and obligations to Cengage Learning Holdings II L.P., and certain other affiliates.

On July 5, 2007, Cengage Learning Holdings II L.P. (i) acquired the stock of certain companies and certain assets; and (ii) assumed certain liabilities, of Thomson Learning from TOC in exchange for cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments (the "Acquisition").

The Acquisition was financed through (i) a common equity capital contribution of \$1,703.1 million (the "Equity Contribution") and (ii) \$5,580.2 million in aggregate gross proceeds of debt financing, less \$90.7 million associated with financing fees, (the "Financing Transactions") as follows:

- \$3,440.0 million of borrowings under \$3,740.0 million of senior secured credit facilities, consisting of a \$3,440.0 million term loan facility with a seven-year maturity and a \$300.0 million revolving credit facility with a six-year maturity;
- \$1,215.6 million aggregate principal amount (\$1,200.1 million gross proceeds) of 10.50% senior notes due 2015;

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- \$519.0 million aggregate principal amount at maturity (\$400.1 million gross proceeds) of 13.25% senior subordinated discount notes due 2015, for which no cash interest will accrue between the date of original issuance and July 15, 2009; and
- \$540.0 million of borrowings under a senior bridge loan credit facility.

The Financing Transactions, together with the Acquisition and Equity Contribution, are hereinafter referred to as the “Transactions”, which represent a subsequent event to these financial statements.

### **Senior Secured Credit Facilities**

The senior secured credit facilities provide Cengage Learning with variable rate financing of \$3,740.0 million, consisting of a seven year \$3,440.0 million term loan facility and a six year \$300.0 million revolving credit facility (together, the “Senior Credit Facilities”). Concurrent with the Acquisition, Cengage Learning borrowed \$3,440.0 million under the term loan facility. The Senior Credit Facilities also provide Cengage Learning with the option to raise, subject to certain limitations, additional incremental term loan facilities, or increase the amount available under its revolving credit facility in an aggregate amount of up to \$750.0 million, which amount may be increased by the amount of any voluntary repayments of the term loans under the Senior Credit Facilities and additional amounts to the extent Cengage Learning maintains certain leverage ratios.

Under the Senior Credit Facilities, Cengage Learning can elect the tenor of each drawdown and loan rollover, as well as which benchmark interest rate would apply, plus a predefined margin based on Cengage Learning’s leverage ratio. Borrowings under the term loan facility and the revolving credit facility bear interest, at Cengage Learning’s option, at a rate equal to a margin over either (a) a base rate determined by reference to the higher of (1) the rate of interest announced publicly by The Royal Bank of Scotland plc, from time to time, as its prime rate and (2) the federal funds effective rate plus 1/2 of 1% or (b) a LIBOR rate determined by reference to the costs of funds for deposits for the interest period relevant to such borrowing. In addition, there is a commitment fee on unutilized borrowings under the revolving credit facility. The commitment fee, letter of credit fee and margin for borrowings under both the term loan facility and the revolving credit facility vary and are based upon certain senior secured leverage ratios.

Commencing on December 31, 2007, Cengage Learning is required to pay quarterly installments of \$8.6 million on the term loans with the remaining amount payable on July 3, 2014. Principal amounts not previously repaid under the revolving credit facility are payable on July 5, 2013.

All obligations under the Senior Credit Facilities are guaranteed by Cengage Learning Holdings II L.P. and substantially all of its material wholly-owned domestic subsidiaries, and are secured by substantially all of the assets of Cengage Learning Holdings II L.P. and such Guarantors, subject to certain customary exceptions.

Subject to certain exceptions, the credit agreement limits the amount Cengage Learning can repay under the senior subordinated discount notes and the loans under the Senior Bridge Facility as well as Cengage Learning’s ability to enter into amendments to the senior subordinated discount notes or the Senior Bridge Facility that are materially adverse to the lenders under the Senior Credit Facilities. The Senior Credit Facilities include provisions whereby a portion of excess cash flow, all of the proceeds from any non-permitted debt issuance and a portion of the proceeds from non-ordinary course asset dispositions, subject to certain exceptions and reinvestment rights, would have to be used to partially prepay the term loan. The Senior Credit Facilities require, among other things, that Cengage Learning maintain an agreed upon senior secured leverage ratio. The Senior Credit Facilities also contain certain other customary restrictions, affirmative covenants and negative covenants.

### **Senior Notes and Senior Subordinated Discount Notes**

Cengage Learning issued \$1,215.6 million aggregate principal amount at maturity of senior notes due 2015 (the “Senior Notes”) and \$519.0 million aggregate principal amount at maturity (\$400.1 million in aggregate gross proceeds) of senior subordinated discount notes due 2015 (the “Senior Subordinated Discount Notes” and, together with the Senior Notes, the “Notes”).

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Interest on the Senior Notes accrues at the rate of 10.50% per annum and is payable in cash semi-annually in arrears on January 15 and July 15 of each year, commencing on January 15, 2008. The Senior Subordinated Discount Notes will not accrue cash interest prior to July 15, 2009. Thereafter, cash interest will accrue on the Senior Subordinated Discount Notes at the rate of 13.25 % per annum and is payable on January 15 and July 15 of each year, commencing on January 15, 2010.

The Notes are unsecured senior obligations. The Senior Subordinated Discount Notes are subordinate to all senior indebtedness, including the Senior Credit Facilities and the Senior Notes. The Notes are guaranteed by Cengage Learning Holdings II L.P. and each of its domestic subsidiaries that guarantee the Senior Credit Facilities.

In accordance with regulations issued by the IRS, to the extent the Senior Subordinated Discount Notes are considered applicable high yield discount obligations, the Company must make a mandatory principal redemption plus accrued interest at the end of each accrual period ending after July 2012.

The Company has agreed to use its reasonable best efforts to file and exchange the Notes for new notes registered under the Securities Act of 1933, as amended, with terms substantially identical in all material respects as the Notes. In the event that the exchange offer registration statement is not filed with the U.S. Securities and Exchange Commission on or prior to the 360<sup>th</sup> day after the original issuance date of the Notes, additional interest will accrue on the Notes.

The indentures that govern the Notes contain certain customary covenants, agreements and events of default.

#### **Senior Bridge Loan Credit Facility**

The senior bridge loan credit agreement (the "Senior Bridge Facility") provides Cengage Learning with financing of \$540.0 million. At Cengage Learning's option, all interest thereunder may be paid in cash, or capitalized through an increase in the principal amount outstanding ("PIK interest"). This election must be made in advance of each rollover. Concurrent with the Acquisition, Cengage Learning borrowed \$540.0 million under the Senior Bridge Facility.

The initial loans will mature on July 5, 2008 and, to the extent they are then unpaid, will automatically be converted into term loans and the term loans will mature on July 5, 2015. At any time on, or after July 5, 2008, the lenders under the Senior Bridge Facility may request to exchange their loans for senior unsecured PIK notes (the "PIK exchange notes"). Cengage Learning is not required to initially issue any PIK exchange notes until it has received exchange requests in an aggregate principal amount of \$50.0 million. Thereafter, requests must be for at least \$1.0 million in aggregate principal amount. Any PIK exchange notes issued will mature on July 5, 2015. Holders of any PIK exchange notes will have registration rights.

Under the Senior Bridge Facility, Cengage Learning can elect the tenor of each loan rollover, as well as which benchmark interest rate would apply, plus a predefined margin. Borrowings under the Senior Bridge Facility initially bear interest at the applicable LIBOR rate plus a margin of 7.75%. The applicable margin increases by 50 basis points on January 5, 2008 and will increase by an additional 50 basis points at the end of every three month period, up to a maximum all-in interest rate of 13.75% per annum.

In accordance with regulations issued by the IRS, to the extent these loans are considered applicable high yield discount obligations, the Company must make mandatory principal prepayments and accrued interest beginning in the second half of 2012.

On or after January 6, 2008 and prior to July 5, 2008, the arrangers of the Senior Bridge Facility may request Cengage Learning to issue bonds and use the proceeds to repay the loans outstanding under the Senior Bridge Facility.

Loans under the Senior Bridge Facility are guaranteed on an unsecured basis by Cengage Learning Holdings II L.P.

The Senior Bridge Facility contains certain customary affirmative covenants, negative covenants and events of default.

#### **Preliminary Allocation of the Purchase Price**

A preliminary allocation of the purchase price was performed using information currently available and is based on preliminary estimates of the fair value of assets acquired and liabilities assumed in connection with the Transactions. The final purchase price allocation is dependent upon, among other things, the finalization of asset and liability valuations. A final

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determination of these fair values will reflect management's consideration of a final valuation prepared by third-party appraisers and will be based on the actual net tangible and identifiable intangible assets that existed as of the closing date of the Acquisition. Any final adjustment will change the allocations of purchase price, which could affect the fair values assigned to the assets and liabilities, including a change to goodwill.

The estimated values of assets and liabilities have been based on a preliminary purchase price which was calculated as follows:

	(in millions)
Acquisition consideration	\$ 7,108.9
Transaction costs (a)	57.7
Retirement of U.K. Pension Obligation (b)	40.2
Total preliminary allocable purchase price	\$ 7,206.8
<b>Estimated Allocation of Purchase Price<sup>(1)</sup></b>	
	(in millions)
Net assets acquired	\$ 1,458.2
Assets and liabilities retained by TOC, net (c)	732.2
Deferred tax adjustments (d)	101.4
Historical net investment of TOC as adjusted for assets and liabilities not acquired	2,291.8
Purchase accounting adjustments:	
Reverse historical intangibles and goodwill (e)	(1,962.0)
Deferred taxes relating to purchase accounting (f)	(674.6)
Deferred revenue	34.4
Other, net	4.1
	(306.3)
Identifiable intangible assets (g)	3,249.0
Goodwill (h)	4,264.1
	\$ 7,206.8

<sup>(1)</sup> As of July 5, 2007

- (a) Includes \$36.4 million of fees paid to certain affiliates of Apax Partners L.P. (hereinafter, collectively referred to as "Apax"), related parties, in connection with the Acquisition.
- (b) Represents £20 million put into escrow to fund The Thomson Corporation PLC pension plan pursuant to Sections 75 and 75A of the U.K. Pensions Act of 1995 and the Occupations Pension Schemes (Employer Debt) Regulations 2005.
- (c) Pursuant to the Acquisition Agreement, Cengage Learning Holdings II L.P. did not acquire notes receivable from TOC, notes payable to TOC, current and long-term portions of long-term debt, current taxes payable and certain other indebtedness related to management retention plans.
- (d) Historical deferred taxes and liabilities of one of the Thomson Learning entities are eliminated upon the consummation of the Acquisition because the acquisition of the entity is accounted for as an asset purchase for income tax purposes.
- (e) Historical intangibles and goodwill are eliminated upon the consummation of the Acquisition.
- (f) Represents recognition of deferred income taxes relating to the Acquisition.

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- (g) Based on management's estimate including the consideration of preliminary external valuation of identifiable intangible assets consisting primarily of content and customer relationships with a weighted average life of 19 years.
- (h) Represents the excess purchase price over the estimated fair value of net identifiable assets acquired. Goodwill will be allocated to the Company's three segments. Approximately \$1,394 million of the goodwill is deductible for tax purposes.

**Advisory Fee Agreements**

Concurrent with the consummation of the Acquisition, Cengage Learning entered into advisory fee agreements with each of Apax and OMERS, respectively (together, the "Advisory Fee Agreements"). Pursuant to the agreement with Apax, Cengage Learning paid a fee of \$36.4 million upon closing of the Acquisition in consideration of services, advice and assistance provided in connection with the Acquisition. In addition, Cengage Learning is obligated to pay an aggregate annual fee of \$10.0 million, payable quarterly in advance on the first day of each quarter during the term of the Advisory Fee Agreements, in consideration of the services to be provided under these Advisory Fee Agreements. Cengage Learning is also obligated to pay associated out of pocket expenses incurred by Apax and OMERS.

At any time in connection with or in anticipation of a change of control or an initial public offering, Apax or OMERS may elect to receive their advisory fees payable under the Advisory Fee Agreements in a single lump sum cash payment equal to the present value of the then unpaid current and future advisory fees payable under the applicable Advisory Fee Agreement, assuming each agreement terminates on the tenth anniversary of the notice date of such election.

Payment of the fees under the Advisory Fee Agreements is subject to deferral due to restrictions imposed upon Cengage Learning in connection with debt financing. Deferred payments will bear interest at an annual rate of 10%, compounded quarterly, until paid.

The fees under the Advisory Fee Agreements may be increased, by mutual agreement of the parties, in the event that Cengage Learning enters into a significant acquisition.

Each Advisory Fee Agreement terminates upon the earlier of (1) the date on which Apax's or OMERS' direct or indirect ownership is below 5%; (2) payment of the remaining advisory fees in a lump sum; or (3) as agreed between the parties to each Advisory Fee Agreement.

**Transition Services Agreements with TOC**

Concurrent with the consummation of the Acquisition, Cengage Learning entered into a Transition Services Agreement with a subsidiary of TOC. Under the Transition Services Agreement, the TOC subsidiary will provide to Cengage Learning various services, including services relating to financial consolidation and reporting, payroll, technology infrastructure, real estate, treasury and cash management, telecommunications and information technology. Under the Transition Services Agreement, the cost of each transition service generally will be based on a flat fee.

Unless specifically indicated below, all services to be provided under the Transition Services Agreement will be provided for a specified period of time, and Cengage Learning can terminate those services in advance upon 30 days written notice without penalty and in certain circumstances, the TOC subsidiary can terminate some services.

Concurrent with the consummation of the Acquisition, Cengage Learning also entered into a Human Resources Services Agreement with the same TOC subsidiary. Under the Human Resources Services Agreement, the TOC subsidiary will provide to Cengage Learning certain employee benefit plan, payroll, administration and other human resources services. Under the terms of the agreement, Cengage Learning is required to establish and maintain certain employee benefit plans pursuant to an administrative service contract, insurance or other arrangement entered into between the Company and a vendor approved by the TOC subsidiary and the third-party service provider to be used by the TOC subsidiary in providing the services under the agreement.

The cost of each service provided under the Human Resources Services Agreement is based on either a flat fee or an allocation (based on size or usage) of the cost incurred by TOC in providing the service. All services to be provided under the Human Resources Services Agreement will be provided for a specified period of time, generally two years from the date of

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the Acquisition, and Cengage Learning does not have the ability to terminate those services or the Human Resources Services Agreement in advance. The TOC subsidiary can generally terminate the services upon six months prior notice.

Concurrent with the consummation of the Acquisition, all employees of Thomson Learning ceased to be active participants in all TOC sponsored employee benefit and stock-based compensation plans described in Note 10, "Benefit Plans" and Note 11, "Stock-Based Compensation". Post Acquisition, the Company did not retain any obligations under, or liabilities with respect to, these plans.

### 3. INVENTORIES

Inventories consist of the following:

	June 30, 2007	December 31,	
		2006	2005
Raw materials	\$ 7,955	\$ 7,422	\$ 6,844
Work-in-progress	4,534	8,185	8,732
Finished goods	236,662	211,515	214,598
	<u>249,151</u>	<u>227,122</u>	<u>230,174</u>
Obsolescence reserve	(63,675)	(65,970)	(62,285)
Inventories, net	<u>\$ 185,476</u>	<u>\$ 161,152</u>	<u>\$ 167,889</u>

### 4. PROPERTY, EQUIPMENT AND CAPITALIZED SOFTWARE FOR INTERNAL USE

Property, equipment and capitalized software for internal use, net, consist of the following:

	June 30, 2007	December 31,	
		2006	2005
Purchased and internally-developed software	\$ 180,539	\$ 155,041	\$ 134,658
Computer hardware	83,225	81,210	77,291
Buildings and building improvements	41,148	41,862	39,978
Machinery and equipment	29,537	25,372	23,784
Leasehold improvements	29,125	28,418	26,884
Furniture and fixtures	18,632	17,855	16,994
Office equipment	6,229	6,234	6,098
Automobiles	2,909	3,131	2,731
Land and land improvements	1,159	1,159	1,159
Total property, equipment and capitalized software for internal use, gross	<u>392,503</u>	<u>360,282</u>	<u>329,577</u>
Less: Accumulated depreciation	(242,197)	(212,326)	(170,272)
Total property, equipment and capitalized software for internal use, net	<u>\$ 150,306</u>	<u>\$ 147,956</u>	<u>\$ 159,305</u>

Depreciation expense (excluding impairment charges) for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004 was \$28,365, \$53,848, \$48,091 and \$41,158, respectively.

Thomson Learning is continuously developing software for internal use designed to provide access to its electronic content through digital portals. In June 2007, the Company recorded an impairment loss of \$1,862 associated with specific software assets which, as a result of changing technologies, no longer support the business operations. The impairment is included in "Depreciation and impairment" on the Combined Statements of Operations and is reported within the "Corporate and other" operating segment.

In 2002, Thomson Learning decided to relocate its warehouse based in Florence, Kentucky to a new warehouse located in Independence, Kentucky. The warehouse continued to be utilized until it was sold in 2004, at which point the Company recognized a gain of \$1,161, which is included in "Selling, general & administrative, excluding depreciation stated below" on the Combined Statements of Operations. The warehouse was part of the "Corporate and other" segment.

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In 2001, Thomson Learning decided to relocate its shared service center from Cincinnati, Ohio to Mason, Ohio and recognized an impairment in the carrying value of \$258 and \$1,100 during the years ended December 31, 2005 and 2004, respectively, which is included in "Selling, general & administrative, excluding depreciation stated below" on the Combined Statements of Operations. Prior to its sale in 2005, the facility was part of the "Corporate and other" segment.

**5. IDENTIFIABLE INTANGIBLE ASSETS**

Identifiable intangible assets, net consist of the following:

	<b>Customer</b>	<b>Database /</b>	<b>Trade</b>	<b>Publishing</b>	<b>Non-</b>	
	<b>Relationships</b>	<b>Content</b>	<b>Names</b>	<b>Rights</b>	<b>compete</b>	<b>Total</b>
					<b>and Other</b>	
<b>As of June 30, 2007</b>						
Identifiable intangible assets, gross	\$ 142,862	\$ 397,943	\$ 118,170	\$ 269,435	\$ 76,239	\$ 1,004,649
Accumulated amortization	(57,771)	(136,040)	(52,852)	(145,925)	(39,736)	(432,324)
Identifiable intangible assets, net	<u>\$ 85,091</u>	<u>\$ 261,903</u>	<u>\$ 65,318</u>	<u>\$ 123,510</u>	<u>\$ 36,503</u>	<u>\$ 572,325</u>
<b>As of December 31, 2006</b>						
Identifiable intangible assets, gross	\$ 142,756	\$ 389,763	\$ 116,120	\$ 270,261	\$ 75,205	\$ 994,105
Accumulated amortization	(54,866)	(123,696)	(51,056)	(142,244)	(36,815)	(408,677)
Identifiable intangible assets, net	<u>\$ 87,890</u>	<u>\$ 266,067</u>	<u>\$ 65,064</u>	<u>\$ 128,017</u>	<u>\$ 38,390</u>	<u>\$ 585,428</u>
<b>As of December 31, 2005</b>						
Identifiable intangible assets, gross	\$ 140,497	\$ 370,915	\$ 115,026	\$ 269,340	\$ 74,873	\$ 970,651
Accumulated amortization	(49,577)	(104,779)	(47,291)	(132,694)	(34,407)	(368,748)
Identifiable intangible assets, net	<u>\$ 90,920</u>	<u>\$ 266,136</u>	<u>\$ 67,735</u>	<u>\$ 136,646</u>	<u>\$ 40,466</u>	<u>\$ 601,903</u>

Publishing rights relate to certain historical acquisitions and are comprised of the cumulative value of trade names, imprints and titles, databases and other intangible assets.

Amortization expense for identifiable intangible assets was \$20,729, \$40,680, \$39,247 and \$38,247 for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

At June 30, 2007, estimated future amortization expense (excluding the impact of purchase accounting associated with the Acquisition) is approximately \$41,000 in fiscal 2008, decreasing thereafter to approximately \$38,000 in fiscal 2012.

In June 2007, Thomson Learning performed a recoverability analysis of identifiable intangible assets associated with a business unit within the International segment that provides vocational training course materials for which customers are entitled to a subsidy from the local government. This business unit has recently been experiencing declining revenues and cash flows resulting from a change in the government's funding policy of certain courses offered to its customers. Using a projected cash flow approach to determine the fair value, the Company recognized an impairment of \$1,744. The identifiable intangible assets impaired were Database / Content of \$1,633 and Customer relationships of \$111 and the impairment is included in "Amortization and impairment of identifiable intangible assets" on the Combined Statements of Operations.

Thomson Learning performed a recoverability analysis of the identifiable intangible assets associated with a product within its Domestic Library Reference segment during the year ended December 31, 2006 due to underperformance of such product in 2006 relative to expectations. Using a projected cash flow approach to determine the fair value, the Company recognized an impairment of \$2,891. The identifiable intangible assets impaired were Database / Content of \$1,981, Customer relationships of \$802, Trade names of \$89 and Non-compete and other of \$19 and the impairment is included in "Amortization and impairment of identifiable intangible assets" on the Combined Statements of Operations.

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**6. INVESTMENTS**

As a result of the decision in June 2007 to dispose of its interest in U21, Thomson Learning performed an evaluation of the fair value thereof. In performing this evaluation, the Company considered general market conditions in the industry, the status of U21's product development efforts, the ability of U21 to meet business milestones and its financial condition and near-term prospects, including the rate at which it is utilizing cash and the potential for additional funding requirements. The result of this evaluation was that the carrying value of the interest had experienced an other-than-temporary decline and Thomson Learning recorded an impairment charge of \$1,706 which is presented within "Equity losses of investee, net of taxes" on the Combined Statements of Operations.

**7. ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

Accounts payable and accrued expenses consist of the following:

	<b>June 30, 2007</b>	<b>December 31,</b>	
		<b>2006</b>	<b>2005</b>
Accounts payable	\$ 71,747	\$ 82,367	\$ 87,442
Accrued royalties	43,902	129,977	128,159
Accrued management incentive plans	33,125	66,355	70,887
Accrued payroll	10,777	10,675	11,082
Accrued other	81,635	58,094	74,318
	<u>\$ 241,186</u>	<u>\$ 347,468</u>	<u>\$ 371,888</u>

Cash overdrafts of \$21,027, \$17,136 and \$10,379 as of June 30, 2007, December 31, 2006 and December 31, 2005, respectively, are included in "Other current liabilities" on the Combined Balance Sheets.

**8. RESTRUCTURING**

In 2006, Thomson Learning initiated a plan to centralize the Domestic Higher Education and Domestic Library Reference editorial production and manufacturing processes into one function. The total restructuring costs of \$3,369 (Domestic Higher Education - \$584; Domestic Library Reference - \$2,785) included severance and relocation of employees as well as contract cancellation costs and property and equipment write downs associated with the closure of associated facilities and are included in "Selling, general and administrative, excluding depreciation stated below" on the Combined Statements of Operations. The restructuring was completed in 2007 and the payments are expected to be completed in 2009.

In 2005, the Domestic Higher Education segment initiated a plan to consolidate three of its office locations and restructure the management of two businesses. The total restructuring costs of \$2,010, which were incurred in 2005 and 2006, are included in "Selling, general and administrative, excluding depreciation stated below" on the Combined Statements of Operations. Such costs included severance and relocation of employees as well as contract cancellation costs associated with the closure of these facilities. The restructuring was completed in 2006 and payments are expected to be completed in 2009.

In 2003, Thomson Learning initiated a restructuring of its Domestic Library Reference segment to better align its cost structure with its revenue producing activities. The total restructuring cost was \$7,127 and included severance of employees, contract cancellation costs associated with leased facilities and write off of property and equipment associated with such facilities. The restructuring was completed in 2004.

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The following is a roll-forward of liabilities associated with these restructurings:

	<b>Contract Cancellation Costs and</b>		<b>Total</b>
	<b>Severance</b>	<b>Other</b>	
December 31, 2003	\$ 3,291	\$ 2,987	\$ 6,278
Additions	-	-	-
Utilization	(3,370)	(2,290)	(5,660)
Adjustments	79	(697)	(618)
December 31, 2004	-	-	-
Additions	276	-	276
Utilization	-	-	-
Adjustments	-	-	-
December 31, 2005	276	-	276
Additions	3,561	1,542	5,103
Utilization	(3,068)	(391)	(3,459)
Adjustments	-	-	-
December 31, 2006	769	1,151	1,920
Additions	-	-	-
Utilization	(541)	(226)	(767)
Adjustments	(72)	-	(72)
June 30, 2007	<u>\$ 156</u>	<u>\$ 925</u>	<u>\$ 1,081</u>

**9. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATION**

Long-term debt consists of the following:

	<b>June 30, 2007</b>		<b>December 31, 2006</b>		<b>December 31, 2005</b>	
	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
Notes payable, due 2006	\$ -	\$ -	\$ -	\$ -	\$ 5,006	\$ 4,967
Notes payable, due 2008	49,915	48,902	69,831	68,191	99,611	97,415
	<u>\$ 49,915</u>	<u>\$ 48,902</u>	<u>\$ 69,831</u>	<u>\$ 68,191</u>	<u>\$ 104,617</u>	<u>\$ 102,382</u>

Each of the notes payable bears interest at a rate of 3.5% per year. The interest rate shall increase by 1% should TOC's credit rating decrease by at least two gradations by a national credit rating agency at any point during the life of the loan. The notes are not collateralized and do not have any restrictive covenants.

An initial discount of \$627 to adjust the stated interest rates to market rate has been treated as a reduction of the related debt and is being accreted over the life of the notes using the effective interest method. The effective interest rate for the six months ended June 30, 2007 was 3.8%.

Cash maturities of notes payable are as follows:

<b>Years Ended June 30,</b>			<b>Unamortized Discount</b>	<b>Carrying Amount</b>
<b>2008</b>	<b>2009</b>	<b>Total</b>		
\$ 35,000	\$ 15,000	\$ 50,000	\$ (85)	\$ 49,915

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**Capital Lease**

Thomson Learning is a lessee in a capital lease agreement for a building located in Farmington Hills, Michigan. The net book value of such property as of June 30, 2007, December 31, 2006 and December 31, 2005 was \$19,281, \$19,659 and \$20,415, respectively, which is net of \$3,403, \$3,024 and \$2,268, respectively, in accumulated depreciation. Interest payments vary based on the three-month London Inter Bank Offered Rate plus a fixed margin of 0.725%. The lease terminates at the earlier of a change in control of the Company or in December 2007, at which point, if there is no change of control, the Company can 1) request a one-year extension of the lease (subject to lessor approval and up to a maximum of five times), 2) sell the property as an exclusive agent of the lessor or 3) purchase the property by settling the amount of the "Capital lease obligation" on the Combined Balance Sheets. Total interest is expected to be \$800 during the year ending June 30, 2008. (See Note 18, "Subsequent Events")

**10. BENEFIT PLANS**

**Defined Contribution Plans**

Certain employees in the United States of America participate in a defined contribution savings plan, administered by TOC, under Section 401(k) of the Internal Revenue Code. The plan covers substantially all United States of America-based employees who meet minimum age and service requirements and allows participants to defer a portion of their annual compensation on a pre-tax basis. Thomson Learning matches 50% of employee contributions up to the first 6% of the employee contribution. For new employees, beginning March 2006, Thomson Learning matches 50% of employee contributions up to the first 8% of the employee contribution. These matching contributions vest based upon an employee's years of service and become fully vested after four years of service. Matching contribution expense directly attributable to Thomson Learning's employees for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004 was \$3,406, \$5,565, \$5,997 and \$5,760, respectively.

Certain employees based outside the United States of America participate in similar plans sponsored by TOC. Under these defined contribution plans, the cost of contributing to the plans is charged to expense as incurred. For the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, the expense associated with these plans was \$584, \$1,333, \$1,085 and \$750, respectively.

**Defined Benefit Pension Plans**

Certain employees in the United States of America participate in a defined benefit pension plan sponsored and administered by TOC. The pension plan calls for benefits to be paid to eligible employees at retirement, based primarily upon years of service and compensation rates near retirement. The majority of the participants become 100% vested in their accrued benefit after completing 5 years of service. Thomson Learning's expense, as allocated by TOC to the Company and other TOC businesses based primarily on the number of participants in the plan, was \$7,474, \$12,805, \$10,261 and \$9,282 for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively. The plan was closed to new participants in March 2006.

Certain employees based outside the United States of America participate in similar plans sponsored by TOC. Under these defined benefit plans, Thomson Learning's cost of contributing to the plans for Company employees is determined by TOC and is charged to expense as incurred. For the six months ended June 30, 2007, and the years ended December 31, 2006, 2005 and 2004, the expense associated with these plans was \$465, \$1,309, \$540 and \$900, respectively.

Additionally, select employees participate in supplemental executive retirement plans. These plans provide qualified employees with additional retirement benefits above that received from the TOC qualified plan. For the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, the expense associated with these plans was \$818, \$1,718, \$2,045 and \$1,964, respectively.

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**Other Post-Retirement Benefits Plans**

Certain employees in the United States of America participate in a defined post-retirement benefit plan sponsored and administered by TOC. The plan calls for certain medical costs, after deductibles, to be paid for after an eligible employee's retirement. The plan has been closed to new participants since 1993. Thomson Learning's expense, as allocated by TOC to the Company and other TOC businesses based primarily on the number of participants in the plan, was \$1,022, \$1,681, \$1,007 and \$1,008 for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

Certain employees based outside the United States of America participate in similar plans sponsored by TOC. Under these defined benefit plans, Thomson Learning's cost of contributing to the plans for Company employees is determined by TOC and is charged to expense as incurred. For the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, the expense associated with these plans was not significant.

**11. STOCK-BASED COMPENSATION**

**Employee Stock Purchase Plan**

In 2005, TOC initiated an Employee Stock Purchase Plan ("ESPP") under which eligible U.S. employees of Thomson Learning may purchase common shares of TOC. Each quarter, participating employees may elect to withhold up to 10% of their eligible compensation, up to a maximum of \$21,250 (whole U.S. dollars) per year, to purchase TOC common shares at a price equal to 85% of the closing price of the shares on the New York Stock Exchange as of the last business day of the quarter. Expense recognized by the Company relating to the ESPP was not significant during the six months ended June 30, 2007 and the years ended December 31, 2006 and 2005.

**Stock Appreciation Rights**

Certain employees of Thomson Learning participate in a TOC-administered plan that provides for the granting of stock appreciation rights ("SAR's"). These rights provide the holder with the opportunity to earn a cash award equal to the fair market value of TOC's common shares less the price at which the SAR was issued. Compensation expense is measured based on the market price of TOC common shares at the end of the reporting period. The SAR's outstanding under the plan have been granted at the closing price of TOC's common shares on the day prior to the date of grant, vest over a four to eight-year period, and expire five to eleven years after the grant date. The compensation expense is recognized over the applicable period in "Selling, general and administrative, excluding depreciation stated below" and "Allocation of Management Costs from TOC" in the Combined Statement of Operations.

A summary of the activity and status of awards to Company employees as of June 30, 2007 and changes during the six months then ended, and December 31, 2006, 2005 and 2004, and changes during the years then ended, is as follows (whole Canadian dollars):

	<b>Six Months Ended June 30, 2007</b>	
	<b>Canadian \$</b>	
	<b>Weighted Average</b>	
	<b>SARs</b>	<b>Exercise Price</b>
Outstanding - January 1	57,000	\$ 42.12
Granted	-	-
Exercised	(7,500)	42.89
Forfeited	(10,000)	41.26
Outstanding - June 30	39,500	42.20
Exercisable - June 30	20,375	43.13

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	Years Ended December 31,					
	2006		2005		2004	
	Canadian \$ Weighted Average		Canadian \$ Weighted Average		Canadian \$ Weighted Average	
	SARs	Exercise Price	SARs	Exercise Price	SARs	Exercise Price
Outstanding - January 1	73,000	\$ 41.53	63,000	\$ 40.52	58,000	\$ 39.43
Granted	-	-	25,000	40.77	15,000	41.74
Exercised	(16,000)	39.44	(15,000)	36.00	-	-
Forfeited	-	-	-	-	(10,000)	36.00
Outstanding - December 31	<u>57,000</u>	42.12	<u>73,000</u>	41.53	<u>63,000</u>	40.52
Exercisable - December 31	<u>28,500</u>	42.94	<u>31,250</u>	41.69	<u>38,250</u>	39.15

The exercised SAR's resulted in cash payments of Canadian \$59, \$59 and \$114 during the six months ended June 30, 2007 and the years ended December 31, 2006 and 2005, respectively.

The following table summarizes additional information of SAR's outstanding as of June 30, 2007 (whole Canadian dollars):

SARs Outstanding				SARs Exercisable		
Canadian \$		Weighted- Average	Canadian \$		Canadian \$	
Range of Exercise Prices	Number Outstanding	Remaining Contractual Life (years)	Weighted- Average Exercise Price	Number Exercisable	Weighted- Average Exercise Price	Exercise Price
\$40.69 - 40.77	22,750	7.9	\$ 40.76	8,688	\$ 40.73	
41.74 - 44.37	12,750	7.1	42.82	7,687	43.09	
44.38 - 48.40	4,000	4.5	48.40	4,000	48.40	

#### Stock Incentive Plan

Under the plan, the exercise price of an option equals the closing market price of TOC's stock on the New York Stock Exchange on the day prior to the date of the grant and the maximum term of an option is 10 years. In general, grants vest 25% per year from the date of issuance. TOC settles employee stock option exercises with newly issued common shares. Under the plan, options may be granted in either Canadian dollars or U.S. dollars. The exercise price for options granted during the years ended December 31, 2005 and 2004 is \$35.13 and \$33.76 (whole U.S. dollars), respectively, and represents the fair value of TOC shares of common stock at the grant date. The weighted average grant date fair value of such granted options was \$7.28 and \$7.55 (whole U.S. dollars) for the years ended December 31, 2005 and 2004, respectively.

The fair value for these options was estimated at the date of the grant by TOC using the Black-Scholes option pricing model. This model requires the use of subjective assumptions, including expected stock price volatility. The principal assumptions used in applying the Black-Scholes option-pricing model for the six months ended June 30, 2007, and the years ended December 31, 2006, 2005 and 2004, respectively, were as follows:

	Six Months Ended	Years Ended December 31,		
	June 30, 2007	2006	2005	2004
Risk-free interest rate	4.7%	4.6%	4.4%	3.8%
Dividend yield	2.3%	2.3%	2.3%	2.3%
Volatility factor	17.1%	18.5%	18.8%	22.9%
Expected life (years)	6	6	6	6

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A summary of the activity and status of the options granted and exercised in Canadian dollars as of June 30, 2007 and changes during the six months then ended, and December 31, 2006, 2005 and 2004, and changes during the years then ended, is as follows (whole Canadian dollars):

	<b>June 30, 2007</b>	
	<b>Canadian \$</b>	
	<b>Weighted</b>	
	<b>Average</b>	
	<b>Options</b>	<b>Exercise Price</b>
Outstanding - January 1	519,500	\$ 50.05
Granted	-	-
Exercised	(10,000)	48.40
Forfeited	(29,000)	53.68
Outstanding - June 30	480,500	49.87
Exercisable - June 30	480,500	49.87

	<b>December 31,</b>					
	<b>2006</b>		<b>2005</b>		<b>2004</b>	
	<b>Canadian \$</b>		<b>Canadian \$</b>		<b>Canadian \$</b>	
	<b>Weighted</b>		<b>Weighted</b>		<b>Weighted</b>	
	<b>Average</b>		<b>Average</b>		<b>Average</b>	
	<b>Options</b>	<b>Exercise Price</b>	<b>Options</b>	<b>Exercise Price</b>	<b>Options</b>	<b>Exercise Price</b>
Outstanding - January 1	616,500	\$ 50.13	661,500	\$ 49.82	719,000	\$ 49.80
Granted	-	-	-	-	-	-
Exercised	(16,000)	41.00	(27,000)	41.00	-	-
Forfeited	(81,000)	52.46	(18,000)	52.40	(57,500)	49.60
Outstanding - December 31	519,500	50.05	616,500	50.13	661,500	49.82
Exercisable - December 31	519,500	50.05	616,500	50.13	561,875	50.48

The exercised options in Canadian dollars had an intrinsic value of Canadian \$14, \$72, and \$94 in the six months ended June 30, 2007 and the years ended December 31, 2006 and 2005, respectively. Total cash received from employees as a result of employee stock option exercises was Canadian \$484, \$656 and \$1,107 during the six months ended June 30, 2007 and the years ended December 31, 2006 and 2005, respectively. In connection with those exercises, the tax benefits realized by Thomson Learning were Canadian \$6, \$29 and \$37 in the six months ended June 30, 2007 and the years ended December 31, 2006 and 2005, respectively.

Options vested were 97,125 and 160,625 during the years ended December 31, 2005 and 2004, respectively. These options had associated aggregate fair values of \$819 and \$1,550, respectively.

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The following table summarizes additional information of Canadian dollar stock options outstanding as of June 30, 2007 (whole Canadian dollars):

<b>Options Outstanding</b>				<b>Options Exercisable</b>		
<b>Canadian \$</b>		<b>Remaining</b>	<b>Canadian \$</b>	<b>Canadian \$</b>		<b>Canadian \$</b>
<b>Exercise</b>	<b>Number</b>	<b>Contractual</b>	<b>Aggregate</b>	<b>Exercise</b>	<b>Number</b>	<b>Aggregate</b>
<b>Prices</b>	<b>Outstanding</b>	<b>Life</b>	<b>Intrinsic</b>	<b>Prices</b>	<b>Exercisable</b>	<b>Intrinsic</b>
		<b>(years)</b>	<b>Value</b>			<b>Value</b>
\$ 41.00	112,000	2.6	\$ 280,000	\$ 41.00	112,000	\$ 280,000
48.40	198,000	4.5	-	48.40	198,000	-
57.40	170,500	3.5	-	57.40	170,500	-
			<u>\$ 280,000</u>			<u>\$ 280,000</u>

A summary of the activity and status of the options granted and exercised in U.S. dollars as of June 30, 2007 and December 31, 2006, 2005 and 2004, and changes during the periods ended on those dates, is as follows (whole U.S. dollars):

	<b>Six Months Ended</b>		<b>Years Ended December 31,</b>			
	<b>June 30, 2007</b>		<b>2006</b>	<b>2005</b>	<b>2004</b>	
	<b>Options</b>	<b>U.S. \$</b>	<b>Options</b>	<b>U.S. \$</b>	<b>Options</b>	<b>U.S. \$</b>
	<b>Weighted</b>		<b>Weighted</b>		<b>Weighted</b>	
	<b>Average</b>		<b>Average</b>		<b>Average</b>	
	<b>Exercise Price</b>		<b>Exercise Price</b>		<b>Exercise Price</b>	
Outstanding - January 1	1,105,438	\$ 33.07	1,381,688	\$ 32.74	979,438	\$ 31.46
Granted	-	-	20,000	37.99	442,000	35.12
Exercised	(28,350)	31.27	(128,250)	31.22	(27,250)	26.54
Forfeited	(36,875)	34.49	(168,000)	32.33	(12,500)	30.52
Outstanding - June 30	<u>1,040,213</u>	33.07	<u>1,105,438</u>	33.07	<u>979,438</u>	31.46
Exercisable - June 30	<u>502,838</u>	31.35	<u>545,032</u>	31.42	<u>433,298</u>	30.45
					<u>222,250</u>	28.86

The exercised options had an aggregate intrinsic value of \$318, \$1,175, \$264 and \$25 during the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively. Total cash received from employees as a result of employee stock option exercises was \$887, \$4,004, \$723 and \$65 during the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively. In connection with those exercises, the tax benefits realized by

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Thomson Learning were \$126, \$466, \$105 and \$10 during the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

Options vested were: 750; 311,172; 242,673 and 153,875 during six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively. These options had associated aggregate fair values of \$5, \$2,247, \$1,752 and \$1,081, respectively.

The following table summarizes additional information of U.S. dollar stock options outstanding as of June 30, 2007 (whole U.S. dollars):

<b>Options Outstanding</b>					<b>Options Exercisable</b>			
U.S. \$ Range of Exercise Prices	Number Outstanding	Weighted Average		U.S. \$ Weighted Average Exercise Price	Number Exercisable	Weighted Average		U.S. \$ Weighted Average Exercise Price
		Remaining Contractual Life (years)	U.S. \$ Aggregate Intrinsic value			Remaining Contractual Life (years)	U.S. \$ Aggregate Intrinsic value	
\$26.06 - 33.49	370,650	6.0	\$ 4,042,941	\$ 30.12	305,900	5.9	\$ 3,554,726	\$ 29.41
33.76 - 37.99	669,563	8.1	4,240,102	34.70	196,938	7.9	1,312,594	33.76
			<u>\$ 8,283,043</u>				<u>\$ 4,867,320</u>	

The compensation expense for this plan is recognized over the applicable period in “Selling, general and administrative, excluding depreciation stated below” and “Allocation of Management Costs from TOC” in the Combined Statement of Operations. Total unrecognized compensation expense related to non-vested awards as of June 30, 2007 was \$3,990.

## 12. ACQUISITIONS AND DIVESTITURES

During the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, Thomson Learning completed 33 acquisitions. These acquisitions augment the Company’s content offerings.

The following provides a brief description of the more significant acquisitions:

Date	Company	Segment	Description
February 2004	EducationToGo	Domestic Higher Education	Provider of content and technology for the delivery of online continuing education courses sold through partnerships with community colleges.
June 2004	NetLearning	Domestic Higher Education	Provider of online training solutions for nurses, hospital technicians, administrators and other healthcare professionals.
July 2004	CompuTaught	Domestic Higher Education	Provider of online real estate education courses and services for higher education institutions and professional associations.
July 2005	Outernet	Domestic Higher Education	Provider of customized print and media learning resources for students enrolled in chemistry and biology lab courses.
December 2005	USA Real	Domestic Higher Education	Provider of exam preparation, pre- and post-

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<b>Date</b>	<b>Company</b>	<b>Segment</b>	<b>Description</b>
	Estate	Education	license courses and other professional development materials to prospective and current real estate license holders.
August 2006	New Editions	International	An international publisher of English language training materials focused on the English primary and secondary markets.
March 2007	Aplia, Inc.	Domestic Higher Education	Provider of online educational content and interactive tools for economic and finance courses.

Pro forma financial information has not been included as acquisitions during the periods presented were not deemed to be material either individually or in aggregate.

Details of net assets acquired of all acquisitions are as follows:

	<b>Six Months Ended</b>	<b>Years Ended December 31,</b>		
	<b>June 30, 2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Cash	\$ 1,193	\$ 317	\$ -	\$ 596
Accounts receivable	(28)	2,424	(476)	1,200
Inventories	801	2,975	773	539
Prepaid expenses and other current assets	142	2,593	-	357
Property and equipment	5,849	1,236	780	2,559
Identifiable intangible assets	8,394	25,063	22,758	38,431
Goodwill	17,690	12,601	13,823	32,597
Other non-current assets	3,000	294	398	62
Total assets	<u>37,041</u>	<u>47,503</u>	<u>38,056</u>	<u>76,341</u>
Accounts payable and accrued expenses	2,004	9,121	2,480	1,974
Deferred revenue	1,560	2,914	1,797	8,922
Other current liabilities	-	1,094	-	-
Deferred tax liability	3,190	5,457	-	597
Other non-current liabilities	60	-	-	532
Total liabilities	<u>6,814</u>	<u>18,586</u>	<u>4,277</u>	<u>12,025</u>
Net assets	<u>\$ 30,227</u>	<u>\$ 28,917</u>	<u>\$ 33,779</u>	<u>\$ 64,316</u>

Approximately \$13,500, \$1,245, \$13,126 and \$19,571 of the goodwill arising from the 2007, 2006, 2005 and 2004 acquisitions, respectively, is deductible for tax purposes.

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The identifiable intangible assets acquired through acquisitions are summarized as follows:

	<u>2007</u>					
	<u>Amount</u>	<u>Weighted Average Amortization Period (years)</u>				
<b>Finite Useful Lives</b>						
Database / Content	\$ 6,400	6				
Trade names	1,994	8				
	<u>\$ 8,394</u>					

	<u>2006</u>		<u>2005</u>		<u>2004</u>	
	<u>Amount</u>	<u>Weighted Average Amortization Period (years)</u>	<u>Amount</u>	<u>Weighted Average Amortization Period (years)</u>	<u>Amount</u>	<u>Weighted Average Amortization Period (years)</u>
<b>Finite Useful Lives</b>						
Customer relationships	\$ 3,256	9	\$ 2,734	9	\$ 5,086	15
Database / Content	20,026	11	18,242	11	30,573	13
Trade names	1,375	5	1,229	8	1,855	7
Non-compete and other	406	2	553	3	917	4
	<u>\$ 25,063</u>		<u>\$ 22,758</u>		<u>\$ 38,431</u>	

Thomson Learning has obligations to pay additional consideration for certain prior acquisitions, typically based upon performance measures contractually agreed to at the time of purchase. Any future payments under such agreements are considered additional purchase price. Additional payments in connection with transactions during the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004 did not have a material impact on the Combined Financial Statements.

In November 2006, Thomson Learning entered into a non-monetary exchange of book titles and content with another publisher. The transaction was accounted for in accordance with SFAS No. 153, "Exchanges of Nonmonetary Assets an Amendment of APB Opinion No. 29" with a value of \$3,000 and resulted in the recognition of a \$1,289 gain.

### 13. INCOME TAXES

The components of (loss) income before taxes by jurisdiction are as follows:

	<u>Six Months Ended</u>	<u>Years Ended December 31,</u>		
	<u>June 30, 2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
United States of America	\$ (99,882)	\$ 183,099	\$ 113,392	\$ 130,142
Other jurisdictions	(17,604)	33,555	37,449	26,043
Total (loss) income before taxes	<u>\$ (117,486)</u>	<u>\$ 216,654</u>	<u>\$ 150,841</u>	<u>\$ 156,185</u>

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The components of benefit from (provision for) income taxes by jurisdiction are as follows:

	<b>Six Months Ended, June 30, 2007</b>	<b>Years Ended December 31,</b>		
		<b>2006</b>	<b>2005</b>	<b>2004</b>
United States of America:				
Current	\$ 76,285	\$ (44,342)	\$ (39,898)	\$ (35,001)
Deferred	(38,838)	(30,252)	(9,870)	(17,303)
Total United States of America	<u>37,447</u>	<u>(74,594)</u>	<u>(49,768)</u>	<u>(52,304)</u>
Other jurisdictions:				
Current	2,892	(11,837)	(11,780)	(10,541)
Deferred	590	889	886	(1,670)
Total Other jurisdictions	<u>3,482</u>	<u>(10,948)</u>	<u>(10,894)</u>	<u>(12,211)</u>
Total worldwide	<u>\$ 40,929</u>	<u>\$ (85,542)</u>	<u>\$ (60,662)</u>	<u>\$ (64,515)</u>

The tax effects of the significant components of temporary differences giving rise to Thomson Learning's deferred tax assets and liabilities at June 30, 2007, December 31, 2006 and December 31, 2005 are as follows:

	<b>June 30,</b>	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Accounts receivable	\$ 30,642	\$ 59,671	\$ 59,777
Inventory	19,063	20,375	18,899
Accrued expenses	15,944	22,162	24,527
Net operating losses	9,553	4,740	3,692
Other tax assets	4,760	4,760	5,682
Total deferred tax assets	<u>79,962</u>	<u>111,708</u>	<u>112,577</u>
Valuation allowance	(8,570)	(3,757)	(2,261)
Net deferred tax assets	<u>71,392</u>	<u>107,951</u>	<u>110,316</u>
Identifiable intangible assets	(133,058)	(133,092)	(127,049)
Goodwill	(170,286)	(157,335)	(129,874)
Other long-lived assets <sup>1</sup>	(16,776)	(20,210)	(12,781)
Total deferred tax liabilities	<u>(320,120)</u>	<u>(310,637)</u>	<u>(269,704)</u>
Net deferred tax liabilities	<u>\$ (248,728)</u>	<u>\$ (202,686)</u>	<u>\$ (159,388)</u>

<sup>1</sup> Other long-lived assets are comprised of property, equipment and capitalized software for internal use and pre-publication costs.

Other tax assets above represent the deferral of tax charges generated from the transfers of technology platforms from one jurisdiction to another. In accordance with GAAP, the tax impact on intercompany transactions must be deferred and amortized to income as the underlying asset is amortized.

The net operating losses recorded above represent tax net operating losses that Thomson Learning has generated on a stand-alone basis. These losses have been calculated solely for the purposes of these Combined Financial Statements.

Thomson Learning is required to assess the realization of its deferred tax assets and the need for a valuation allowance on a stand-alone basis. The assessment requires judgment on the part of management with respect to benefits that could be realized from future taxable income, as well as other positive and negative factors influencing the realization of deferred tax assets. As a result of Thomson Learning's history of net operating losses and expected future losses in certain jurisdictions, a valuation allowance has been established for those items where it is more likely than not that some portion or all of the deferred tax assets will not be realized.

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In the Combined Balance Sheets, deferred tax assets and liabilities are shown net if they are in the same jurisdiction. The components of the net deferred tax liability as reported on the Combined Balance Sheets as of June 30, 2007, December 31, 2006 and December 31, 2005, respectively, are as follows:

	<b>June 30,</b>	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Current deferred tax assets	\$ 57,461	\$ 93,585	\$ 94,380
Non-current deferred tax assets	4,760	4,760	5,682
Non-current deferred tax liabilities	(310,949)	(301,031)	(259,450)
Net deferred tax liabilities	<u>\$ (248,728)</u>	<u>\$ (202,686)</u>	<u>\$ (159,388)</u>

A reconciliation of the statutory U.S. federal income tax rate to Thomson Learning's effective tax rate for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively, is as follows:

	<b>Six Months Ended</b>	<b>Years Ended December 31,</b>		
	<b>June 30, 2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Statutory rate	35.0 %	35.0 %	35.0 %	35.0 %
Foreign tax differential	(1.4)%	(1.2)%	(2.4)%	1.2 %
State and local tax	4.0 %	3.7 %	3.4 %	3.9 %
Other	(2.8)%	2.0 %	4.2 %	1.2 %
Effective rate	<u>34.8 %</u>	<u>39.5 %</u>	<u>40.2 %</u>	<u>41.3 %</u>

As discussed in Note 1, "Basis of Presentation and Summary of Significant Accounting Policies", Thomson Learning adopted a new policy for accounting for uncertain income tax positions effective January 1, 2007. As a result of this change, Thomson Learning recorded a non-cash charge of \$2,125 to its opening retained earnings as of January 1, 2007 with an offsetting increase to "Net investment of TOC". Such unrecognized tax benefits are recognized in "Net investment of TOC" in the accompanying Combined Balance Sheets as the liabilities will be indemnified by TOC subsequent to the disposition of Thomson Learning.

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

Balance at January 1, 2007	\$ 9,796
Additions based on tax positions related to the current year	550
Impact of foreign currency	138
Balance at June 30, 2007	<u>\$ 10,484</u>

If recognized, all of these unrecognized tax benefits would favorably affect Thomson Learning's income tax expense. The Company believes that unrecognized tax benefits in the amount of \$6,566 will lapse within the next 12 months due to the change in ownership resulting from the Acquisition and associated tax grouping statutes within a specific tax jurisdiction. As of June 30, 2007, Thomson Learning had accrued an aggregate of \$1,560 related to interest and penalties associated with these tax positions.

The entities within these Combined Financial Statements are included within consolidated tax returns filed by certain TOC affiliates. As of June 30, 2007, the tax years subject to examination for these TOC affiliates by major jurisdiction are as follows:

<b><u>Jurisdiction</u></b>	<b><u>Tax Year</u></b>
United States - Federal	2003 - 2006
United Kingdom	2005 - 2006

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At June 30, 2007, Thomson Learning had net operating loss carry-forwards for income tax purposes of \$21,189 that will expire in 2008 through 2027, if not utilized, and \$7,412 available to offset future taxable income indefinitely.

**14. SUPPLEMENTAL CASH FLOW INFORMATION**

Details of “Changes in working capital and other items, net of acquisitions” are:

	<b>Six Months Ended</b>	<b>Years Ended December 31,</b>		
	<b>June 30, 2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Accounts receivable, net	\$ 118,503	\$ (42,898)	\$ (14,459)	\$ 20,012
Inventories	(22,496)	10,070	(2,565)	6,804
Prepaid expenses and other current assets	(4,321)	(2,445)	1,445	(5,701)
Accounts payable and accrued expenses	(114,393)	(38,894)	52,523	13,272
Deferred revenue	(26,548)	7,298	10,998	1,577
Current taxes payable	239	4,149	4,397	3,118
Other, net	2,711	10,467	3,647	5,344
	<u>\$ (46,305)</u>	<u>\$ (52,253)</u>	<u>\$ 55,986</u>	<u>\$ 44,426</u>

Cash paid for interest expense on debt and the capital lease, excluding interest paid to TOC, amounted to \$2,039, \$9,180, \$3,679, and \$6,367 for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively. Income taxes paid, net of any refunds, amounted to \$4,085, \$4,951, \$5,297, and \$5,505 for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

**15. RELATED PARTY TRANSACTIONS**

In accordance with Securities and Exchange Commission Staff Accounting Bulletin 1-B, “Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity”, the Combined Financial Statements include an allocation of TOC corporate expenses. The nature of these costs relate to the office of the chief executive and chief financial officers, internal and external audit fees, treasury, investor relations, strategic sourcing and risk management. Such costs have been allocated to Thomson Learning based on the Company’s revenue in proportion to the total revenue of TOC. The amounts allocated to Thomson Learning for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004 were \$25,274, \$47,691, \$41,033 and \$34,081, respectively. Such amounts are selling, general and administrative in nature and are included in “Allocation of management costs from TOC” on the Combined Statements of Operations.

Thomson Learning generated revenue from related parties of \$4,946, \$11,510, \$11,420 and \$11,740 during the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

Because of the related party relationships outlined above and elsewhere within these Combined Financial Statements, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

**16. COMMITMENTS, CONTINGENCIES AND GUARANTEES**

**Claims and Legal Actions**

Thomson Learning is involved in ordinary and routine litigation incidental to its business. In the opinion of management, there are no pending legal proceedings that would have a material adverse effect on the Combined Financial Statements of Thomson Learning.

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**Leases**

Thomson Learning leases certain facilities and other operating equipment under non-cancelable operating lease arrangements expiring at various dates through 2091. Future minimum lease payments under these leases were as follows:

<b>Years Ending June 30,</b>	
2008	\$ 26,004
2009	22,689
2010	18,865
2011	17,112
2012	10,954
thereafter	41,204
	<u>\$ 136,828</u>

Rent expense was approximately \$10,560, \$23,380, \$21,297 and \$21,889 for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

**Other Commitments**

As of June 30, 2007, Thomson Learning had approximately \$23,584 of outstanding purchase commitments which are not recorded in the Combined Financial Statements. Such agreements were entered into with third parties for commitments to purchase or license content to be used in Thomson Learning's educational products and for royalty guarantees derived from minimum usage requirements in agreements with content providers.

The committed purchase amounts by year are as follows:

<b>Year Ending June 30</b>	
2008	\$ 9,889
2009	8,371
2010	5,324
2011	-
2012	-
	<u>\$ 23,584</u>

**Guarantees**

Under Thomson Learning's standard terms and conditions of sale, the Company warrants ownership of its products and provides certain warranties and indemnifications in relation thereto. Thomson Learning is not aware of any instances that would result in payments being made as a result of these warranties and indemnifications, and therefore, no reserve has been recorded in the Combined Financial Statements in relation thereto.

**17. SEGMENT INFORMATION**

Thomson Learning operates in three reportable segments worldwide. Such segments are strategic business groups that offer products and services to target markets. The accounting policies applied by the segments are the same as those applied by the Company. All transactions between reportable segments are eliminated upon combination and reflected in the Corporate and other segment. Thomson Learning's segments are:

*Domestic Higher Education.* The Domestic Higher Education segment publishes higher-education textbooks and provides tailored learning solutions for students and professionals.

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*Domestic Library Reference.* The Domestic Library Reference segment is a publisher for libraries, schools, and businesses. With its reference content, Thomson Learning creates and maintains databases that are published online, in print and in microform.

*International.* The International segment of Thomson Learning provides learning solutions in various formats to individuals and businesses located outside the United States of America.

Thomson Learning discloses information about its reportable segments based on the measures used by management in assessing the performance of those reportable segments. The Company uses “Segment operating profit”, which is operating income before amortization and impairment of identifiable intangible assets and before allocation of corporate management costs from TOC, to measure the operating performance of its segments. Management uses this measure because amortization and impairment of identifiable intangible assets and the allocation of corporate management costs from TOC are not considered to be controllable operating costs for purposes of assessing the current performance of the segments. Segment operating profit does not have any standardized meaning prescribed by GAAP. Total asset information by segment is not shown because it is not provided to or reviewed by the chief operating decision maker.

Select financial information for Thomson Learning’s segments is as follows:

**Six Months Ended June 30, 2007**

	<b>Revenues</b>	<b>Amortization of Pre-publication Costs</b>	<b>Depreciation and Impairment</b>	<b>Segment Operating (Loss) Profit</b>
Domestic Higher Education	\$ 279,122	\$ (25,985)	\$ (4,134)	\$ (7,492)
Domestic Library Reference	148,542	(14,943)	(6,481)	41,219
International	138,644	(6,023)	(2,158)	(23,800)
Segment totals	566,308	(46,951)	(12,773)	9,927
Corporate and other <sup>1</sup>	10,573	-	(17,454)	(68,119)
Total	\$ 576,881	\$ (46,951)	\$ (30,227)	\$ (58,192)

**Year Ended December 31, 2006**

	<b>Revenues</b>	<b>Amortization of Pre-publication costs</b>	<b>Depreciation and Impairment</b>	<b>Segment Operating Profit (Loss)</b>
Domestic Higher Education	\$ 997,844	\$ (83,201)	\$ (6,966)	\$ 290,166
Domestic Library Reference	322,346	(30,357)	(14,107)	94,788
International	328,733	(11,339)	(3,420)	24,144
Segment totals	1,648,923	(124,897)	(24,493)	409,098
Corporate and other <sup>1</sup>	21,390	-	(29,355)	(61,249)
Total	\$ 1,670,313	\$ (124,897)	\$ (53,848)	\$ 347,849

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**Year Ended December 31, 2005**

	<b>Revenues</b>	<b>Amortization of Pre-publication Costs</b>	<b>Depreciation and Impairment</b>	<b>Segment Operating Profit (Loss)</b>
Domestic Higher Education	\$ 949,978	\$ (82,203)	\$ (9,215)	\$ 265,881
Domestic Library Reference	309,528	(28,961)	(13,474)	82,359
International	298,696	(8,813)	(3,353)	37,001
Segment totals	1,558,202	(119,977)	(26,042)	385,241
Corporate and other <sup>1</sup>	20,611	-	(22,049)	(61,108)
Total	<u>\$ 1,578,813</u>	<u>\$ (119,977)</u>	<u>\$ (48,091)</u>	<u>\$ 324,133</u>

**Year Ended December 31, 2004**

	<b>Revenues</b>	<b>Amortization of Pre-publication Costs</b>	<b>Depreciation and Impairment</b>	<b>Segment Operating Profit (Loss)</b>
Domestic Higher Education	\$ 889,713	\$ (78,678)	\$ (6,938)	\$ 258,809
Domestic Library Reference	298,611	(27,922)	(12,849)	72,897
International	267,626	(9,132)	(2,739)	26,090
Segment totals	1,455,950	(115,732)	(22,526)	357,796
Corporate and other <sup>1</sup>	23,830	-	(18,632)	(52,981)
Total	<u>\$ 1,479,780</u>	<u>\$ (115,732)</u>	<u>\$ (41,158)</u>	<u>\$ 304,815</u>

<sup>1</sup> Corporate and other includes shipping and handling revenue, revenue from administrative services and inter-segment eliminations and corporate costs.

The following table reconciles Segment operating (loss) income per the business segment information to operating income per the Combined Statements of Operations.

	<b>Six Months Ended</b>	<b>Years Ended December 31,</b>		
	<b>June 30, 2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Segment operating (loss) profit	\$ (58,192)	\$ 347,849	\$ 324,133	\$ 304,815
Less: Allocation of management costs from TOC	(25,274)	(47,691)	(41,033)	(34,081)
Less: Amortization and impairment of identifiable intangible assets	(22,473)	(43,571)	(39,247)	(38,247)
Operating (loss) income	<u>\$ (105,939)</u>	<u>\$ 256,587</u>	<u>\$ 243,853</u>	<u>\$ 232,487</u>

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The following table shows Thomson Learning's carrying amounts of goodwill by segment along with changes in such amounts during the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004:

	<b>Domestic Higher Education</b>	<b>Domestic Library Reference</b>	<b>International</b>	<b>Total</b>
Carrying amount at December 31, 2003	\$ 974,126	\$ 255,586	\$ 70,518	\$ 1,300,230
Additions	25,869	1,083	5,645	32,597
Purchase accounting adjustments	(19)	-	247	228
Translation	-	-	5,487	5,487
Carrying amount at December 31, 2004	999,976	256,669	81,897	1,338,542
Additions	13,322	-	501	13,823
Purchase accounting adjustments	190	-	686	876
Translation	-	-	(7,939)	(7,939)
Carrying amount at December 31, 2005	1,013,488	256,669	75,145	1,345,302
Additions	2,802	-	9,799	12,601
Purchase accounting adjustments	711	-	-	711
Translation	-	-	8,382	8,382
Carrying amount at December 31, 2006	1,017,001	256,669	93,326	1,366,996
Additions	17,690	-	-	17,690
Purchase accounting adjustments	(188)	-	624	436
Translation	-	-	2,821	2,821
Carrying amount at June 30, 2007	<u>\$ 1,034,503</u>	<u>\$ 256,669</u>	<u>\$ 96,771</u>	<u>\$ 1,387,943</u>

**Geographic Information**

Thomson Learning has business operations throughout the world. The following table contains revenue and long-lived assets information by country of origin for the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004:

	<b>2007</b>		<b>2006</b>		<b>2005</b>		<b>2004</b>	
	<b>Revenue</b>	<b>Long-lived Assets</b>	<b>Revenue</b>	<b>Long-lived Assets</b>	<b>Revenue</b>	<b>Long-lived Assets</b>	<b>Revenue</b>	<b>Long-lived Assets</b>
United States of America	\$ 442,642	\$ 870,622	\$ 1,357,484	\$ 864,996	\$ 1,295,695	\$ 923,402	\$ 1,226,480	\$ 941,763
Rest of world	134,239	85,871	312,829	86,971	283,118	60,468	253,300	55,733
Total	<u>\$ 576,881</u>	<u>\$ 956,493</u>	<u>\$ 1,670,313</u>	<u>\$ 951,967</u>	<u>\$ 1,578,813</u>	<u>\$ 983,870</u>	<u>\$ 1,479,780</u>	<u>\$ 997,496</u>

Long-lived assets are comprised of property, equipment and capitalized software for internal use, pre-publication costs and identifiable intangible assets.

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**18. SUBSEQUENT EVENTS**

On July 5, 2007, Cengage Learning Holdings II L.P. acquired the stock and assets of Thomson Learning from TOC pursuant to the Acquisition Agreement in exchange for cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments. See Note 2, "Acquisition of Thomson Learning" for additional information related to this transaction.

Due to the change in control of Thomson Learning resulting from the Acquisition, the capital lease of the building located in Farmington Hills, Michigan, terminated. The Company negotiated an extension of the current lease term and on October 31, 2007 purchased the property by settling the amount of the "Capital lease obligation".

On August 31, 2007, Thomson Learning changed its name to Cengage Learning, which included amending the certificate of limited partnership of the Company to change its name to "Cengage Learning Holdings II L.P." On October 18, 2007, the Company changed its fiscal year end from December 31 to June 30.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Throughout this document, references to "we", "our", the "Company" and "Thomson Learning" refer to certain wholly-owned indirect subsidiaries and divisions of The Thomson Corporation ("TOC") managed together by a single management team reflecting the assets, liabilities, revenues and expenses directly attributed to TOC's Domestic Higher Education and Domestic Library Reference businesses as well as certain international businesses. The financial statements of Thomson Learning for the periods presented herein are combined on the basis of common control. Thomson Learning owns 50% of Universitas 21 Global ("U21"), a joint venture between the Company and a consortium of 19 universities from around the world, which it accounts for using the equity method.

The following discussion and analysis of our financial condition and results of operations for the six month periods ended June 30, 2007 and 2006, and the years ended December 31, 2006, 2005 and 2004, all of which are prior to July 5, 2007, the consummation of the acquisition of Thomson Learning by Cengage Learning Holdings II L.P. (together with its consolidated subsidiaries, "Cengage Learning"), and the related equity contribution and financing transactions discussed below, hereinafter referred to as the "Transactions". Accordingly, unless otherwise indicated, the discussion and analysis of historical periods does not reflect the Transactions and the impact that the Transactions will have on us, including increased levels of indebtedness and the impact of purchase accounting. This discussion contains forward-looking statements about our business, operations and industry that involve risks and uncertainties, such as statements regarding our plans, objectives, expectations and intentions. Our future results and financial condition may differ materially from those we currently anticipate. See "*Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995.*"

**Overview**

We are a global print and electronic publisher of textbooks, reference materials and other educational resources for the higher education, professional training and library reference markets.

We operate in the following three reportable segments worldwide:

- *Domestic higher education segment* - publishes higher education textbooks and provides tailored learning solutions, including digital learning solutions, for students, faculty, institutions and professionals.
- *Domestic library reference segment* - provider of authoritative reference and educational content, primarily for academic, public and K-12 libraries.
- *International segment* - sells our U.S. textbooks into international markets, adapts U.S. textbooks for various international markets and publishes and sells textbooks by non-U.S. authors.

We categorize shipping and handling revenue, revenue from administrative services and intersegment elimination and corporate costs under a segment reporting line item referred to as "Corporate and other" which represents approximately 1% of our annual combined revenues.

**Sources of Revenue**

*Products.* In our domestic higher education segment, the primary source of revenue is textbooks sold for use in two- and four-year colleges and universities, where professors drive the textbook "adoption" decision by selecting which textbooks will be used in their courses. We predominantly sell to the bookstores and other distribution channels. Students typically purchase textbooks through a college bookstore or online distribution channel. Some schools, like career and for-profit schools, make institutional purchases for all students in a course and charge for the textbooks as part of the course fee. Total revenue is gross textbook sales less the estimated value of returns. In the domestic library reference market, the primary decision makers for purchases are librarians. The sale is often direct, though some libraries purchase from distributors. In addition, some states, municipalities, etc. have formed coalitions to drive uniformity of purchases and achieve scale in their buying. We generate revenue from academic, K-12, public and special (corporate, government and hospital) libraries.

*Services and other.* Services and other revenues include revenues from the delivery of content in electronic format and administrative services such as distribution, warehousing and payroll. In our domestic higher education segment, the adoption

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and purchase decisions for digital services are similar to print. However, digital products are more likely to be purchased via online channels and typically have a finite time frame (i.e., a semester) after which a user's access and support are terminated. In the domestic library reference market, providers attempt to encourage repurchase and up-sell by tracking online usage to demonstrate the product's utility to library end-users.

*Operating expenses.* Our operating expenses are comprised principally of:

- products cost of revenues, which are costs directly related to publishing our textbooks and printed proprietary reference materials such as the cost of paper, printing and binding costs and royalty payments to our authors;
- services and other cost of revenues, which are costs directly related to our digital services for the domestic higher education segment and publishing our digital proprietary reference materials such as hosting and subscription services costs and royalty payments to our authors;
- amortization of pre-publication costs, which are costs related to the creation of a book, reference material, or other media, and includes costs for the associated delivery method when such media is electronic;
- selling, general and administrative expenses, which are the salaries and related costs for our sales staff and our other employees and the marketing and administrative costs of operating our business; and
- depreciation and amortization, which represent the depreciation of our property, equipment and capitalized software for internal use as well as the amortization of our identifiable intangible assets.

### **Stand-alone Company**

We have historically operated as divisions of TOC and not as a stand-alone company. The combined financial statements included in this report have been derived from the accounting records of TOC using the historical results of operations and the historical basis of assets and liabilities directly attributable to Thomson Learning. The historical financial information included in this transition report and annual report may not reflect what our results of operations, financial position and cash flows would have been had we operated as a separate, stand-alone company without the shared resources of TOC for the periods presented and may not be indicative of our future results of operations, financial position and cash flows.

Historically, we were allocated general corporate expenses from TOC for corporate-related functions based on our revenue in proportion to the total revenue of TOC. General corporate expense allocations include executive management, internal and external audit fees, treasury, investor relations, strategic sourcing and risk management. We were allocated general corporate expenses from TOC of \$25.3 million and \$21.8 million during the six months ended June 30, 2007 and 2006, respectively, and \$47.7 million, \$41.0 million, and \$34.1 million for the years ended December 31, 2006, 2005 and 2004, respectively. We believe the assumptions and methodologies underlying the allocations of general corporate expenses from TOC are reasonable. However, such expenses are not indicative of, nor is it practical or meaningful for us to estimate for all historical periods presented, the actual level of expenses that would have been incurred had we been operating as a separate, stand-alone public or private company.

We generated revenue from related parties of \$4,946, \$11,510, \$11,420 and \$11,740 during the six months ended June 30, 2007 and the years ended December 31, 2006, 2005 and 2004, respectively.

Our financing needs are supported by borrowings to and from TOC. We periodically lend to or borrow money from various subsidiaries of TOC as part of TOC's overall cash management and capitalization program. Certain of these arrangements are subject to written loan agreements specifying repayment terms and interest payments.

### **Seasonality**

The academic calendar drives the purchasing behavior of our customers, with purchases for the fall semester in the third calendar quarter and purchases for the winter/spring semester in the fourth calendar quarter before the holiday break. We produce a significant amount of books in advance of these two order periods, and approximately 67% of our revenue is recorded in the third and fourth quarter of the calendar year.

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The decreases in accounts receivable, accounts payable and accrued expenses as well as the increases in Notes payable to TOC and other current liabilities from December 31, 2006 to June 30, 2007 are a natural result of the seasonality of the business.

## **Recent Developments**

### **The Acquisition and Related Financing Transactions**

On May 11, 2007, certain indirect wholly-owned subsidiaries of TOC entered into a Stock and Asset Purchase Agreement (the "Acquisition Agreement") with Apax/TL Holdings LLC, an affiliate of Apax Partners ("Apax") and OMERS Capital Partners ("OMERS") and certain of their affiliates. Pursuant to the Acquisition Agreement, Apax/TL Holdings LLC assigned its rights and obligations among certain affiliates, including Cengage Learning Holdings II L.P.

On July 5, 2007, Cengage Learning Holdings II L.P. (i) acquired the stock of certain companies and certain assets; and (ii) assumed certain liabilities, of Thomson Learning from TOC in exchange for cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments (the "Acquisition").

The Acquisition was financed through (i) a common equity capital contribution of \$1,703.1 million (the "Equity Contribution") and (ii) \$5,580.2 million in aggregate gross proceeds of debt financing (the "Financing Transactions") as follows:

- \$3,440.0 million of borrowings under \$3,740.0 million of senior secured credit facilities, consisting of a \$3,440.0 million term loan facility with a seven-year maturity and a \$300.0 million revolving credit facility with a six-year maturity;
- \$1,215.6 million aggregate principal amount (\$1,200.1 million gross proceeds) of 10.50% senior notes due 2015;
- \$519.0 million aggregate principal amount at maturity (\$400.1 million gross proceeds) of 13.25% senior subordinated discount notes due 2015, for which no cash interest will accrue between the date of original issuance and July 15, 2009; and
- \$540.0 million of borrowings under a senior bridge loan credit facility.

The Financing Transactions, together with the Acquisition and Equity Contribution, are hereinafter referred to as the "Transactions", which are included as a subsequent event to the financial statements.

### **Advisory Fee Agreement**

Concurrent with the consummation of the Acquisition, we entered into advisory fee agreements with Apax and OMERS, respectively (together, the "Advisory Fee Agreements"). Pursuant to the agreement with Apax, we paid a fee of \$36.4 million upon closing of the Acquisition in consideration of services, advice and assistance provided in connection with the Acquisition. In addition, Cengage Learning is obligated to pay an aggregate annual fee of \$10.0 million, plus out of pocket expenses, quarterly in consideration of the services provided under these Advisory Fee Agreements in advance on the first day of each quarter during the term of the Advisory Fee Agreements. The Company is also obligated to pay associated out of pocket expenses as incurred.

At any time in connection with or in anticipation of a change of control or an initial public offering, Apax or OMERS may elect to receive their advisory fees payable under the Advisory Fee Agreements in a single lump sum cash payment equal to the present value of the then unpaid current and future advisory fees payable under the applicable Advisory Fee Agreement, assuming each agreement terminates on the tenth anniversary of the notice date of such election.

Payment of the fees under the Advisory Fee Agreements is subject to deferral due to restrictions imposed upon us in connection with debt financing. Deferred payments will bear interest at an annual rate of 10%, compounded quarterly, until paid.

The fees under the Advisory Fee Agreements may be increased, by mutual agreement of the parties, in the event that we enter into a significant acquisition or business combination.

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Each Advisory Fee Agreement terminates upon the earlier of (1) the date on which Apax's or OMERS' direct or indirect ownership is below 5%; (2) payment of the remaining advisory fees in a lump sum; or (3) as agreed between the parties to each Advisory Fee Agreement.

**Transition Services Agreements with TOC**

Concurrent with the consummation of the Acquisition, we entered into a Transition Services Agreement with a subsidiary of TOC. Under the Transition Services Agreement, the TOC subsidiary will provide to us various services, including services relating to financial consolidation and reporting, payroll, technology infrastructure, real estate, treasury and cash management, telecommunications and information technology. Under the Transition Services Agreement, the cost of each transition service generally will be based on a flat fee.

Unless specifically indicated below, all services to be provided under the Transition Services Agreement will be provided for a specified period of time, and we can terminate those services in advance upon 30 days written notice without penalty and in certain circumstances, the TOC subsidiary can terminate some services.

Concurrent with the consummation of the Acquisition, we also entered into a Human Resources Services Agreement with the same TOC subsidiary. Under the Human Resources Services Agreement, the TOC subsidiary will provide to us certain employee benefit plan, payroll, administration and other human resources services. Under the terms of the agreement, We are required to establish and maintain certain employee benefit plans pursuant to an administrative service contract, insurance or other arrangement entered into between ourselves and a vendor approved by the TOC subsidiary and the third-party service provider to be used by the TOC subsidiary in providing the services under the agreement.

The cost of each service provided under the Human Resources Services Agreement is based on either a flat fee or an allocation (based on size or usage) of the cost incurred by TOC in providing the service. All services to be provided under the Human Resources Services Agreement will be provided for a specified period of time, generally two years from the date of the Acquisition, and we do not have the ability to terminate those services or the Human Resources Services Agreement in advance. The TOC subsidiary can generally terminate the services upon six months prior notice.

Concurrent with the consummation of the Acquisition, our employees ceased to be active participants in all TOC sponsored employee benefit and stock-based compensation plans. Post Acquisition, we did not retain any obligations under or liabilities with respect to these plans.

**Change of Fiscal Year End**

On October 18, 2007, we changed our fiscal year end from December 31 to June 30.

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**Results of Operations**

**The Six Months Ended June 30, 2007 Compared With The Six Months Ended June 30, 2006**

(Dollars in millions)	<u>Six Months Ended June 30,</u>		<u>Percentage</u>
	<u>2007</u>	<u>2006</u>	<u>Change</u>
<b>Statement of Operations</b>			
Revenues:			
Domestic higher education	\$ 279.1	\$ 267.0	4.5 %
Domestic library reference	148.5	148.0	0.3 %
International	138.6	125.9	10.1 %
Corporate and other	10.7	9.3	15.1 %
Total revenues	<u>576.9</u>	<u>550.2</u>	4.9 %
Cost of revenues, excluding depreciation stated below:			
Products	259.3	249.6	3.9 %
Services and other	47.7	44.1	8.2 %
Amortization of pre-publication costs	47.0	45.5	3.3 %
Total cost of revenues, excluding depreciation stated below	<u>354.0</u>	<u>339.2</u>	4.4 %
Selling, general & administrative, excluding depreciation stated below	250.9	206.7	21.4 %
Allocation of management costs from TOC	25.3	21.8	16.1 %
Depreciation and impairment	30.2	25.9	16.6 %
Amortization and impairment of identifiable intangible assets	22.4	20.1	11.4 %
Total costs and expenses	<u>682.8</u>	<u>613.7</u>	11.3 %
Operating loss	(105.9)	(63.5)	66.8 %
Interest expense with TOC	(9.4)	(20.1)	(53.2)%
Interest expense	(2.2)	(2.6)	(15.4)%
Loss before taxes	(117.5)	(86.2)	36.3 %
Benefit from income taxes	40.9	33.1	23.6 %
Equity losses of investee, net of taxes	(4.8)	(4.0)	20.0 %
Net loss	<u>\$ (81.4)</u>	<u>\$ (57.1)</u>	42.6 %

**Revenues** increased by \$26.7 million, or approximately 4.9%, to \$576.9 million for the six months ended June 30, 2007 from \$550.2 million for the six months ended June 30, 2006, due to growth in domestic higher education revenue and the impact of foreign currency translation.

Our domestic higher education revenue increased by \$12.1 million, or approximately 4.5%, to \$279.1 million for the six months ended June 30, 2007 from \$267.0 million for the same period in the prior year. The increase was driven by higher sales in the humanities, social sciences, and business and economics disciplines as well as continued growth in custom products partially offset by fewer shipping days at the end of the period and lower school sales as a result of fewer adoption opportunities.

Our domestic library reference revenue increased by \$0.5 million, or approximately 0.3%, to \$148.5 million for the six months ended June 30, 2007 from \$148.0 million for the same period in the prior year. Results reflect the growth in digital products, partially offset by a decline in print reference material and microfilm.

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Our international revenue increased by \$12.7 million, or approximately 10.1%, to \$138.6 million for the six months ended June 30, 2007 from \$125.9 million for the same period in the prior year. This increase was driven by growth in Australia as well as the impact of foreign currency translation.

**Cost of revenues, excluding depreciation** increased by \$14.8 million, or approximately 4.4%, to \$354.0 million for the six months ended June 30, 2007 from \$339.2 million for the six months ended June 30, 2006, primarily related to increased costs to support our higher revenues.

Our products cost of revenues increased by \$9.7 million, or approximately 3.9%, to \$259.3 million for the six months ended June 30, 2007 from \$249.6 million for the same period in the prior year. These costs predominantly include paper, printing and binding costs, as well as author royalties, all of which vary as revenues increase or decrease. The increase was directly a result of revenue growth and the impact of currency in our international operations.

Our services and other cost of revenues increased by \$3.6 million, or approximately 8.2%, to \$47.7 million for the six months ended June 30, 2007 from \$44.1 million for the same period in the prior year. These costs include the variable cost of royalties, hosting and subscription-related costs largely in our domestic library reference business. The increase was primarily due to an increase in digital revenues.

Amortization of pre-publication costs increased by \$1.5 million, or approximately 3.3%, to \$47.0 million for the six months ended June 30, 2007 from \$45.5 million for the same period in the prior year. This marginal increase was due primarily to higher sales and growth in the business.

**Selling, general & administrative expenses, excluding depreciation** increased by \$44.2 million, or approximately 21.4%, to \$250.9 million for the six months ended June 30, 2007 from \$206.7 million for the same period in the prior year. This increase largely resulted from retention and other bonus arrangements and professional service fees incurred in advance of the Transactions of \$28.4 million and the impact of foreign currency.

**Allocation of management costs from TOC** increased by \$3.5 million, or approximately 16.1%, to \$25.3 million for the six months ended June 30, 2007 from \$21.8 million for the same period in the prior year. This increase was due primarily to higher compensation costs and professional fees incurred by TOC.

**Depreciation and impairment** increased by \$4.3 million, or approximately 16.6%, to \$30.2 million for the six months ended June 30, 2007 from \$25.9 million for the same period in the prior year. This increase is due primarily to a \$1.9 million impairment of internally developed software applications which no longer support our business operations.

**Amortization and impairment of identifiable intangible assets** increased by \$2.3 million, or approximately 11.4%, to \$22.4 million for the six months ended June 30, 2007 from \$20.1 million for the same period in the prior year primarily reflecting a \$1.7 million impairment charge resulting from the reduction in forecasted revenue and cash flow in one of our international businesses in response to reduced government funding for one of the business unit's products.

**Interest expense with TOC** decreased by \$10.7 million, or approximately 53.2%, to \$9.4 million for the six months ended June 30, 2007 from \$20.1 million for the six months ended June 30, 2006, due principally to lower average net borrowings from TOC.

**Interest expense** decreased by \$0.4 million, or approximately 15.4%, to \$2.2 million for the six months ended June 30, 2007 from \$2.6 million for the six months ended June 30, 2006. This decrease is attributed to lower long-term debt reflecting the principal payments of \$35.0 million in 2006.

**Benefit from income taxes** increased by \$7.8 million, or approximately 23.6%, to \$40.9 million for the six months ended June 30, 2007 from \$33.1 million for the six months ended June 30, 2006 due principally to the increased loss before taxes. Our effective tax rate for the six months ended June 30, 2007 is 34.8% and for the six months ended June 30, 2006 is 38.4%.

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Our effective tax rate is subject to change based on nonrecurring events as well as recurring factors including geographical mix of income or loss before taxes and the related tax rates in those jurisdictions. In addition, our effective tax rate will change based on discrete or other nonrecurring events (such as audit settlements) that may not be predictable.

*Equity losses of investee, net of taxes* increased by \$0.8 million, or approximately 20.0%, to \$4.8 million for the six months ended June 30, 2007 from \$4.0 million for the six months ended June 30, 2006, primarily as a result of our recognition of an impairment to the carrying value of U21, our equity investee, of \$1.7 million.

**The Year Ended December 31, 2006 Compared With The Year Ended December 31, 2005**

(Dollars in millions)	<u>Years Ended December 31,</u>		<u>Percentage</u>
	<u>2006</u>	<u>2005</u>	<u>Change</u>
<b>Statement of Operations</b>			
Revenues:			
Domestic higher education	\$ 997.9	\$ 950.0	5.0 %
Domestic library reference	322.3	309.5	4.1 %
International	328.7	298.7	10.0 %
Corporate and other	21.4	20.6	3.9 %
Total revenues	<u>1,670.3</u>	<u>1,578.8</u>	5.8 %
Cost of revenues, excluding depreciation stated below:			
Products	626.3	608.1	3.0 %
Services and other	94.1	88.9	5.8 %
Amortization and pre-publication costs	124.9	120.0	4.1 %
Total cost of revenues, excluding depreciation stated below	<u>845.3</u>	<u>817.0</u>	3.5 %
Expenses:			
Selling, general & administrative, excluding depreciation stated below	423.3	389.7	8.6 %
Allocation of management costs from TOC	47.7	41.0	16.3 %
Deprecation and impairment	53.8	48.1	11.9 %
Amortization and impairment of identifiable intangible assets	43.6	39.2	11.2 %
Total costs and expenses	<u>1,413.7</u>	<u>1,335.0</u>	5.9 %
Operating income	256.6	243.8	5.3 %
Gain on nonmonetary transaction	1.3	-	NM
Interest expense with TOC	(35.7)	(87.2)	(59.1) %
Interest expense	(5.5)	(5.8)	(5.2) %
Income before taxes	216.7	150.8	43.7 %
Provision for income taxes	(85.6)	(60.7)	41.0 %
Equity losses of investee, net of taxes	(6.9)	(7.9)	(12.7) %
Net income	<u>\$ 124.2</u>	<u>\$ 82.2</u>	51.2 %

NM - Not meaningful

*Revenues* increased by \$91.5 million, or approximately 5.8%, to \$1,670.3 million for the year ended December 31, 2006 from \$1,578.8 million for the year ended December 31, 2005, due to increases in each of our segments.

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Our domestic higher education revenue increased by \$47.9 million, or approximately 5.0%, to \$997.9 million for the year ended December 31, 2006 from \$950.0 million for year ended December 31, 2005. This increase was due primarily to increased revenues in custom solutions and digital products. Growth was primarily driven from the business and economics disciplines.

Our domestic library reference revenue increased by \$12.8 million, or approximately 4.1%, to \$322.3 million for the year ended December 31, 2006 from \$309.5 million for the year ended December 31, 2005. This increase resulted from an increase in digital products (largely archives and e-books) partially offset by a continued decline in print revenues as libraries continue to migrate from print to digital products.

Our international revenue increased by \$30.0 million, or approximately 10.0%, to \$328.7 million for the year ended December 31, 2006 from \$298.7 million for the year ended December 31, 2005. This growth was driven by strong English Language Training (ELT) growth in Asia, particularly China, as well as ELT and higher education growth in Latin America.

*Cost of revenues, excluding depreciation* increased by \$28.3 million, or approximately 3.5%, to \$845.3 million for the year ended December 31, 2006 from \$817 million for the year ended December 31, 2005, primarily related to increased costs to support increased revenue.

Our products cost of revenues increased by \$18.2 million, or approximately 3.0%, to \$626.3 million for the year ended December 31, 2006 from \$608.1 million for the year ended December 31, 2005. This increase was directly the result of the increase in revenues. These costs predominantly include paper, printing and binding costs, as well as author royalties, all of which vary as revenues increase or decrease.

Our services and other cost of revenues increased by \$5.2 million, or approximately 5.8%, to \$94.1 million for the year ended December 31, 2006 from \$88.9 million for the year ended December 31, 2005. This increase was primarily tied to the increase in our digital revenues. These costs include the variable cost of royalties, hosting and subscription-related costs, largely in our library reference business.

Amortization of pre-publication costs increased by \$4.9 million, or approximately 4.1%, to \$124.9 million for the year ended December 31, 2006 from \$120.0 million for the year ended December 31, 2005. This increase was due primarily to investments in pre-publication costs, higher sales and growth in the business.

*Selling, general & administrative expenses, excluding depreciation* increased by \$33.6 million, or approximately 8.6%, to \$423.3 million for the year ended December 31, 2006 from \$389.7 million for the year ended December 31, 2005. This increase resulted largely from restructuring costs associated with various businesses, corporate and shared service functions as well as strategic investments in various international businesses and infrastructure in China and India.

*Allocation of management costs from TOC* increased by \$6.7 million, or approximately 16.3%, to \$47.7 million for the year ended December 31, 2006 from \$41.0 million for the year ended December 31, 2005. This increase was driven primarily by higher compensation costs and professional services fees incurred by TOC.

*Depreciation and impairment* increased by \$5.7 million, or approximately 11.9%, to \$53.8 million for the year ended December 31, 2006 from \$48.1 million for the year ended December 31, 2005. This increase can be attributed to depreciation of property and equipment related to infrastructure investments.

*Amortization and impairment of identifiable intangible assets* increased by \$4.4 million, or approximately 11.2%, to \$43.6 million for the year ended December 31, 2006 from \$39.2 million for the year ended December 31, 2005. This increase primarily reflects an impairment charge of \$2.9 million associated with a product within our domestic library reference segment and to the impact of having a full year of amortization for recently completed acquisitions.

*Gain on nonmonetary transaction* of \$1.3 million for the year ended December 31, 2006 reflects a non-monetary exchange of book titles and content with another publisher.

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*Interest expense with TOC* decreased by \$51.5 million, or approximately 59.1%, to \$35.7 million for the year ended December 31, 2006, from \$87.2 million for the year ended December 31, 2005, due principally to a capital contribution of \$906.0 million in March 2006 from TOC that was used to reduce Notes payable to TOC.

*Interest expense* decreased by \$0.3 million, or approximately 5.2%, to \$5.5 million for the year ended December 31, 2006, from \$5.8 million for the year ended December 31, 2005, due primarily to lower long-term debt reflecting the principal payment made during 2006 in the amount of \$35.0 million, offset by higher interest on our capital lease obligation.

*Provision for income taxes* increased by \$24.9 million, or approximately 41.0 %, to \$85.6 million for the year ended December 31, 2006, from \$60.7 million for the year ended December 31, 2005. This increase is attributed to an increase in income before taxes. Our effective tax rate for the year ended December 31, 2006 is 39.5% and for the year ended December 31, 2005 is 40.2%.

Our effective tax rate is subject to change based on nonrecurring events as well as recurring factors including geographical mix of income or loss before taxes and the related tax rates in those jurisdictions. In addition, our effective tax rate will change based on discrete or other nonrecurring events (such as audit settlements) that may not be predictable.

*Equity losses of investee, net of taxes* decreased by \$1.0 million, or approximately 12.7%, to \$6.9 million for the year ended December 31, 2006, from \$7.9 million for the year ended December 31, 2005, as a result of reduced expenses incurred by our equity investee.

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**The Year Ended December 31, 2005 Compared With The Year Ended December 31, 2004**

(Dollars in millions)	<u>Years Ended December 31,</u>		<u>Percentage</u>
	<u>2005</u>	<u>2004</u>	<u>Change</u>
<b>Statement of Operations</b>			
Revenues:			
Domestic higher education	\$ 950.0	\$ 889.7	6.8 %
Domestic library reference	309.5	298.6	3.7 %
International	298.7	267.6	11.6 %
Corporate and other	20.6	23.9	(13.8) %
Total revenues	<u>1,578.8</u>	<u>1,479.8</u>	6.7 %
Cost of revenues, excluding depreciation stated below:			
Products	608.1	575.6	5.6 %
Services and other	88.9	74.7	19.0 %
Amortization and pre-publication costs	120.0	115.7	3.7 %
Total cost of revenues, excluding depreciation stated below	<u>817.0</u>	<u>766.0</u>	6.7 %
Expenses:			
Selling, general & administrative, excluding depreciation stated below	389.7	367.7	6.0 %
Allocation of management costs from TOC	41.0	34.1	20.2 %
Depreciation and impairment	48.1	41.2	16.7 %
Amortization and impairment of identifiable intangible assets	39.2	38.3	2.3 %
Total costs and expenses	<u>1,335.0</u>	<u>1,247.3</u>	7.0 %
Operating income	243.8	232.5	4.8 %
Interest expense with TOC	(87.2)	(74.2)	17.5 %
Interest expense	(5.8)	(2.1)	176.2 %
Income before taxes	150.8	156.2	(3.5) %
Provision for income taxes	(60.7)	(64.5)	(5.9) %
Equity losses of investee, net of taxes	(7.9)	(7.6)	3.9 %
Net income	<u>\$ 82.2</u>	<u>\$ 84.1</u>	(2.4) %

**Revenues** increased by \$99.0 million, or approximately 6.7%, to \$1,578.8 million for the year ended December 31, 2005 from \$1,479.8 million for the year ended December 31, 2004, due principally to domestic higher education as well as international revenues.

Our domestic higher education revenue increased by \$60.3 million, or approximately 6.8%, to \$950.0 million for the year ended December 31, 2005 from \$889.7 million for the year ended December 31, 2004. This increase was due primarily to increased sales of custom solutions, growth in the business and economics disciplines as well as strong sales associated with a K-12 adoption in Texas.

Our domestic library reference revenue increased by \$10.9 million, or approximately 3.7%, to \$309.5 million for the year ended December 31, 2005 from \$298.6 million for the year ended December 31, 2004. This increase resulted from an increase in digital products (largely archives and e-books) partially offset by a continued decline in print revenues as libraries continued to migrate from print to digital products.

Our international revenue increased by \$31.1 million, or approximately 11.6%, to \$298.7 million for the year ended December 31, 2005 from \$267.6 million for the year ended December 31, 2004. This increase was driven by ELT growth in Asia, particularly China.

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*Cost of revenues, excluding depreciation* increased by \$51.0 million, or approximately 6.7%, to \$817.0 million for the year ended December 31, 2005 from \$766.0 million for the year ended December 31, 2004, primarily related to the increased costs to support increased revenues.

Our products cost of revenues increased by \$32.5 million, or approximately 5.6%, to \$608.1 million for the year ended December 31, 2005 from \$575.6 million for the year ended December 31, 2004. This increase was directly the result of the increase in revenues. These costs predominantly include paper, printing and binding costs, as well as author royalties, all of which vary as revenues increase or decrease.

Our services and other cost of revenues increased by \$14.2 million, or approximately 19.0%, to \$88.9 million for the year ended December 31, 2005 from \$74.7 million for the year ended December 31, 2004. This increase was primarily tied to the increase in our digital revenues. These costs include the variable cost of royalties, hosting and subscription related costs, largely in our library reference business.

Amortization of pre-publication costs increased by \$4.3 million, or approximately 3.7%, to \$120.0 million for the year ended December 31, 2005 from \$115.7 million for the year ended December 31, 2004. This increase was due primarily to investments in pre-publication costs, higher sales and growth in the business.

*Selling, general & administrative expenses, excluding depreciation* increased by \$22.0 million, or approximately 6.0%, to \$389.7 million for the year ended December 31, 2005 from \$367.7 million for the year ended December 31, 2004. This increase was largely due to increased incentive compensation related to the sales growth and financial performance of the business as well as higher compensation costs at TOC.

*Allocation of management costs from TOC* increased by \$6.9 million, or approximately 20.2%, to \$41.0 million for the year ended December 31, 2005 from \$34.1 million for the year ended December 31, 2004. This increase was driven primarily by higher compensation costs and professional services fees incurred by TOC.

*Depreciation and impairment* increased by \$6.9 million, or approximately 16.7%, to \$48.1 million for the year ended December 31, 2005 from \$41.2 million for the year ended December 31, 2004. This increase can be attributed to depreciation of property and equipment related to infrastructure investments.

*Amortization and impairment of identifiable intangible assets* increased by \$0.9 million, or approximately 2.3%, to \$39.2 million for the year ended December 31, 2005 from \$38.3 million for the year ended December 31, 2004. This increase was due primarily to having a full year of amortization for recently completed acquisitions.

*Interest expense with TOC* increased by \$13.0 million, or approximately 17.5%, to \$87.2 million for the year ended December 31, 2005 from \$74.2 million for the year ended December 31, 2004 as a result of higher notes payable to TOC and lower notes receivable from TOC during 2005.

*Interest expense* increased by \$3.7 million, or approximately 176.2%, to \$5.8 million for the year ended December 31, 2005 from \$2.1 million for the year ended December 31, 2004. This increase was driven by a full year of interest on long-term debt that was issued in the fourth quarter of 2004.

*Provision for income taxes* decreased by \$3.8 million, or approximately 5.9%, to \$60.7 million for the year ended December 31, 2005 from \$64.5 million for the year ended December 31, 2004 as a result of the lower profit before taxes. Our effective tax rate for the year ended December 31, 2005 is 40.2% and for the year ended December 31, 2004 is 41.3%.

Our effective tax rate is subject to change based on nonrecurring events as well as recurring factors including geographical mix of income or loss before taxes and the related tax rates in those jurisdictions. In addition, our effective tax rate will change based on discrete or other nonrecurring events (such as audit settlements) that may not be predictable.

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*Equity losses of investee, net of taxes* increased by \$0.3 million, or approximately 3.9%, to \$7.9 million for the year ended December 31, 2005 from \$7.6 million for the year ended December 31, 2004 due principally to higher total expenses of our equity investee.

**Liquidity and Capital Resources**

The following table sets forth other financial data and our cash flows from operating, investing and financing activities for the six month periods ended June 30, 2007 and 2006, and the years ended December 31, 2006, 2005 and 2004:

(Dollars in millions)	Six Months Ended June 30,		Years Ended December 31,		
	2007	2006	2006	2005	2004
<b>Other Financial Data</b>					
Additions to property, equipment and capitalized software for internal use	\$ 26.8	\$ 16.9	\$ 43.7	\$ 48.2	\$ 48.3
Additions to pre-publication costs	61.3	56.2	119.6	126.2	142.6
<b>Statements of Cash Flows</b>					
Net cash provided (used) by operating activities	\$ 24.2	\$ (42.2)	\$ 332.2	\$ 362.7	\$ 353.6
Net cash used by investing activities	(121.4)	(78.7)	(194.9)	(212.4)	(250.8)
Net cash provided (used) by financing activities	79.0	115.0	(133.5)	(155.1)	(82.2)
Impact on cash and cash equivalents					
from change in foreign currency	0.9	0.1	1.5	(1.5)	1.2
Net (decrease) increase in cash and cash equivalents	\$ (17.3)	\$ (5.8)	\$ 5.3	\$ (6.3)	\$ 21.8

Our principal sources of liquidity are our existing cash, internally generated cash flow from operations and borrowings under our arrangements with TOC. The principal uses of cash are to fund planned operating expenditures and capital expenditures, including investments in products and technology offerings.

Our financing needs are supported by borrowings to and from TOC. We periodically lend to or borrow money from various subsidiaries of TOC as part of TOC's overall cash management and capitalization program. Certain of these arrangements are subject to written loan agreements specifying repayment terms and interest payments. These notes are reflected separately in the Combined Balance Sheet based on their legal form. Since these notes are part of TOC's overall capitalization of us, changes in the notes' balances are reflected as financing activities in the Combined Statement of Cash Flows.

We had a net working capital deficit of \$601.4 million as of June 30, 2007, which includes the following balances which were not acquired or assumed by Cengage Learning Holdings II L.P as part of the Acquisition: (i) \$693.9 million of current liabilities payable to TOC; (ii) \$35.0 million of current portion of long-term debt; and (iii) \$23.8 million of current notes receivables due from TOC.

**Cash Flows**

**Operating activities.** Net cash provided by operating activities was \$24.2 million for the six months ended June 30, 2007, as compared to net cash used by operating activities of \$42.2 million for the six months ended June 30, 2006. This net improvement of \$66.4 million was attributable to more favorable timing of payments of accounts payable and accruals for professional fees and management bonuses incurred in the current period which were paid subsequent to the Acquisition, partially offset by increased losses during the period.

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Net cash provided from operating activities for the year ended December 31, 2006 decreased by \$30.5 million, or approximately 8.4%, to \$332.2 million from \$362.7 million for the year ended December 31, 2005. This decrease was due primarily to higher bonus and royalty payments.

Net cash provided from operating activities for the year ended December 31, 2005 increased by \$9.1 million, or approximately 2.6%, to \$362.7 million from \$353.6 million for the year ended December 31, 2004. This increase resulted primarily from lower working capital levels.

**Investing activities.** Net cash used by investing activities for the six months ended June 30, 2007 increased by \$42.7 million, or approximately 54.3%, to \$121.4 million from \$78.7 million for the same period in 2006. This increase resulted from acquisitions of businesses, a capital infusion into our equity investee of \$5.2 million, higher spending on pre-publication costs and increased additions to property, equipment and capitalized software for internal-use, primarily for the development of a disaster recovery center for our shared services center in Independence, Kentucky.

Net cash used by investing activities for the year ended December 31, 2006 decreased by \$17.5 million, or approximately 8.2%, to \$194.9 million from \$212.4 million for the year ended December 31, 2005. This decrease was due primarily to fewer acquisitions of businesses, smaller capital infusions into our equity investee, smaller additions to pre-publication costs and smaller additions to property, equipment and capitalized software for internal use.

Net cash used by investing activities for the year ended December 31, 2005 decreased by \$38.4 million, or approximately 15.3%, to \$212.4 million from \$250.8 million for the year ended December 31, 2004. This decrease was attributable primarily to fewer acquisitions of businesses, smaller additions to pre-publication costs, offset by a capital infusion into our equity investee and additions to pre-publication costs and smaller additions to property, equipment and capitalized software for internal use.

**Financing activities.** Net cash provided by financing activities for the six months ended June 30, 2007 decreased by \$36.0 million, or approximately 31.3%, to \$79.0 million from \$115.0 million for the same period in 2006. This decrease was the result of proceeds from notes payable/receivable to TOC, offset by a decrease in the net investment of TOC.

Net cash used by financing activities for the year ended December 31, 2006 decreased by \$21.6 million, or approximately 13.9%, to \$133.5 million from \$155.1 million for the year ended December 31, 2005. This decrease was due primarily to an increase in cash overdrafts, an increase in the net investment of TOC, a decrease in repayments of a term loan with TOC, offset, in part, by higher repayments of notes payable/receivable to TOC.

Net cash used by financing activities for the year ended December 31, 2005 increased by \$72.9 million, or approximately 88.7%, to \$155.1 million from \$82.2 million for the year ended December 31, 2004. This increase was attributable primarily to higher repayments of long-term debt, a decrease in proceeds from the issuance of long-term debt, a decrease in cash overdrafts, a decrease in proceeds from notes payable/receivable to TOC and an increase in repayments of a term loan with TOC, offset, in part, by a lower decrease in the net investment of TOC.

#### **Cash position and Indebtedness**

As of June 30, 2007, our total cash and cash equivalents were \$18.8 million and we had total indebtedness of approximately \$769.8 million, compared to total cash and cash equivalents and total indebtedness as of December 31, 2006 of \$36.1 million and \$562.7 million, respectively.

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**Contractual Obligations and Commitments**

The following table summarizes our future contractual obligations as of June 30, 2007, excluding the effects of the Transactions:

<b>(Dollars in millions)</b>	<b>Less than 1 Year</b>	<b>2-3 Years</b>	<b>4-5 Years</b>	<b>More than 5 Years</b>	<b>Total</b>
<b>Contractual Obligations</b>					
Notes payable to TOC <sup>(1)</sup>	\$ 693.9	\$ -	\$ -	\$ -	\$ 693.9
Notes payable, due 2008 <sup>(2)</sup>	36.5	15.3	-	-	51.8
Capital lease obligation <sup>(3)</sup>	26.8	-	-	-	26.8
Operating lease obligations <sup>(4)</sup>	26.0	41.6	28.0	41.2	136.8
Purchase obligations <sup>(5)</sup>	9.9	13.7	-	-	23.6
Total	\$ 793.1	\$ 70.6	\$ 28.0	\$ 41.2	\$ 932.9

<sup>(1)</sup> Amounts exclude interest. (See Note 1, "Basis of Presentation and Summary of Significant Accounting Policies")

<sup>(2)</sup> Amounts include cash maturity payments and interest payments due. Interest is presented using the stated interest rate of 3.5%. (See Note 9, "Long-term Debt and Capital Lease Obligation")

<sup>(3)</sup> Amounts include the interest portion of future minimum capital lease payments. Interest is estimated using the rate in effect as of June 30, 2007. (See Note 9, "Long-term Debt and Capital Lease Obligation")

<sup>(4)</sup> Represents minimum rental payments for operating leases having initial or remaining non-cancelable lease terms. We lease many of our facilities as well as other property and equipment under operating leases in the normal course of business. The minimum lease payments do not include contingent rental expense. Some lease agreements provide us with the option to renew the lease or purchase the leased property. Our future operating lease obligations would change if we exercised these renewal options and if we entered into additional operating lease agreements. Future operating lease obligations are not recognized on our Combined Balance Sheets. (See Note 16, "Commitments, Contingencies and Guarantees")

<sup>(5)</sup> Purchase obligations are defined as an agreement to purchase goods or services that is enforceable and legally binding and specifying all significant terms, including the following: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and approximate timing of the transaction. The purchase obligation amounts disclosed above represent estimates of the minimum for which we are obligated and the time period in which cash outflows will occur. Purchase orders and authorizations to purchase that involve no firm commitment from either party are excluded from the above table. In addition, contracts that can be unilaterally cancelled with no termination fee or with proper notice are excluded from our total purchase obligations except for the amount of the termination fee or the minimum amount of goods that must be purchased during the requisite notice period. Purchase obligations are not recognized on our Combined Balance Sheets. (See Note 16, "Commitments, Contingencies and Guarantees")

**Off-Balance Sheet Transactions**

Although we generally do not utilize off-balance sheet arrangements in our operations, we enter into operating leases in the ordinary course of our business.

**Indebtedness and Liquidity Post-Transactions**

As a result of the completion of the Transactions, we are highly leveraged. On an as-adjusted basis for the Transactions, as of June 30, 2007, our total indebtedness would have been \$5,606.2 million. We also have an additional \$300.0 million available for borrowing under our revolving credit facility and we may incur additional indebtedness pursuant to an uncommitted incremental term loan facility subject to certain limitations. Our liquidity requirements will be significant, primarily due to our debt service requirements. After giving effect to the Transactions, our cash interest expense for the three and six months ended June 30, 2007 would have been \$98.0 million and \$202.8 million, respectively. In addition, our liquidity and our ability to fund our capital requirements is dependent on our future financial performance, which is subject to general economic, financial and other factors that are beyond our control. If those factors significantly change or other unexpected factors adversely affect us, our business may not generate sufficient cash flow from operations or we may not be able to obtain future financings to meet our liquidity needs. We anticipate that to the extent additional liquidity is necessary

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to fund our operations, it would be funded through borrowings under our revolving credit facility, the incurrence of other indebtedness, additional equity financings or a combination of these potential sources of liquidity. We may not be able to obtain this additional liquidity on terms acceptable to us or at all.

Management expects our cash flows from operations, combined with availability under our new revolving credit facility, to provide sufficient liquidity to fund our current obligations, projected working capital requirements, restructuring obligations and capital spending for the foreseeable future.

In assessing our liquidity, our management reviews and analyzes our current cash on-hand, the number of days our sales are outstanding, the contractual rates that we have established with our payers, inventory turns, foreign exchange rates, capital expenditure commitments and income tax rates. Our principal liquidity requirements will be to meet our debt service requirements, working capital and capital expenditure needs.

### **Senior Secured Credit Facilities**

The senior secured credit facilities provide us with variable rate financing of \$3,740.0 million, consisting of a seven year \$3,440.0 million term loan facility and a six year \$300.0 million revolving credit facility (together, the "Senior Credit Facilities"). Concurrent with the Acquisition, we borrowed \$3,440.0 million under the term loan facility. The Senior Credit Facilities also provide us with the option to raise, subject to certain limitations, additional incremental term loan facilities, or increase the amount available under its revolving credit facility in an aggregate amount of up to \$750.0 million, which amount may be increased by the amount of any voluntary repayments of the term loans under the Senior Credit Facilities and additional amounts to the extent we maintain certain leverage ratios.

Under the Senior Credit Facilities, we can elect the term of each drawdown and loan rollover, as well as which benchmark interest rate would apply, plus a predefined margin based on our leverage ratio. Borrowings under the term loan facility and the revolving credit facility bear interest, at our option, at a rate equal to a margin over either (a) a base rate determined by reference to the higher of (1) the rate of interest announced publicly by The Royal Bank of Scotland plc, from time to time, as its prime rate and (2) the federal funds effective rate plus 1/2 of 1% or (b) a LIBOR rate determined by reference to the costs of funds for deposits for the interest period relevant to such borrowing. In addition, there is a commitment fee on unutilized borrowings under the revolving credit facility. The commitment fee, letter of credit fee and margin for borrowings under both the term loan facility and the revolving credit facility vary and are based upon certain senior secured leverage ratios.

Commencing on December 31, 2007, we are required to pay quarterly installments of \$8.6 million on the term loans with the remaining amount payable on July 3, 2014. Principal amounts not previously repaid under the revolving credit facility are payable on July 5, 2013.

All obligations under the Senior Credit Facilities are guaranteed by Cengage Learning Holdings II L.P. and substantially all of its material wholly-owned domestic subsidiaries, and are secured by substantially all of the assets of Cengage Learning Holdings II L.P. and such Guarantors, subject to certain customary exceptions.

Subject to certain exceptions, the credit agreement limits the amount that we can repay under the senior subordinated discount notes and the loans under the Senior Bridge Facility as well as our ability to enter into amendments to the senior subordinated discount notes or the Senior Bridge Facility that are materially adverse to the lenders under the Senior Credit Facilities. The Senior Credit Facilities include provisions whereby a portion of excess cash flow, all of the proceeds from any non-permitted debt issuance and a portion of the proceeds from non-ordinary course asset dispositions, subject to certain exceptions and reinvestment rights, would have to be used to partially prepay the term loan. The Senior Credit Facilities require, among other things, that we maintain an agreed upon senior secured leverage ratio. The Senior Credit Facilities also contain certain other customary restrictions, affirmative covenants and negative covenants.

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**Senior Notes and Senior Subordinated Discount Notes**

We issued \$1,215.6 million aggregate principal amount at maturity of senior notes due 2015 (the "Senior Notes") and \$519.0 million aggregate principal amount at maturity (\$400.1 million in aggregate gross proceeds) of senior subordinated discount notes due 2015 (the "Senior Subordinated Discount Notes" and, together with the Senior Notes, the "Notes").

Interest on the Senior Notes accrues at the rate of 10.50% per annum and is payable in cash semi-annually in arrears on January 15 and July 15 of each year, commencing on January 15, 2008. The Senior Subordinated Discount Notes will not accrue cash interest prior to July 15, 2009. Thereafter, cash interest will accrue on the Senior Subordinated Discount Notes at the rate of 13.25 % per annum and is payable on January 15 and July 15 of each year, commencing on January 15, 2010.

The Notes are unsecured senior obligations. The Senior Subordinated Discount Notes are subordinate to all senior indebtedness, including the Senior Credit Facilities and the Senior Notes. The Notes are guaranteed by Cengage Learning Holdings II L.P. and each of its domestic subsidiaries that guarantee the Senior Credit Facilities.

In accordance with regulations issued by the IRS, to the extent the Senior Subordinated Discount Notes are considered applicable high yield discount obligations, we must make a mandatory principal redemption plus accrued interest at the end of each accrual period ending after July 2012.

We have agreed to use our reasonable best efforts to file and exchange the Notes for new notes registered under the Securities Act of 1933, as amended, with terms substantially identical in all material respects as the Notes. In the event that the exchange offer registration statement is not filed with the U.S. Securities and Exchange Commission on or prior to the 360<sup>th</sup> day after the original issuance date of the Notes, additional interest will accrue on the Notes.

The indentures that govern the Notes contain certain customary covenants, agreements and events of default.

**Senior Bridge Loan Credit Facility**

The senior bridge loan credit agreement (the "Senior Bridge Facility") provides us with financing of \$540.0 million. At our option, all interest thereunder may be paid in cash, or capitalized through an increase in the principal amount outstanding ("PIK interest"). This election must be made in advance of each rollover. Concurrent with the Acquisition, we borrowed \$540.0 million under the Senior Bridge Facility.

The initial loans will mature on July 5, 2008 and, to the extent they are then unpaid, will automatically be converted into term loans and the term loans will mature on July 5, 2015. At any time on, or after July 5, 2008, the lenders under the Senior Bridge Facility may request to exchange their loans for senior unsecured PIK notes (the "PIK exchange notes"). We are not required to initially issue any PIK exchange notes until we have received exchange requests in an aggregate principal amount of \$50.0 million. Thereafter, requests must be for at least \$1.0 million in aggregate principal amount. Any PIK exchange notes issued will mature on July 5, 2015. Holders of any PIK exchange notes will have registration rights.

Under the Senior Bridge Facility, we can elect the term of each loan rollover, as well as which benchmark interest rate would apply, plus a predefined margin. Borrowings under the Senior Bridge Facility initially bear interest at the applicable LIBOR rate plus a margin of 7.75%. The applicable margin increases by 50 basis points on January 5, 2008 and will increase by an additional 50 basis points at the end of every three month period, up to a maximum all-in interest rate of 13.75% per annum.

In accordance with regulations issued by the IRS, to the extent these loans are considered applicable high yield discount obligations, we must make mandatory principal prepayments and accrued interest beginning in the second half of 2012.

On or after January 6, 2008 and prior to July 5, 2008, the arrangers of the Senior Bridge Facility may request us to issue bonds and use the proceeds to repay the loans outstanding under the Senior Bridge Facility.

Loans under the Senior Bridge Facility are guaranteed on an unsecured basis by Cengage Learning Holdings II L.P.

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The Senior Bridge Facility contains certain customary affirmative covenants, negative covenants and events of default.

**Contractual Obligations and Commitments**

The following table summarizes our future contractual obligations as of June 30, 2007, after giving effect to the Transactions:

(Dollars in millions)	Less than 1 Year	2-3 Years	4-5 Years	More than 5 Years	Total
<b>Contractual Obligations</b>					
Notes payable to TOC <sup>(1)</sup>	\$ -	\$ -	\$ -	\$ -	\$ -
Notes payable, due 2008 <sup>(1)</sup>	-	-	-	-	-
Capital lease obligation (including interest) <sup>(2)</sup>	26.8	-	-	-	26.8
Acquisition related debt:					
Senior secured credit facilities <sup>(3)</sup>	25.8	68.8	68.8	3,276.6	3,440.0
10.50% Senior notes, due 2015 <sup>(3)</sup>	-	-	-	1,215.6	1,215.6
13.25% Senior subordinated discount notes <sup>(3)</sup>	-	-	-	519.0	519.0
Senior bridge facility <sup>(4)</sup>	-	-	-	540.0	540.0
Interest payments on Acquisition related debt <sup>(5)</sup>	336.8	832.3	928.2	2,242.3	4,339.6
Management advisory fee obligations <sup>(6)</sup>	-	31.0	20.0	50.0	101.0
Operating lease obligations <sup>(7)</sup>	26.0	41.6	28.0	41.2	136.8
Purchase obligations <sup>(8)</sup>	9.9	13.7	-	-	23.6
Transition services arrangements with TOC <sup>(9)</sup>	3.2	2.8	-	-	6.0
<b>Total</b>	<b>\$ 428.5</b>	<b>\$ 990.2</b>	<b>\$ 1,045.0</b>	<b>\$ 7,884.7</b>	<b>\$ 10,348.4</b>

<sup>(1)</sup> This liability was not assumed by Cengage Learning Holdings II L.P. (See Note 2, "Acquisition of Thomson Learning")

<sup>(2)</sup> Amounts include the interest portion of future minimum capital lease payments assuming termination of the lease as a result of a change in control of Thomson Learning. (See Note 9, "Long-term Debt and Capital Lease Obligation")

<sup>(3)</sup> Amounts reflect scheduled maturity principal payments. (See Note 2, "Acquisition of Thomson Learning").

<sup>(4)</sup> Amount reflects scheduled cash maturity assuming Cengage Learning elects the option of an additional 7 year term extension. (See Note 2, "Acquisition of Thomson Learning").

<sup>(5)</sup> Interest on variable rate debt is estimated based upon the rate in effect as of July 5, 2007 and interest on fixed rate debt is presented using the stated interest rate. Interest on the Senior Bridge facility is estimated based upon the rate in effect as of July 5, 2007 and assuming that Cengage Learning elects to capitalize all interest until the final maturity date. All amounts exclude amortization of debt discounts and the amortization of debt issuance costs which would be included in interest expense in our Statements of Operations. (See Note 2, "Acquisition of Thomson Learning")

<sup>(6)</sup> Represents payments based on the level of management fees (\$10.0 million per annum) as of July 5, 2007 and assumes a minimum period of 10 years, also including interest of \$1 million associated with the deferral of payment in the first year. The first annual payment (for fiscal 2007) will be made on July 5, 2008, and payments thereafter are due in advance on a quarterly basis, commencing with the quarter ending September 30, 2008. Such fees are subject to increase upon our purchase of another business or the merging of our Company with another business. At any time in connection with or in anticipation of a change of control or an initial public offering, Apax or OMERS may elect to receive their advisory fees in a single lump sum cash payment equal to the present value of future fees payable for a period of 10 years. (See Note 2, "Acquisition of Thomson Learning")

<sup>(7)</sup> Represents minimum rental payments for operating leases having initial or remaining non-cancelable lease terms. We lease many of our facilities as well as other property and equipment under operating leases in the normal course of business. The minimum lease payments do not include contingent rental expense. Some lease agreements provide us with the option to renew the lease or purchase the leased property. Our future operating lease obligations would change if we exercised these renewal options and if we entered into additional operating lease agreements. Future operating lease obligations are not recognized in our Balance Sheets. (See Note 16, "Commitments, Contingencies and Guarantees")

<sup>(8)</sup> Purchase obligations are defined as an agreement to purchase goods or services that is enforceable and legally binding and specifying all significant terms, including the following: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and approximate timing of the transaction. The purchase obligation amounts disclosed above represent estimates of the minimum for which we are obligated and the time period in which cash outflows will occur.

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Purchase orders and authorizations to purchase that involve no firm commitment from either party are excluded from the above table. In addition, contracts that can be unilaterally cancelled with no termination fee or with proper notice are excluded from our total purchase obligations except for the amount of the termination fee or the minimum amount of goods that must be purchased during the requisite notice period. Purchase obligations are not recognized on our Balance Sheets. (See Note 16, "Commitments, Contingencies and Guarantees")

<sup>(9)</sup> Based on current levels of usage and/or costs of provider. (See Note 2, "Acquisition of Thomson Learning")

**Critical Accounting Policies and Estimates**

In preparing our Combined Financial Statements and accounting for the underlying transactions and balances, we apply various accounting policies. We consider the policies disclosed as critical to understanding our Combined Financial Statements, as their application places the most significant demands on management's judgment, since financial reporting results rely on estimates of matters that are inherently uncertain. For a detailed discussion of the application of these accounting policies, refer to Note 1, "Basis of Presentation and Summary of Significant Accounting Policies" to these Combined Financial Statements. Excluding the change in accounting policy related to the adoption of the provisions of Financial Accounting Standards Board Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*", there have been no changes in the application of critical accounting policies since December 31, 2006.

**Recent Accounting Pronouncements**

Please refer to Note 1, "Basis of Presentation and Summary of Significant Accounting Policies" to these Combined Financial Statements for a discussion of recent accounting standards that we have not yet been required to implement, but which may affect us in the future, as well as those accounting standards that have been adopted during 2007.

**CENGAGE LEARNING HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**Quantitative and Qualitative Disclosures about Market Risk**  
**(In thousands of U.S. dollars unless otherwise indicated)**

We are exposed to market risk from foreign currency exchange rates and interest rates, which could affect operating results, financial position and cash flows. We manage our exposure to these market risks through our regular operating and financing activities and, when appropriate, through the use of derivative financial instruments. These derivative financial instruments are utilized to hedge economic exposures as well as reduce earnings and cash flow volatility resulting from shifts in market rates. As permitted, certain of these derivative contracts may be designated for hedge accounting treatment under FASB Statement No. 133, "*Accounting for Derivative Instruments and Hedging Activities*". However, certain of these instruments may not qualify for hedge accounting treatment and, accordingly, our results of operations may be exposed to some level of volatility. Volatility to our results of operations will vary with the type and amount of derivative hedges outstanding, as well as fluctuations in the currency and interest rate market during the period.

We may periodically enter into limited types of derivative contracts, including interest rate and cross currency interest rate swap agreements and interest rate collars to manage interest rate exposures; foreign currency spot, forward, swap and option contracts to manage foreign currency exposures. The fair market values of all our derivative contracts change with fluctuations in interest rates and/or currency rates and are designed so that any changes in their values are offset by changes in the values of the underlying exposures. Derivative financial instruments are held solely as risk management tools and not for trading or speculative purposes.

By their nature, all derivative instruments involve, to varying degrees, elements of market and credit risk not recognized in our financial statements. The market risk associated with these instruments resulting from currency exchange and interest rate movements is expected to offset the market risk of the underlying transactions, assets and liabilities being hedged. We do not believe there is a significant risk of loss in the event of non-performance by derivative counterparties because these transactions are executed with a diversified group of major financial institutions. Further, our policy is to deal with counterparties having a minimum investment-grade or better credit rating. Credit risk is managed through the continuous monitoring of exposures to such counterparties.

At June 30, 2007, we did not have any outstanding derivative instruments.

**CENGAGE LEARNING HOLDINGS II L.P.**  
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**Selected Financial Data**

(In million of U.S. dollars except for Ratio of earnings to fixed charges)

The following selected financial data for the six months ended June 30, 2007 and June 30, 2006 and the years ended December 31, 2006, 2005 and 2004, respectively, is presented below:

	<b>Six Months Ended</b>		<b>Years Ended</b>		
	<b>June 30,</b>		<b>December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Statement of operations data</b>					
Revenues	\$ 576.9	\$ 550.2	\$ 1,670.3	\$ 1,578.8	\$ 1,479.8
Operating (loss) income	(105.9)	(63.5)	256.6	243.9	232.5
<b>Statement of cash flows data</b>					
Net cash provided (used) by operating activities	\$ 24.2	\$ (42.2)	\$ 332.2	\$ 362.7	\$ 353.6
Net cash used (provided) by investing activities	(121.4)	(78.7)	(194.9)	(212.4)	(250.8)
Net cash provided (used) by financing activities	79.0	115.1	(133.5)	(155.1)	(82.2)
<b>Balance sheet data</b>					
Cash and cash equivalents	\$ 18.8		\$ 36.1	\$ 30.7	
Total assets	2,954.7		3,086.7	3,035.5	
Total debt	769.8		562.7	1,524.7	
<b>Other financial data</b>					
Capital expenditures	\$ 26.8	\$ 16.9	\$ 43.7	\$ 48.2	\$ 48.3
Pre-publication costs	61.3	56.2	119.6	126.2	142.6
Ratio of earnings to fixed charges <sup>(1)</sup>	-	-	5.42	2.51	2.87

<sup>(1)</sup> See Computation of Ratio of Earnings to Fixed Charges

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**Computation of Ratio of Earnings to Fixed Charges**  
(In million of U.S. dollars except for Ratio of earnings to fixed charges)

	<b>Six Months Ended</b>		<b>Years Ended</b>		
	<b>June 30,</b>		<b>December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Fixed Charges</b>					
Interest expense	\$ 11.6	\$ 22.7	\$ 41.2	\$ 93.0	\$ 76.3
Portion of rental expense which represents interest factor	3.5	4.0	7.8	7.1	7.3
Total fixed charges	<u>\$ 15.1</u>	<u>\$ 26.7</u>	<u>\$ 49.0</u>	<u>\$ 100.1</u>	<u>\$ 83.6</u>
<b>Earnings available for fixed charges</b>					
Earnings <sup>(1)</sup>	\$ (117.5)	\$ (86.2)	\$ 216.7	\$ 150.8	\$ 156.2
Add fixed charges	15.1	26.7	49.0	100.1	83.6
Total earnings available for fixed charges	<u>\$ (102.4)</u>	<u>\$ (59.5)</u>	<u>\$ 265.7</u>	<u>\$ 250.9</u>	<u>\$ 239.8</u>
<b>Ratio of earnings to fixed charges</b> <sup>(2)</sup>	<u>-</u>	<u>-</u>	<u>5.42</u>	<u>2.51</u>	<u>2.87</u>

<sup>(1)</sup> Earnings comprises pre-tax (loss) income from continuing operations before adjustments for equity losses of investee, net of taxes.

<sup>(2)</sup> For purposes of calculating the ratio of earnings to fixed charges, earnings consist of income before income taxes plus fixed charges. Fixed charges include: interest expense, whether expensed or capitalized, amortization of debt issuance cost and the portion of rental expense representative of the interest factor. Our earnings calculated in accordance with U.S. GAAP were inadequate to cover fixed charges for the six months ended June 30, 2007 and 2006 by \$132.6 million and \$112.9 million, respectively.

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