



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
Thomson Reuters Corporation,
previously The Thomson Corporation)

Third Quarter Report
Three and Nine Months Ended
March 31, 2008

Unaudited Consolidated and Combined Financial Statements and
Management's Discussion and Analysis of Financial Condition and Results of Operations

As of the end of the period covered by this report, Cengage Learning Holdings II L.P. and its consolidated subsidiaries (the “Company”) 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 100% 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 the Company’s debt and securities, to post, on a publicly accessible page on the Company’s website and otherwise make available, financial information that Cengage Learning Holdings II L.P. 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 Cengage Learning 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, which was comprised of wholly-owned indirect subsidiaries and divisions of Thomson Reuters Corporation, previously 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.

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

This 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 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)
Quarterly Report as of March 31, 2008 (Successor) and
for the Three Months Ended March 31, 2008 (Successor),
the Period July 5, 2007 to March 31, 2008 (Successor),
the Period July 1, 2007 to July 4, 2007 (Predecessor) and
the Three and Nine Months Ended March 31, 2007 (Predecessor)
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CENGAGE LEARNING HOLDINGS II L.P.
(AS SUCCESSOR TO THOMSON LEARNING)
Consolidated Balance Sheet at March 31, 2008 (Successor)
and Combined Balance Sheet at June 30, 2007 (Predecessor)
(UNAUDITED)
(in thousands of U.S. dollars unless otherwise indicated)

| | <u>Successor</u> <u>March 31,</u> <u>2008</u> | <u>Predecessor</u> <u>June 30,</u> <u>2007</u> |
|---|---|--|
| Assets | | |
| Cash and cash equivalents | \$ 177,514 | \$ 18,774 |
| Accounts receivable, net | 217,663 | 236,693 |
| Notes receivable from TOC (Predecessor) | - | 23,820 |
| Inventories | 179,399 | 185,476 |
| Deferred tax assets | - | 57,461 |
| Prepaid expenses and other current assets | 39,604 | 40,611 |
| Total current assets | <u>614,180</u> | <u>562,835</u> |
| Property, equipment and capitalized software for internal use, net | 158,387 | 150,306 |
| Pre-publication costs, net | 219,211 | 233,862 |
| Author advances, net | 23,186 | 24,809 |
| Identifiable intangible assets, net | 3,131,943 | 572,325 |
| Goodwill | 4,364,174 | 1,387,943 |
| Deferred tax assets | - | 4,760 |
| Deferred financing costs | 81,499 | - |
| Other non-current assets | 21,848 | 17,817 |
| Total assets | <u>\$ 8,614,428</u> | <u>\$ 2,954,657</u> |
| Liabilities and Owners' Equity | | |
| Accounts payable and accrued expenses | \$ 246,027 | \$ 241,186 |
| Accrued interest | 27,500 | - |
| Deferred revenue | 142,775 | 133,694 |
| Current portion of long-term debt | 34,400 | 35,000 |
| Capital lease obligation | - | 26,022 |
| Notes payable to TOC (Predecessor) | - | 693,877 |
| Current taxes payable | 15,609 | 12,355 |
| Fair value of interest rate swaps and other current liabilities | 86,003 | 22,136 |
| Total current liabilities | <u>552,314</u> | <u>1,164,270</u> |
| Long-term debt | 5,624,733 | 14,915 |
| Deferred tax liabilities | 972,711 | 310,949 |
| Fair value of interest rate swaps and other non-current liabilities | 107,360 | 10,760 |
| Total liabilities | <u>7,257,118</u> | <u>1,500,894</u> |
| Commitments, contingencies and guarantees (Note 14) | | |
| Net investment of TOC (Predecessor) | - | 1,402,513 |
| Partners' capital (Successor) | 1,486,074 | - |
| Accumulated other comprehensive (loss) income | (128,764) | 51,250 |
| Total liabilities and owners' equity | <u>\$ 8,614,428</u> | <u>\$ 2,954,657</u> |

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

CENGAGE LEARNING HOLDINGS II L.P.
(AS SUCCESSOR TO THOMSON LEARNING)
Consolidated Statement of Operations for the Three Months Ended March 31, 2008 (Successor)
and Combined Statement of Operations for the Three Months ended March 31, 2007 (Predecessor)
(UNAUDITED)
(In thousands of U.S. dollars unless otherwise indicated)

| | <u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>March 31,</u> <u>2008</u> | <u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>March 31,</u> <u>2007</u> |
|--|--|--|
| Revenues: | | |
| Products | \$ 204,380 | \$ 181,808 |
| Services and other | 81,836 | 84,680 |
| Total revenues | <u>286,216</u> | <u>266,488</u> |
| Cost of revenues, excluding depreciation stated below: | | |
| Products | 140,553 | 124,609 |
| Services and other | 18,065 | 23,032 |
| Amortization of pre-publication costs | 26,832 | 22,001 |
| Total cost of revenues, excluding depreciation stated below | <u>185,450</u> | <u>169,642</u> |
| Selling, general & administrative, excluding depreciation stated below | 105,733 | 118,488 |
| Allocation of management costs from TOC (Note 20) | - | 11,597 |
| Depreciation | 15,123 | 13,886 |
| Amortization of identifiable intangible assets | 51,154 | 10,297 |
| Total costs and expenses | <u>357,460</u> | <u>323,910</u> |
| Operating loss | (71,244) | (57,422) |
| Interest expense with TOC | - | (4,505) |
| Interest income | 2,493 | 15 |
| Interest expense | (138,239) | (541) |
| Loss before taxes | (206,990) | (62,453) |
| Benefit from income taxes | 11,710 | 23,078 |
| Equity losses of investees, net of taxes | - | (1,652) |
| Net loss | <u>\$ (195,280)</u> | <u>\$ (41,027)</u> |

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

CENGAGE LEARNING HOLDINGS II L.P.
(AS SUCCESSOR TO THOMSON LEARNING)
Consolidated Statement of Operations for the Period July 5, 2007 to March 31, 2008 (Successor) and
Combined Statements of Operations for the Period July 1, 2007 to July 4, 2007 (Predecessor)
and the Nine Months Ended March 31, 2007 (Predecessor)
(UNAUDITED)
(In thousands of U.S. dollars unless otherwise indicated)

| | <u>Successor</u> | <u>Predecessor</u> | |
|--|--|--|---|
| | <u>Period July 5, 2007 to March 31, 2008</u> | <u>Period July 1, 2007 to July 4, 2007</u> | <u>Nine Months Ended March 31, 2007</u> |
| Revenues: | | | |
| Products | \$ 1,120,709 | \$ 16,249 | \$ 1,069,850 |
| Services and other | 293,237 | 2,427 | 316,792 |
| Total revenues | <u>1,413,946</u> | <u>18,676</u> | <u>1,386,642</u> |
| Cost of revenues, excluding depreciation stated below: | | | |
| Products | 529,297 | 7,099 | 503,065 |
| Services and other | 73,868 | 1,002 | 71,269 |
| Amortization of pre-publication costs | 103,782 | 862 | 101,390 |
| Total cost of revenues, excluding depreciation stated below | <u>706,947</u> | <u>8,963</u> | <u>675,724</u> |
| Selling, general & administrative, excluding depreciation stated below | 307,369 | 5,001 | 335,119 |
| Allocation of management costs from TOC (Note 20) | - | 821 | 37,484 |
| Depreciation | 43,575 | 641 | 41,870 |
| Amortization of identifiable intangible assets | 162,099 | 308 | 33,769 |
| Total costs and expenses | <u>1,219,990</u> | <u>15,734</u> | <u>1,123,966</u> |
| Operating income | 193,956 | 2,942 | 262,676 |
| Gain on sale of equity investee | 844 | - | - |
| Gain on nonmonetary transaction | - | - | 1,289 |
| Interest income (expense) with TOC | - | 6 | (20,130) |
| Interest income | 6,000 | 3 | 39 |
| Interest expense | <u>(414,981)</u> | <u>-</u> | <u>(3,429)</u> |
| (Loss) income before taxes | (214,181) | 2,951 | 240,445 |
| Provision for income taxes | (802) | (1,095) | (95,551) |
| Equity losses of investee, net of taxes | (2,017) | (63) | (4,585) |
| Net (loss) income | <u>\$ (217,000)</u> | <u>\$ 1,793</u> | <u>\$ 140,309</u> |

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

CENGAGE LEARNING HOLDINGS II L.P.
(AS SUCCESSOR TO THOMSON LEARNING)
Consolidated Statement of Cash Flows for the Period July 5, 2007 to March 31, 2008 (Successor) and
Combined Statements of Cash Flows for the Period July 1, 2007 to July 4, 2007 (Predecessor)
and the Nine Months Ended March 31, 2007 (Predecessor)
(UNAUDITED)
(In thousands of U.S. dollars unless otherwise indicated)

| | Successor | Predecessor | |
|--|--|--|---|
| | Period July 5, 2007 to March 31, 2008 | Period July 1, 2007 to July 4, 2007 | Nine Months Ended March 31, 2007 |
| Cash Flows from Operating Activities | | | |
| Net (loss) income | \$ (217,000) | \$ 1,793 | \$ 140,309 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | | |
| Amortization of pre-publication costs | 103,782 | 862 | 101,390 |
| Depreciation | 43,575 | 641 | 41,870 |
| Amortization of identifiable intangible assets | 162,099 | 308 | 33,769 |
| Amortization of debt discounts and deferred financing costs | 50,786 | - | - |
| Non-cash interest on Senior Bridge Loan Facility | 54,757 | - | - |
| Non-cash interest on interest rate swaps | 7,886 | - | - |
| Provision for deferred taxes | (10,136) | 826 | 26,306 |
| Equity losses of investees, net of taxes | 2,017 | 63 | 4,585 |
| Gain on sale of equity investee | (844) | - | - |
| Changes in operating assets and liabilities, net of acquisitions | 135,705 | 3,565 | 21,260 |
| Other, net | 3,074 | (91) | 2,655 |
| Net cash provided by operating activities | <u>335,701</u> | <u>7,967</u> | <u>372,144</u> |
| Cash Flows from Investing Activities | | | |
| Acquisitions of business, less cash therein | (7,192,929) | - | (46,246) |
| Proceeds from sale of equity investee | 2,000 | - | - |
| Capital infusion into equity investee | - | - | (5,222) |
| Additions to pre-publication costs | (88,875) | (8) | (89,187) |
| Additions to property, equipment and capitalized software for internal use | (27,319) | - | (33,625) |
| Proceeds from disposition of property, equipment and capitalized software for internal use | 360 | - | 16 |
| Other, net | (20) | - | (146) |
| Net cash used by investing activities | <u>(7,306,783)</u> | <u>(8)</u> | <u>(174,410)</u> |
| Cash Flows from Financing Activities | | | |
| Proceeds from issuance of debt | 5,580,202 | - | - |
| Debt issuance costs | (90,911) | - | - |
| Borrowings under the revolving credit facility | 41,500 | - | - |
| Repayments under the revolving credit facility | (41,500) | - | - |
| Repayments of Senior Secured Credit Facility and capital lease obligation | (43,222) | - | (15,019) |
| Capital contribution | 1,703,074 | - | - |
| Change in cash overdrafts | (15,839) | (6,908) | 29,683 |
| Repayments from notes payable/receivable to TOC, net | - | (5,186) | (175,592) |
| Increase in net investment of TOC | - | 392 | (24,858) |
| Net cash provided (used) by financing activities | <u>7,133,304</u> | <u>(11,702)</u> | <u>(185,786)</u> |
| Impact on Cash and Cash Equivalents from Change in Foreign Currency | <u>261</u> | <u>-</u> | <u>1,570</u> |
| Net Increase (Decrease) in Cash and Cash Equivalents | <u>162,483</u> | <u>(3,743)</u> | <u>13,518</u> |
| Cash and Cash Equivalents | | | |
| Beginning of period | 15,031 | 18,774 | 24,950 |
| End of period | <u>\$ 177,514</u> | <u>\$ 15,031</u> | <u>\$ 38,468</u> |

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

CENGAGE LEARNING HOLDINGS II L.P.
(AS SUCCESSOR TO THOMSON LEARNING)
Combined Statements of Owners' Equity and Comprehensive Income
for the Nine Months Ended March 31, 2007 (Predecessor)
and the Period July 1, 2007 to July 4, 2007 (Predecessor)
(UNAUDITED)
(In thousands of U.S. dollars unless otherwise indicated)

| | Net Investment of TOC | Accumulated Other Comprehensive Income | Total Owners' Equity | Comprehensive Income |
|---|-----------------------------|---|----------------------------|-------------------------|
| June 30, 2006 | \$ 1,433,531 | \$ 34,318 | \$ 1,467,849 | |
| Increase in net investment of TOC | (23,307) | - | (23,307) | |
| Net income | 140,309 | - | 140,309 | \$ 140,309 |
| Foreign currency translation adjustment | - | 13,070 | 13,070 | 13,070 |
| Unrealized gain on derivative instruments | - | 224 | 224 | 224 |
| Comprehensive income | | | | <u>\$ 153,603</u> |
| March 31, 2007 | <u>\$ 1,550,533</u> | <u>\$ 47,612</u> | <u>\$ 1,598,145</u> | |
| June 30, 2007 | \$ 1,402,513 | \$ 51,250 | \$ 1,453,763 | |
| Increase in net investment of TOC | 392 | - | 392 | |
| Net income | 1,793 | - | 1,793 | \$ 1,793 |
| Foreign currency translation adjustment | - | 2,273 | 2,273 | 2,273 |
| Comprehensive income | | | | <u>\$ 4,066</u> |
| July 4, 2007 | <u>\$ 1,404,698</u> | <u>\$ 53,523</u> | <u>\$ 1,458,221</u> | |

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

CENGAGE LEARNING HOLDINGS II L.P.
(AS SUCCESSOR TO THOMSON LEARNING)
Consolidated Statement of Partners' Capital and Comprehensive Loss
for the Period July 5, 2007 to March 31, 2008 (Successor)
(UNAUDITED)
(In thousands of U.S. dollars unless otherwise indicated)

| | General Partner's Capital ⁽¹⁾ | Limited Partners' Capital ⁽¹⁾ | Total Partners' Capital | Accumulated Other Comprehensive (Loss) | Total Owners' Equity | Total Comprehensive Loss |
|--|---|---|--|---|-------------------------------------|---|
| July 5, 2007 | \$ - | \$ - | \$ - | \$ - | \$ - | |
| Capital contribution on July 5, 2007 ⁽¹⁾ | - | 1,703,074 | 1,703,074 | - | 1,703,074 | |
| Net loss | - | (217,000) | (217,000) | - | (217,000) | \$ (217,000) |
| Foreign currency translation adjustment | - | - | - | 35,206 | 35,206 | 35,206 |
| Unrealized loss on derivative instruments | - | - | - | (163,970) | (163,970) | (163,970) |
| Comprehensive loss | | | | | | <u>\$ (345,764)</u> |
| March 31, 2008 | <u>\$ -</u> | <u>\$ 1,486,074</u> | <u>\$ 1,486,074</u> | <u>\$ (128,764)</u> | <u>\$ 1,357,310</u> | |

⁽¹⁾ The General Partner's and Limited Partners' contributions in whole U.S. dollars on July 5, 2007 were \$1.00 and \$1,703,074,189, respectively.

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

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

1. BASIS OF PRESENTATION

Cengage Learning Holdings II L.P. and its consolidated subsidiaries (hereinafter collectively referred to as “Cengage Learning”, “Successor” or the “Company” for the three months ended March 31, 2008 and the period July 5, 2007 to March 31, 2008) is the successor to Thomson Learning, which was comprised of wholly-owned indirect subsidiaries and divisions of Thomson Reuters Corporation, previously The Thomson Corporation (“TOC”), managed together by a single management team (hereinafter collectively referred to as “Thomson Learning” or “Predecessor” for the nine month period ended March 31, 2007 and the period July 1, 2007 to July 4, 2007).

The accompanying unaudited combined interim 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 combined on the basis of common control. The unaudited consolidated interim financial statements of Cengage Learning together with the combined interim financial statements of Thomson Learning are hereinafter collectively referred to as the “Financial Statements”.

The Financial Statements are prepared in accordance with the accounting policies described in the Transition Report for the Six Months Ended June 30, 2007 and Annual Report for the Years Ended December 31, 2006, 2005 and 2004 (the “Transition Report”). Certain information and note disclosures included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted. The Financial Statements should be read in conjunction with the Transition Report. Certain reclassifications have been made to the Predecessor financial statements to conform to the current presentation.

In the opinion of management, the Financial Statements include all adjustments (consisting of normal recurring adjustments) considered necessary by management to fairly state the results of operations, financial position and cash flows.

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 an initial cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments (the “Acquisition”). In accordance with Cengage Learning’s accounting policy, the Company has performed a preliminary allocation related to the purchase price of the Acquisition, and the fair value of the net assets acquired of Thomson Learning. The remaining excess cost of the Acquisition over the fair values attributed to underlying net tangible assets and identifiable intangible assets has been assigned to goodwill. As discussed in Note 2, “Acquisition of Thomson Learning”, this preliminary allocation reflects management’s estimates and may be subject to change.

On October 18, 2007, Cengage Learning Holdings II L.P. changed its fiscal year end from December 31 to June 30.

As described in Note 20, “Related Party Transactions”, prior to the Acquisition, Thomson Learning and other subsidiaries of TOC engaged in extensive intercompany transactions, and Thomson Learning relied on TOC for some of its administrative support for which it was allocated costs using methodologies that management believes were reasonable. The amounts recorded for these transactions and allocations were not necessarily representative of the amounts that would have been reflected in the Financial Statements had Thomson Learning been an entity operated independently of TOC. In addition, a variety of transactions occurred between Thomson Learning, TOC and other subsidiaries of TOC. Other than those transactions reflected as notes payable to or receivable from TOC, these transactions are presented in the Predecessor Financial Statements as related party transactions, the net effect of which is presented within “Net investment of TOC” on the Combined Balance Sheet. All transactions recorded through the “Net investment of TOC” are reflected as financing activities in the accompanying Combined Statements of Cash Flows.

Costs incurred by Thomson Learning for employee retention bonuses and professional services fees in connection with the Acquisition amounted to approximately \$500 and \$11,500 during the four day period ended July 4, 2007 and the nine months ended March 31, 2007, respectively, and have been recorded in “Selling, general & administrative, excluding depreciation” on the Combined Statements of Operations. Employee retention bonuses and professional services fees totaling approximately \$9,500 were incurred during the three months ended March 31, 2007.

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

Notes Receivable and Notes Payable with TOC

Prior to the Acquisition, Thomson Learning periodically lent to, or borrowed money from, various subsidiaries of TOC as part of TOC's overall cash management and capitalization program. These arrangements were 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. As the balances pursuant to these notes fluctuated on a frequent basis, Thomson Learning classified both the "Notes receivable from TOC" and "Notes payable to TOC" as a current asset and a current liability, respectively. As these notes were part of TOC's overall capitalization of Thomson Learning, changes in the notes' balances have been reflected as financing activities in the Combined Statements of Cash Flows. Cengage Learning did not acquire these notes receivable or assume these notes payable as part of the Acquisition (see Note 2, "Acquisition of Thomson Learning").

2. ACQUISITION OF THOMSON LEARNING

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 an initial cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments pursuant to a stock and asset purchase agreement (the "Acquisition Agreement"). During the third quarter of fiscal 2008, Cengage Learning and TOC entered into a working capital settlement agreement whereby the parties agreed to a reduction in the purchase price of \$17.3 million, which was remitted to the Company in February 2008.

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 debt financing, less \$90.9 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;
- \$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". See Note 11, "Debt" for additional descriptions of the Financing Transactions.

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. During the three months ended March 31, 2008, the Company revised the purchase price allocation for identifiable intangible assets to \$3,285.2 million, consisting primarily of publishing rights and database content (See Note 10, "Identifiable Intangible Assets").

A final determination of fair values will reflect all actual net tangible and identifiable intangible assets that existed as of July 5, 2007. Any final adjustments may change the allocations of purchase price, which could affect the fair values assigned to the assets and liabilities, including a change to goodwill and related deferred taxes.

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

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

| | <u>(in millions)</u> |
|---|----------------------|
| Acquisition consideration | \$ 7,108.9 |
| Working capital purchase price adjustment | (17.3) |
| Transaction costs (a) | 58.8 |
| Retirement of U.K. pension obligation (b) | 40.2 |
| Total preliminary allocable purchase price | \$ 7,190.6 |
| Estimated Allocation of Purchase Price⁽¹⁾ | |
| | <u>(in millions)</u> |
| Thomson Learning net assets as of July 4, 2007 | \$ 1,458.2 |
| Assets and liabilities retained by TOC, net (c) | 744.0 |
| Deferred tax adjustments (d) | 101.4 |
| Historical net investment of TOC as adjusted for assets and liabilities not acquired | 2,303.6 |
| Purchase accounting adjustments: | |
| Reverse historical intangible assets and goodwill (e) | (1,962.0) |
| Deferred taxes relating to purchase accounting (f) | (834.3) |
| Deferred revenue | 36.0 |
| Fair value adjustments to property, equipment and capitalized software for internal use | 26.7 |
| Other, net | (5.5) |
| | (435.5) |
| Identifiable intangible assets | 3,285.2 |
| Goodwill (g) | 4,340.9 |
| | \$ 7,190.6 |

⁽¹⁾ Amounts are as of March 31, 2008.

- (a) Includes \$36.4 million of fees and \$0.3 million of out-of-pocket expenses paid to certain affiliates of Apax Partners L.P. (hereinafter, collectively referred to as “Apax”) in connection with the Acquisition. See Note 20, “Related Party Transactions”.
- (b) Represents £20 million paid primarily 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.

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- (c) Pursuant to the Acquisition Agreement, Cengage Learning did not acquire notes receivable from TOC, notes payable to TOC, current and long-term portions of long-term debt 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 intangible assets and goodwill are eliminated upon the consummation of the Acquisition.
- (f) Represents recognition of deferred income taxes relating to the Acquisition at the corporate level. The net deferred tax liability related to the purchase price allocation increased from the preliminary allocation. This change was primarily related to the recognition of a valuation allowance for certain deferred tax assets that are not realizable, the deferred tax liabilities related to purchase price allocation for fixed assets and software, the impact of the revised allocation between the value attributed to the US business versus the non-US businesses, and the impact of the revised allocation within the United States between Cengage Learning and Gale.
- (g) Represents the excess purchase price over the estimated fair value of net identifiable assets acquired. Goodwill is attributable to Cengage Learning's three segments. Approximately \$1,272 million of goodwill is deductible for tax purposes.

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.

Costs incurred under the Transition Services Agreement for the three months ended March 31, 2008 and the period July 5, 2007 to March 31, 2008 amounted to approximately \$100 and \$500, respectively.

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 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.

Costs incurred under the Human Resources Services Agreement for the three months ended March 31, 2008 and the period July 5, 2007 to March 31, 2008 amounted to approximately \$700 and \$2,000, respectively.

Benefit Plans

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 16, "Benefit

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Plans” and Note 17, “Stock-Based Compensation”. Post Acquisition, the Company did not retain any obligations under, or liabilities with respect to, these plans.

Pro Forma Financial Information

The pro forma results below include the effects of the Acquisition as if it had been consummated as of July 1, 2007 and July 1, 2006 for the three and nine months ended March 31, 2008 and 2007, respectively. The pro-forma results include: (i) the amortization associated with the estimated value of acquired identifiable intangible assets; (ii) interest expense associated with the debt used to fund the Acquisition; and (iii) advisory fees payable to Apax and OMERS Capital Partners (“OMERS”) (see Note 20, “Related Party Transactions”). The pro forma results do not include any anticipated benefits from cost savings or adjustments to exclude the allocation of management costs from TOC. Accordingly, the pro forma financial information below is not necessarily indicative of either future results of operations or results that might have been achieved had the Acquisition been consummated as of these dates.

| | <u>Three Months Ended March 31,</u> | | <u>Nine Months Ended March 31,</u> | |
|-------------------------|-------------------------------------|-------------|------------------------------------|--------------|
| | <u>2008</u> | <u>2007</u> | <u>2008</u> | <u>2007</u> |
| Revenue | \$ 286,216 | \$ 263,295 | \$ 1,432,622 | \$ 1,383,972 |
| Operating (loss) income | (71,244) | (105,264) | 194,495 | 101,835 |
| Net loss | (195,280) | (236,924) | (222,607) | (324,606) |

3. ACQUISITION OF HOUGHTON MIFFLIN COLLEGE ASSETS

On November 30, 2007, Cengage Learning entered into a definitive agreement with Houghton Mifflin Company (“Houghton Mifflin”), under which the Company will acquire the assets of Houghton Mifflin’s College Division (“HM College”) for \$750 million in cash, subject to working capital and cash flow adjustments. The purchase agreement contains customary representations, warranties and covenants. The acquisition of HM College assets will expand and complement the range of textbooks, study guides, custom publications and digital solutions that Cengage Learning provides to professors and students in two- and four-year colleges and universities.

The Company expects to finance the acquisition through approximately \$625 million of incremental term loan borrowings under the Senior Secured Credit Facilities, with the remainder financed through an equity contribution to the Cengage Learning Holdings II L.P. (the “Partnership”). The acquisition is expected to close by June 30, 2008 upon satisfaction of regulatory approvals and other customary closing conditions.

4. SEASONALITY AND COMPARABILITY

Typically, a greater portion of Cengage Learning’s revenue, operating profit and operating cash flow is derived in the first half of the fiscal year because customer buying patterns are concentrated during this period, while costs are incurred more evenly throughout the year. As a result, operating margins generally decrease as the fiscal year progresses. For these reasons, the performance of Cengage Learning’s 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 addition, as a result of the Acquisition, assets and liabilities have been adjusted to their fair values and accordingly, historical valuation reserves have been eliminated.

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”. Pursuant to the terms of the Acquisition, TOC agreed to indemnify

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Cengage Learning against certain taxes and associated expenses, including those related to unrecognized tax benefits, imposed on or payable by the Company for any taxable period that ends on or before July 5, 2007 or is allocable to the period ending on the same date.

5. CRITICAL ACCOUNTING POLICIES

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 Financial Statements and accompanying notes. Although these estimates are based on management's best knowledge of current events and actions that Cengage 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 (for periods prior to July 5, 2007) and the determination of fair values related to purchase accounting and used in the assessment of the realizability of long-lived assets, goodwill and identifiable intangible assets.

Summary of Critical Accounting Policies

Revenue Recognition: Cengage 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 digital resources. Services and other revenues include revenues from the delivery of content in digital format and administrative services (e.g., distribution, warehousing and payroll). Cengage 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 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.

Allowance for Doubtful Accounts and Reserve for Sales Returns: Cengage Learning's accounts receivable are due from universities, bookstores, libraries and corporations. Trade accounts receivable are recorded at the invoiced amount and

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do not bear interest. Accounts receivable are reflected net of an allowance for doubtful accounts and sales returns of \$131,271 and \$118,028 at March 31, 2008 and June 30, 2007, respectively. The Company 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 collections and sales returns experience and the economic and competitive environment.

Inventories: Inventories, which are principally comprised of books, other print products and digital 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 digital. Pre-publication costs are amortized upon publication of the title over estimated economic lives of one to six years, being the estimated expected operating life cycle of the title. See “—Impairment of Long-lived Assets” below.

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.

At March 31, 2008, Cengage Learning had goodwill of \$4,364 million and identifiable intangible assets, net of \$3,132 million included on the Consolidated Balance Sheet. If expectations for revenue and cash flows decline or if market conditions deteriorate, the Company may not be able to realize the carrying values of its goodwill and identifiable intangible assets and could be required to record a charge for impairment.

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.

Income Taxes: Cengage Learning accounts for income taxes in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 109, *Accounting for Income Taxes* applied to Cengage Learning Holdings II L.P. and each of its consolidated subsidiaries, which are liable for tax in various jurisdictions. No provision for income taxes is recorded for the limited partnership, Cengage Learning Holdings II L.P., as any liabilities or benefits for income taxes flow to the partners and are their obligations or benefits.

In accordance with FASB Interpretation Number 18, *Accounting for Income Taxes in Interim Periods* (“FIN 18”), the Company excluded from the consolidated worldwide effective tax rate computations, certain jurisdictions where no tax benefit of losses, either year-to-date or anticipated for the fiscal year, would be recognized. Accordingly, the tax rates for the three months ended March 31, 2008 and the period July 5, 2007 to March 31, 2008 exclude the benefit of losses in the U.S. as well as selected foreign jurisdictions in which the Company provides a valuation allowance against the loss carry-forward.

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The effective tax rate is dependent upon the geographic distribution of worldwide earnings or losses, tax regulations in each geographic region, the availability of tax credits and carry-forwards, and the effectiveness of the Company's tax planning strategies. Assumptions used in estimating the Company's annual effective tax rate are regularly monitored and adjusted. If actual results differ from those estimates, future income tax expense could be materially affected.

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 periods shown is the taxes payable or receivable for the period and the change during the period in deferred income tax assets and liabilities.

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

6. RECENT ACCOUNTING PRONOUNCEMENTS

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. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which delays the effective date of SFAS No. 157 for one year for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on at least an annual basis. As such, the adoption of this standard on July 1, 2008 is limited to financial assets and liabilities, which primarily affects the valuation of the Company's derivative instruments. Cengage Learning is currently evaluating the impact of this standard on its 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 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. Cengage Learning is currently evaluating the impact of this standard on its Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations*. This guidance requires the acquiring entity in a business combination to recognize the assets acquired, liabilities assumed and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with separate recognition of the costs of the acquisition. SFAS No. 141(R) also requires the acquirer in a business combination achieved in stages to recognize the identifiable assets and liabilities, and the noncontrolling interest in the acquiree, at the full amounts of their fair values. SFAS No. 141(R) is effective as of the beginning of the first fiscal year after December 15, 2008. Cengage Learning will adopt this standard in fiscal year 2010 and its effects on future periods will depend on the nature and significance of any business combinations subject to this standard.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133*. This guidance requires disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008 with early adoption permitted. Cengage Learning is currently evaluating the impact of this standard on its Financial Statements.

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7. INVENTORIES

Inventories consist of the following:

| | <u>Successor</u> <u>March 31,</u> <u>2008</u> | <u>Predecessor</u> <u>June 30,</u> <u>2007</u> |
|----------------------|---|--|
| Raw materials | \$ 5,574 | \$ 7,955 |
| Work-in-progress | 2,364 | 4,534 |
| Finished goods | 193,615 | 234,279 |
| | <u>201,553</u> | <u>246,768</u> |
| Obsolescence reserve | (22,154) | (61,292) |
| Inventories, net | <u>\$ 179,399</u> | <u>\$ 185,476</u> |

8. PROPERTY, EQUIPMENT AND CAPITALIZED SOFTWARE FOR INTERNAL USE

In December 2007, the Company finalized the purchase price allocation for property, equipment and capitalized software for internal use, and increased the values of purchased and internally-developed software by \$2,831; buildings and building improvements by \$9,755 and land and land improvements by \$14,024.

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

| | <u>Successor</u> <u>March 31,</u> <u>2008</u> | <u>Predecessor</u> <u>June 30,</u> <u>2007</u> |
|--|---|--|
| Purchased and internally-developed software | \$ 81,127 | \$ 180,539 |
| Buildings and building improvements | 41,669 | 41,148 |
| Computer hardware | 26,370 | 83,225 |
| Land and land improvements | 15,174 | 1,159 |
| Leasehold improvements | 14,435 | 29,125 |
| Machinery and equipment | 14,435 | 29,537 |
| Furniture and fixtures | 5,324 | 18,632 |
| Office equipment | 1,979 | 6,229 |
| Automobiles | 1,210 | 2,909 |
| Total property, equipment and capitalized software for internal use, gross | <u>201,723</u> | <u>392,503</u> |
| Less: Accumulated depreciation | (43,336) | (242,197) |
| Total property, equipment and capitalized software for internal use, net | <u>\$ 158,387</u> | <u>\$ 150,306</u> |

9. INVESTMENTS

In November 2007, Cengage Learning sold its 50% investment in Universitas 21 Global (“U21”), a joint venture between the Company and a consortium of 19 universities from around the world, for cash proceeds of \$2,000. The Company accounted for U21 using the equity method and recognized a gain of \$844 on the sale as a result of equity losses recognized since July 5, 2007.

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10. IDENTIFIABLE INTANGIBLE ASSETS

In March 2008, the Company revised the purchase price allocation of identifiable intangible assets related to the acquisition of Thomson Learning. Management estimated the fair value of the intangible assets using valuation techniques appropriate to the nature of the intangible asset and consistent with the market, income and cost approaches. The valuation techniques required management to make certain estimates and assumptions including, but not limited to, revenue and expense growth rates, interest rates, economic useful lives of the intangibles, and obsolescence rates. Identifiable intangible assets consist of the following:

| | Customer Relationships | Database / Content | Trade Names | Publishing Rights | Non- compete and Other | Total |
|---------------------------------------|-----------------------------------|-------------------------------|------------------------|------------------------------|---------------------------------------|---------------------|
| As of March 31, 2008 | | | | | | |
| Identifiable intangible assets, gross | \$ 316,220 | \$ 707,537 | \$ 409,685 | \$ 1,828,584 | \$ 32,000 | \$ 3,294,026 |
| Accumulated amortization | (56,240) | (38,662) | (25,712) | (29,962) | (11,507) | (162,083) |
| Identifiable intangible assets, net | <u>\$ 259,980</u> | <u>\$ 668,875</u> | <u>\$ 383,973</u> | <u>\$ 1,798,622</u> | <u>\$ 20,493</u> | <u>\$ 3,131,943</u> |
| Weighted average life | <u>21</u> | <u>21</u> | <u>15</u> | <u>23</u> | <u>5</u> | |

Amortization expense for identifiable intangible assets was \$51,154 for the three months ended March 31, 2008 and \$162,099 for the period July 5, 2007 to March 31, 2008. At March 31, 2008, estimated annual amortization expense for the remainder of fiscal 2008 and each of the next four fiscal years is as follows:

| Years Ending June 30, | |
|------------------------------|-----------|
| Remainder of fiscal 2008 | \$ 50,592 |
| 2009 | 158,875 |
| 2010 | 158,826 |
| 2011 | 158,400 |
| 2012 | 158,400 |

During the nine months ended March 31, 2007, Thomson Learning performed a recoverability analysis of the identifiable intangible assets associated with a product within its Gale segment due to underperformance of such product in the twelve months ended December 31, 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. The impairment is included in "Amortization of identifiable intangible assets" on the Combined Statements of Operations.

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11. DEBT

Short-term borrowings consist of the following:

| | <u>Successor</u> <u>March 31,</u> <u>2008</u> | <u>Predecessor</u> <u>June 30,</u> <u>2007</u> |
|--|---|--|
| Current portion of notes payable, due 2008 | | \$ 35,000 |
| Current portion of senior secured credit facilities: | | |
| Term loan facility | \$ 34,400 | - |
| Capital lease obligation | - | 26,022 |
| Notes payable to TOC | - | 693,877 |
| | <u>\$ 34,400</u> | <u>\$ 754,899</u> |

Long-term debt consists of the following:

| | <u>Successor</u> <u>March 31,</u> <u>2008</u> | <u>Predecessor</u> <u>June 30,</u> <u>2007</u> |
|--|---|--|
| Senior secured credit facilities: | | |
| Term loan facility | \$ 3,422,800 | |
| Fixed rate notes: | | |
| 10.50% Senior Notes due 2015 | 1,215,600 | |
| Unamortized discount on 10.50% Notes due 2015 | (13,986) | |
| 13.25% Senior Subordinated Discount Notes due 2015 | 519,000 | |
| Unamortized discount on 13.25% Notes due 2015 | (79,038) | |
| Senior Bridge Loan Credit Facility | 594,757 | |
| Notes payable, due 2008 | | \$ 50,000 |
| Unamortized discount on notes payable due 2008 | | (85) |
| Total long-term debt | <u>5,659,133</u> | <u>49,915</u> |
| Less: current portion | (34,400) | (35,000) |
| | <u>\$ 5,624,733</u> | <u>\$ 14,915</u> |

Scheduled payments due on long-term debt as of March 31, 2008, for the remainder of fiscal 2008, the next four years and thereafter are as follows:

| <u>Fiscal Year Ending June 30,</u> | | | | | | |
|------------------------------------|-------------|-------------|-------------|-------------|-------------------|--------------|
| <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>Thereafter</u> | <u>Total</u> |
| \$ 8,600 | \$ 34,400 | \$ 34,400 | \$ 34,400 | \$ 34,400 | \$5,605,957 | \$5,752,157 |

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Senior Secured Credit Facilities

The senior secured credit facilities provide the Company 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, the Company borrowed \$3,440.0 million under the term loan facility and incurred \$58.7 million of related financing costs. Such costs are included in “Deferred financing costs” on the Consolidated Balance Sheet and are being amortized over the term of the Senior Credit Facilities. The Senior Credit Facilities also provide the Company 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.

Under the Senior Credit Facilities, the Company 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 the Company’s leverage ratio. Borrowings under the term loan facility for the three months ended March 31, 2008 and the period July 5, 2007 to March 31, 2008 bore interest at an average annual rate of 6.32% and 7.50%, respectively. In addition, during the period July 5, 2007 to March 31, 2008, the Company borrowed and repaid \$35 million of term loans under the revolver at an average annual rate of 8.07%. The interest rate for term loan borrowings under the term loan facility and the revolving credit facility were the applicable LIBOR rate plus a margin of 2.75% during the period July 5, 2007 to February 18, 2008 and LIBOR rate plus a margin of 2.50% during the period February 19, 2008 to March 31, 2008. The Company also borrowed and repaid \$6.5 million of swing line loans under the revolver during the period July 5, 2007 to March 31, 2008 at an average annual rate of 9.86%. The interest rate for swing line loans under the revolving credit facility were the applicable base rate (prime) plus a margin of 1.75% for the period outstanding. Under the revolver, up to \$150 million is available for the issuance of letters of credit, of which \$6.4 million was outstanding as at March 31, 2008 at a cost of 2.25% to 2.75% per annum.

In addition, there is an annual commitment fee of 0.50% 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 may be reduced in the future if the Company attains certain leverage ratios.

The Company is required to pay quarterly installments of \$8.6 million on the term loans with the first payment on December 31, 2007 and 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.

The Senior Credit Facilities require, among other things, that the Company maintain an agreed upon senior secured leverage ratio. As of March 31, 2008, the Company was in compliance with the applicable senior secured leverage ratio.

Subject to certain exceptions, the credit agreement limits the amount the Company can repay under the senior subordinated discount notes and the loans under the senior bridge loan credit facility as well as the Company’s ability to enter into amendments to the senior subordinated discount notes or the senior bridge loan credit 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 also contain certain other customary restrictions, affirmative covenants, negative covenants and events of default.

The Company expects to finance the acquisition of the assets of HM College (See Note 3, “Acquisition of Houghton Mifflin College Assets”) through approximately \$625 million of incremental term loan borrowings under the Senior Secured Credit Facilities.

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Senior Notes and Senior Subordinated Discount Notes

The Company issued \$1,215.6 million aggregate principal amount at maturity (\$1,200.1 million in aggregate gross proceeds) 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”). The Company incurred \$21.5 million of related financing costs for the issuance of the Notes, which are included in “Deferred financing costs” on the Consolidated Balance Sheet and are being amortized over the term of the Notes.

Interest on the Senior Notes accrues at an annual rate of 10.50% 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 an annual rate of 13.25% 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.

In the event that an exchange offer registration statement with respect to the Notes is not filed with the Securities and Exchange Commission on, or prior to the 360th day after the original issuance date of the Notes, additional interest will accrue on the Notes and the Company will be required to pay such interest until the Notes may be resold without restriction under securities laws.

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 the Company with financing of \$540.0 million. At the Company’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 three-month interest period. Concurrent with the Acquisition, the Company borrowed \$540.0 million under the Senior Bridge Facility and incurred \$10.7 million of related financing costs. Such costs are included in “Deferred financing costs” on the Consolidated Balance Sheet and are being amortized over the full term of 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”). Any PIK exchange notes issued will mature on July 5, 2015. In the event that on the 240th day following the issuance date of the PIK exchange notes, neither a shelf registration statement has been declared effective nor has a registered exchange offer been consummated, additional interest will accrue and the Company will be required to pay such interest until the PIK exchange notes may be resold without restriction under securities laws.

Under the Senior Bridge Facility, the Company 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 currently bear interest at the applicable LIBOR rate plus a margin of 7.75% to 8.25%. Borrowings under the Senior Bridge Facility for the three months ended March 31, 2008 and the period July 5, 2007 to March 31, 2008 bore interest at an average annual rate of 12.87% and 13.04%, respectively. The applicable margin increased by 50 basis points on January 5, 2008 and will increase by an additional 50 basis points at the end of every three month interest period, up to a maximum interest rate of 13.75% per annum.

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The Company elected to capitalize interest due on the loan in the amount of \$18,531 for the three months ended March 31, 2008 and \$54,757 for the period July 5, 2007 to March 31, 2008, as an increase to the principal amount of the loan through its scheduled rollover date of March 31, 2008. 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 payments in cash beginning in the second half of 2012.

On or after January 6, 2008 and prior to July 5, 2008, subject to certain conditions, the arrangers of the Senior Bridge Facility may request the Company to issue bonds and use the proceeds to repay the loans outstanding under the Senior Bridge Facility. Any such bonds will have terms and conditions consistent with precedent high yield debt securities of the Company.

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.

Capital Lease Obligation

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 lease term and on October 31, 2007, purchased the property by settling the outstanding capital lease obligation of \$26,013, plus accrued interest of \$183.

Notes Payable, Due 2008

The notes payable bore interest at a rate of 3.5% per year, subject to increase in certain circumstances. Cengage Learning did not assume this liability as part of the Acquisition. (See Note 2, "Acquisition of Thomson Learning").

12. FINANCIAL INSTRUMENTS

Cengage Learning is exposed to market risk from foreign currency exchange rates and interest rates, which could affect operating results, financial position and cash flows. Exposure to these market risks is managed through the 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 SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. However, certain of these instruments may not qualify for hedge accounting treatment and, accordingly, the results of operations may be exposed to some level of volatility. Volatility to the Company's 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.

The Company periodically may 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, and foreign currency spot, forward, swap and option contracts to manage foreign currency exposures. The fair market values of all these 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 by the Company 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 the Company's 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. The Company's policy is to deal with counterparties having a single A or better credit rating. Credit risk is managed through the continuous monitoring of exposures to such counterparties.

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Interest Rate Risk Management

Interest rate swap agreements are used to manage interest rate exposure in order to achieve a desired proportion of variable and fixed rate debt. These derivatives may be designated as fair value hedges or cash flow hedges depending on the nature of the risk being hedged. Thomson Learning did not hold any interest rate swap instruments as of June 30, 2007 and July 4, 2007.

In July and August 2007, the Company entered into three respective interest rate swaps with an amortizing aggregate notional amount of \$3,056 million which were designated and accounted for as cash flow hedges from inception. These swaps were structured to hedge the variable LIBOR interest rate component of the term loan borrowings under the Senior Credit Facilities, converting a declining percentage of the debt from a variable rate commitment to a fixed rate commitment, starting initially at 90%, and reducing to 40% over four years. The notional amount of the interest rate swaps during the three months ended March 31, 2008 was \$3,044 million.

On December 21, 2007, the Company entered into an interest rate basis swap with an amortizing notional amount of \$3,044 million in anticipation of changes in the term and benchmark interest rate for loan rollovers for the next twelve months. The new swap was structured to convert the variable LIBOR interest rate component of the long-term borrowings under the Senior Credit Facilities from a one-month LIBOR rate to a three month LIBOR rate for a twelve month period. As a result, the Company de-designated its original swaps for cash flow hedge accounting purposes, at which time the after tax fair value of these hedges recorded in AOCL was \$85,547, and designated and accounted for both the original and new basis swaps as a cash flow hedge. All components of each derivative's gain or loss was included in the assessment of hedge effectiveness and no amount of ineffectiveness was recorded in the Consolidated Statement of Operations.

The following is a summary of the Company's cash flow hedges as of March 31, 2008:

| <u>Date of Execution</u> | <u>Commencement Date</u> | <u>Initial Notional Amount</u> | <u>Weighted Average Interest Rate Paid</u> | <u>Weighted Average Interest Rate Received</u> | <u>Basis</u> | <u>Maturity</u> | <u>Fair Value Liability</u> |
|--------------------------|--------------------------|--------------------------------|--|--|--------------|-----------------|-----------------------------|
| July 24, 2007 | September 28, 2007 | \$1,375,000 | 5.314% | 5.017% | LIBOR | 2011 | \$ 82,656 |
| July 26, 2007 | September 28, 2007 | 1,375,000 | 5.194% | 5.017% | LIBOR | 2011 | 78,905 |
| August 23, 2007 | September 28, 2007 | 306,000 | 4.885% | 5.017% | LIBOR | 2009 | 10,137 |
| December 21, 2007 | December 31, 2007 | 3,044,000 | 4.727% | 3.668% | LIBOR | 2008 | 158 |
| | | | | | | | <u>\$ 171,856</u> |

The fair value of the Company's interest rate swap agreements are classified within its Balance Sheets as follows:

| | <u>Successor</u> <u>March 31,</u> <u>2008</u> | <u>Predecessor</u> <u>June 30,</u> <u>2007</u> |
|---|---|--|
| Fair value of interest rate swaps and other current liabilities | \$ 79,416 | \$ - |
| Fair value of interest rate swaps and other non-current liabilities | 92,440 | - |
| | <u>\$ 171,856</u> | <u>\$ -</u> |

Accumulated Other Comprehensive Loss ("AOCL")

During the period July 5, 2007 to March 31, 2008, a \$171,856 after-tax decrease in the fair value of cash flow hedges was recorded in AOCL while an amount of \$7,886 was reclassified into earnings and is included in "Interest (expense) income, net" on the Consolidated Statement of Operations. This resulted in an ending unrealized loss position relating to derivative instruments in AOCL of \$163,970 as of March 31, 2008.

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There was no AOCL activity associated with derivative financial instruments during the period July 1, 2007 to July 4, 2007.

During the nine months ended March 31, 2007, a \$224 after-tax increase in the fair value of cash flow hedges was recorded in AOCL. No amounts were transferred to earnings as a result of scheduled payments and receipts on the Company's cash flow hedges during the period, which resulted in an ending unrealized gain position relating to derivative instruments in AOCL of \$224 as of March 31, 2007.

13. EQUITY

Under the Cengage Learning Holdings II L.P. partnership agreement, Cengage Learning Holdings II L.P.'s income is allocated to the general partner and the limited partners on a pro rata basis in accordance with the amount of the partners' contributions to Cengage Learning Holdings II L.P. Partners make capital contributions to the Partnership in such amounts and at such times as they mutually agree. The General Partner has absolute discretion to make any distributions to a partner, which include a return of all or any part of such partner's capital contribution, provided that upon the dissolution of the Partnership, the assets of the Partnership must be distributed as provided in Section 17-804 of the Delaware Revised Uniform Limited Partnership Act.

14. COMMITMENTS, CONTINGENCIES AND GUARANTEES

Commitment to Acquire Houghton Mifflin College Assets

On November 30, 2007, Cengage Learning entered into a definitive agreement with Houghton Mifflin, under which the Company will acquire the assets of HM College for \$750 million in cash, subject to working capital and cash flow adjustments. (See Note 3, "Acquisition of Houghton Mifflin College Assets").

Claims and Legal Actions

Cengage 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 Cengage Learning's business, financial condition or results of operations.

Guarantees

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

15. RESTRUCTURING

The restructuring disclosures below have been reclassified to reflect the impact of the Company's segment reorganization (see Note 21, "Segment Information"). Restructuring charges are included in "Cost of revenues, excluding depreciation" and "Selling, general & administrative, excluding depreciation" on the Consolidated and Combined Statements of Operations.

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Acquisition and Post-Acquisition Programs

In connection with the Acquisition, management initiated programs related to downsizing the employee base, exiting certain activities and engaging in other actions designed to reduce Cengage Learning's cost structure and improve productivity. Accordingly, Cengage Learning recorded restructuring liabilities in its July 5, 2007 opening balance sheet of \$13,940 (Academic & Professional - \$6,624; Gale - \$688; International - \$1,626; Corporate and Other - \$5,002). The liabilities relate to the severance costs associated with the elimination of approximately 300 positions throughout the organization. The restructuring, as well as all related payments, are expected to be completed by December 31, 2008.

The following is a summary of activity in the Acquisition-related restructuring liabilities:

| | <u>Severance</u> |
|----------------|------------------|
| July 5, 2007 | \$ 13,940 |
| Additions | - |
| Utilization | (8,443) |
| Adjustments | (142) |
| March 31, 2008 | <u>\$ 5,355</u> |

In December 2007, additional programs were announced and Cengage Learning recorded restructuring costs of \$1,851 (Gale - \$1,236; International - \$615) for severance costs associated with the elimination of approximately 30 positions throughout the organization, as well as contract cancellation costs and property and equipment impairments. The restructuring, as well as all payments, are expected to be completed by June 30, 2009.

The following is a summary of activity in the post-Acquisition restructuring liabilities:

| | <u>Severance</u> | <u>Contract Cancellation Costs and Other</u> | <u>Total</u> |
|----------------|------------------|--|-----------------|
| July 5, 2007 | \$ - | \$ - | \$ - |
| Additions | 1,381 | 470 | 1,851 |
| Utilization | (135) | (470) | (605) |
| Adjustments | (14) | - | (14) |
| March 31, 2008 | <u>\$ 1,232</u> | <u>\$ -</u> | <u>\$ 1,232</u> |

Pre-Acquisition (Predecessor) Programs

In 2006, a plan was initiated to centralize the Academic & Professional and Gale editorial production and manufacturing processes into one function. The total restructuring costs of \$3,369 (Academic & Professional - \$584; Gale - \$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. The restructuring was completed by June 30, 2007 and the payments are expected to be completed in 2009.

In 2005, the Academic & Professional 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, 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.

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The following is a summary of activity in the Pre-Acquisition (Predecessor) restructuring liabilities:

| | Contract Cancellation Costs and | | |
|----------------|--|-----------------|-----------------|
| | Severance | Other | Total |
| June 30, 2006 | \$ 2,580 | \$ 1,131 | \$ 3,711 |
| Additions | - | 302 | 302 |
| Utilization | (2,296) | (395) | (2,691) |
| Adjustments | (72) | - | (72) |
| March 31, 2007 | <u>\$ 212</u> | <u>\$ 1,038</u> | <u>\$ 1,250</u> |

| | Contract Cancellation Costs and | | |
|----------------|--|---------------|-----------------|
| | Severance | Other | Total |
| June 30, 2007 | \$ 156 | \$ 925 | \$ 1,081 |
| Additions | - | - | - |
| Utilization | (1) | (5) | (6) |
| Adjustments | - | - | - |
| July 4, 2007 | <u>\$ 155</u> | <u>\$ 920</u> | <u>\$ 1,075</u> |
| | \$ 155 | \$ 920 | \$ 1,075 |
| Additions | - | - | - |
| Utilization | (155) | (367) | (522) |
| Adjustments | - | - | - |
| March 31, 2008 | <u>\$ -</u> | <u>\$ 553</u> | <u>\$ 553</u> |

In the normal course of business, the Company constantly reviews its businesses, assets and personnel, which may result in changes that could, in the future, result in additional restructuring charges.

16. BENEFIT PLANS

Defined Contribution Plans

Subsequent to the Acquisition, the Company initiated the Cengage Learning 401(k) Savings Plan in the U.S. The Company matches 100% of employee contributions up to 4% of the employee's compensation, as defined. These matching contributions vest based upon an employee's years of service, including years of service earned as an employee of Predecessor, and become fully vested after four years of service. The Company also initiated defined contribution plans for employees outside the U.S.

Prior to the Acquisition, certain Predecessor employees in the U.S. participated in a defined contribution savings plan, administered by TOC, under Section 401(k) of the Internal Revenue Code. The plan covered substantially all U.S.-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. In addition, certain employees based outside the U.S. participated in similar plans sponsored by TOC. Under these defined contribution plans, the cost of contributing to the plans is charged to expense as incurred. Upon consummation of the Acquisition, all Predecessor employee participants of these plans ceased to be active participants of the TOC administered plans.

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Defined Benefit Pension Plans

Prior to the Acquisition, certain employees participated in certain defined benefit pension plans sponsored and administered by TOC. Under these defined benefit plans, Predecessor's cost of contributing to the plans for its employees was determined by TOC and charged to expense as incurred. Predecessor's expense, as allocated based primarily on the number of participants in the plan, was \$3,988 and \$11,188 for the three and nine months ended March 31, 2007, respectively.

Additionally, select employees participated in supplemental executive retirement plans. These plans provided qualified employees with additional retirement benefits above that received from the TOC qualified plans. The expense associated with these plans was \$409 and \$1,268 for the three and nine months ended March 31, 2007, respectively.

Predecessor's allocated expense for these plans for the period July 1, 2007 through July 4, 2007 was not significant.

Effective July 5, 2007, all Predecessor employee participants of both the defined benefit pension plans and the supplemental executive retirement plans ceased to be active participants of those plans. Post-Acquisition, Cengage Learning did not retain any obligations under or liabilities with respect to any of these plans.

Other Post-Retirement Benefits Plans

Prior to the Acquisition, certain employees in the U.S. participated in a defined post-retirement benefit plan sponsored and administered by TOC. The plan called for certain medical costs, after deductibles, to be paid for after an eligible employee's retirement. The plan had been closed to new participants since 1993. Predecessor's expense, as allocated by TOC based primarily on the number of participants in the plan, was \$511 and \$1,352 for the three and nine months ended March 31, 2007, respectively. Certain employees based outside the U.S. participated in similar plans sponsored by TOC. The expense associated with these plans was not significant for the three and nine months ended March 31, 2007.

Predecessor's allocated expense for the period July 1, 2007 through July 4, 2007, for all plans, was not significant. Effective July 5, 2007, all Predecessor employee participants ceased to be active participants of these plans. Post acquisition, Cengage Learning did not retain any obligations under or liabilities with respect to any of these plans.

17. STOCK-BASED COMPENSATION

Employee Stock Purchase Plan

Prior to the Acquisition, certain eligible employees in the U.S. participated in an Employee Stock Purchase Plan under which participants could purchase common shares of TOC. Effective July 5, 2007, all Predecessor employee participants ceased to be active participants of this plan. Post-Acquisition, Cengage Learning did not retain any obligations under or liabilities with respect to this plan.

Stock Appreciation Rights

Prior to the Acquisition, certain employees participated in a TOC-administered plan that provided for the granting of stock appreciation rights ("SAR"). These rights provided 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. Effective July 5, 2007, all Predecessor employee participants ceased to be active participants of this plan. Post-Acquisition, Cengage Learning did not retain any obligations under or liabilities with respect to this plan.

Stock Incentive Plan

Prior to the Acquisition, certain employees also participated in a TOC-administered stock-option plan. Effective July 5, 2007, all outstanding stock-options became fully vested and participants were granted a limited period during which to

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exercise such options. Predecessor employee participants also ceased to be active participants of this plan. Post-Acquisition, Cengage Learning did not retain any obligations under or liabilities with respect to this plan.

18. INCOME TAXES

Cengage Learning's effective income tax rate for the period July 5, 2007 to March 31, 2008 is 0.4%. The effective tax rates for the Predecessor periods July 1, 2007 to July 4, 2007 and the three and nine months ended March 31, 2007 were 37.1%, 37.0% and 39.7%, respectively. The Company's effective tax rate reflects the impact of projected loss-making jurisdictions on a full year basis where the associated tax benefits are not anticipated to be realized. For these jurisdictions, no tax provision or benefit is recorded, however due to seasonality of income before tax, certain of these jurisdictions are profitable in the period July 5, 2007 to March 31, 2008.

Cengage Learning had \$3,058 of unrecognized tax benefits as of March 31, 2008. Pursuant to the terms of the Acquisition, TOC agreed to indemnify Cengage Learning against certain taxes and associated expenses imposed on or payable by the Company for any taxable period that ends on or before July 5, 2007 or is allocable to the period ending on the same date. In addition, as a result of the Acquisition, unrecognized tax benefits in the amount of \$6,566 lapsed due to the change in ownership and associated tax grouping statutes within a specific tax jurisdiction.

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

| | |
|--|------------------------|
| Balance at July 1, 2007 | \$ 10,484 |
| Decrease due to change in ownership on July 5, 2007 | (6,566) |
| Decrease due to lapse in the applicable statute of limitations | (860) |
| Balance at March 31, 2008 | <u><u>\$ 3,058</u></u> |

If recognized, all of these benefits would favorably affect income tax expense. As of March 31, 2008, Cengage Learning had accrued an aggregate of \$1,734 for interest and penalties associated with these tax positions.

Prior to the Acquisition, the entities within the Combined Financial Statements were included within consolidated tax returns filed by certain TOC affiliates. As of March 31, 2008, the tax years subject to examination for these TOC affiliates by major jurisdiction were as follows:

| Jurisdiction | Tax Year |
|-------------------------|-----------------|
| United States - Federal | 2003 - 2006 |
| United Kingdom | 2006 |

19. SUPPLEMENTAL CASH FLOW INFORMATION

Non Cash Transactions

During the period July 5, 2007 to March 31, 2008, the Company capitalized the interest accrued on its Senior Bridge Loan Facility of \$54,757.

Concurrent with the Acquisition, TOC converted the net amount outstanding under "Notes payable to TOC" and "Notes receivable from TOC" to equity.

In November 2006, the Company 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, *Exchange of Nonmonetary Assets with an Amendment of APB Opinion No. 29*, with a value of \$3,000 and resulted in the recognition of a \$1,289 gain.

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Changes in Operating Assets and Liabilities

Details of “Changes in operating assets and liabilities, net of acquisitions” are:

| | <u>Successor</u> | <u>Predecessor</u> | |
|---|--|--|---|
| | <u>Period</u> <u>July 5, 2007 to</u> <u>March 31,</u> <u>2008</u> | <u>Period</u> <u>July 1, 2007</u> <u>to July 4,</u> <u>2007</u> | <u>Nine Months</u> <u>Ended</u> <u>March 31,</u> <u>2007</u> |
| Accounts receivable, net | \$ 42,238 | \$ (8,894) | \$ (7,082) |
| Inventories | 7,870 | 812 | 20,904 |
| Prepaid expenses and other current assets | 16,890 | (1,037) | (2,332) |
| Accounts payable and accrued expenses | 15,490 | 9,208 | (1,131) |
| Accrued interest payable | 27,500 | - | - |
| Deferred revenue | 24,098 | 3,784 | 1,908 |
| Current taxes payable | 8,802 | - | 4,295 |
| Author advances, net | 696 | - | (5,432) |
| Other, net | (7,879) | (308) | 10,130 |
| | <u>\$ 135,705</u> | <u>\$ 3,565</u> | <u>\$ 21,260</u> |

Cash paid for interest expense on debt, including borrowings under the revolving credit facility and the capital lease, and excluding net borrowings from TOC (prior to July 5, 2007), amounted to \$273,682 for the period July 5, 2007 to March 31, 2008 and \$2,719 for the nine months ended March 31, 2007. Amounts paid for interest for the period July 1, 2007 to July 4, 2007 were not significant.

In December 2007, the Company paid the remaining \$1,500 due for the purchase of a business acquired in May 2007.

20. RELATED PARTY TRANSACTIONS

Because of the related party relationships outlined below and elsewhere within these 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.

Acquisition and Post-acquisition Transactions

Advisory Fee Agreements

Concurrent with the consummation of the Acquisition, Cengage Learning entered into advisory fee agreements with 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 provided under these Advisory Fee Agreements. The Company 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 and 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.

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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 (i) the date on which Apax's or OMERS' direct or indirect ownership is below 5%; (ii) payment of the remaining advisory fees in a lump sum; or (iii) as agreed between the parties to each Advisory Fee Agreement.

The Company recorded expense for Advisory Fees of \$2,500 and \$7,361 for the three months ended March 31, 2008 and the period July 5, 2007 to March 31, 2008, respectively, which is included in "Selling, general and administrative expense, excluding depreciation" in the Consolidated Statements of Operations. The accrued advisory fees, along with the accrued interest of \$371 are included in "Accounts payable and accrued expenses" on the Consolidated Balance Sheet.

Agreements with Nelson

Cengage Learning entered into a Master Services Agreement with Nelson Education, Ltd. ("Nelson"). Nelson is majority owned by funds affiliated with OMERS, with Apax holding the minority interest. Under the Master Services Agreement, Cengage Learning is to provide Nelson with various services including services relating to business and technology services, content services, commission's services, customer service and operations, management services, fulfillment services and business information support services and Nelson is to provide Cengage Learning with certain real estate services. The cost of each of the services to be provided under the Master Services Agreement is based on a set fee. No fees are payable under the Master Services Agreement for services provided prior to July 1, 2008.

All services under the Master Services Agreement are to be provided for a specified period of time, and Nelson can generally terminate those services in advance upon 30 days written notice without penalty.

In addition, Cengage Learning is party to an operating agreement with Nelson under which Nelson is the Company's exclusive authorized distributor for sale and /or distribution of print and digital publications in Canada. Nelson also has the exclusive right to adapt, customize and translate Cengage Learning publications. The operating agreement sets certain restrictions on the use of Cengage Learning content, including restricting Nelson's ability to adapt certain texts, limiting the dollar amount of sales of "first edition" texts and restricting Nelson from marketing adaptations or translations it has created outside of Canada.

Nelson is required by the operating agreement to pay Cengage Learning royalties of a percentage of net sales for certain specified publications, adaptations of textbooks created by Nelson, translations of textbooks by Nelson and certain Nelson customized products.

Initially the operating agreement has an 11-year term to January 1, 2018, and thereafter it is subject to automatic one year extensions unless cancelled by one of the parties. The operating agreement may also be terminated upon material breach, bankruptcy or the mutual agreement of the parties.

Cengage Learning recorded revenue from Nelson of \$1,720 and \$17,195 for the three months ended March 31, 2008 and the period July 5, 2007 to March 31, 2008, respectively. The amount due from Nelson of \$3,364 at March 31, 2008 is included in "Accounts receivable, net" on the Consolidated Balance Sheet.

Pre-Acquisition 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

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office of the chief executive and chief financial officers, internal and external audit fees, treasury, investor relations, strategic sourcing and risk management. Such costs were allocated to Thomson Learning based on its revenue in proportion to the total revenue of TOC. The amounts allocated to Thomson Learning were: \$821 for the period July 1, 2007 through July 4, 2007; and \$11,597 and 37,484 for the three and nine months ended March 31, 2007, respectively. Such amounts were 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 \$2 during the period from July 1, 2007 through July 4, 2007, and \$2,337 and \$8,783 for the three and nine months ended March 31, 2007, respectively.

21. SEGMENT INFORMATION

Cengage Learning has historically operated in three reportable segments worldwide: Domestic Higher Education, Domestic Library Reference and International. On October 1, 2007, the Company restructured its operations into the following three reportable segments: Academic & Professional, Gale and International. Such segments are strategic business groups that offer products and services to target markets and reflect the manner in which the chief operating decision maker of the Successor entity regularly reviews the operating results of the business and makes decisions about resources to be allocated. Prior period segment data has been restated to conform to this presentation. The accounting policies applied by the segments are the same as those applied by the Company. All transactions between reportable segments are eliminated upon consolidation or combination and reflected in the "Corporate and other" segment. Cengage Learning's segments are:

Academic & Professional. The Academic & Professional segment provides higher-education textbooks and tailored learning solutions, including digital learning solutions, for students, faculty, institutions and professionals in the U.S. and Latin America.

Gale. The Gale segment is a provider of authoritative reference and educational content for libraries, schools, and businesses. With its reference content, Gale creates and maintains databases that are published online, in print and in microfilm.

International. The International segment sells Cengage Learning's U.S. textbooks into international markets; adapts U.S. textbooks for various international markets; publishes and sells textbooks by non-U.S. authors; and provides learning solutions in various formats to individuals and businesses located outside the U.S. and Latin America, as well as English language training products sold globally, including the U.S. market.

Cengage Learning discloses information about its reportable segments based on the measures used by management in assessing the performance of those reportable segments. Cengage Learning uses "Segment operating profit (loss)", which is operating income (loss) before the allocation of corporate management costs from TOC (Predecessor) and amortization of identifiable intangible assets, to measure the operating performance of its segments. Management uses this measure because the allocation of corporate management costs from TOC (Predecessor) and the amortization of identifiable intangible assets are not considered to be controllable operating costs for purposes of assessing the current performance of the segments. Segment operating profit (loss) 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.

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Select financial information for Cengage Learning's segments is as follows:

| | Successor | | Predecessor | |
|----------------------------------|--|----------------------|--|----------------------|
| | Three Months Ended March 31, 2008 | | Three Months Ended March 31, 2007 | |
| | Segment Operating | | Segment Operating | |
| | Revenues | Profit (Loss) | Revenues | Profit (Loss) |
| Academic & Professional | \$ 157,625 | \$ (5,083) | \$ 134,330 | \$ (13,219) |
| Gale | 61,944 | 9,820 | 65,497 | 14,947 |
| International | 67,314 | (6,656) | 61,446 | (9,565) |
| Segment totals | <u>286,883</u> | <u>(1,919)</u> | <u>261,273</u> | <u>(7,837)</u> |
| Corporate and other ¹ | (667) | (18,171) | 5,215 | (27,691) |
| Total | <u>\$ 286,216</u> | <u>\$ (20,090)</u> | <u>\$ 266,488</u> | <u>\$ (35,528)</u> |

| | Successor | | Predecessor | | | |
|----------------------------------|--|-------------------|--|-----------------|---|-------------------|
| | Period July 5, 2007 to March 31, 2008 | | Period July 1, 2007 to July 4, 2007 | | Nine Months Ended March 31, 2007 | |
| | Segment Operating Profit | | Segment Operating Profit | | Segment Operating Profit | |
| | Revenues | (Loss) | Revenues | (Loss) | Revenues | (Loss) |
| Academic & Professional | \$ 934,350 | \$ 329,693 | \$ 14,573 | \$ 6,668 | \$ 888,738 | \$ 311,324 |
| Gale | 227,839 | 66,272 | 1,426 | (157) | 239,806 | 68,829 |
| International | 256,724 | 20,286 | 2,542 | (307) | 240,822 | 18,479 |
| Segment totals | <u>1,418,913</u> | <u>416,251</u> | <u>18,541</u> | <u>6,204</u> | <u>1,369,366</u> | <u>398,632</u> |
| Corporate and other ¹ | (4,967) | (60,196) | 135 | (2,133) | 17,276 | (64,703) |
| Total | <u>\$ 1,413,946</u> | <u>\$ 356,055</u> | <u>\$ 18,676</u> | <u>\$ 4,071</u> | <u>\$ 1,386,642</u> | <u>\$ 333,929</u> |

¹ Corporate and other includes shipping and handling revenue, revenue from administrative services, inter-segment eliminations, corporate costs, and the effect of purchase accounting on deferred revenue relating to the Acquisition.

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

| | <u>Successor</u> | <u>Predecessor</u> |
|--|-----------------------|-----------------------|
| | <u>Three Months</u> | <u>Three Months</u> |
| | <u>Ended</u> | <u>Ended</u> |
| | <u>March 31, 2008</u> | <u>March 31, 2007</u> |
| Segment operating loss | \$ (20,090) | \$ (35,528) |
| Less: Allocation of management costs from TOC | - | (11,597) |
| Less: Amortization of identifiable intangible assets | (51,154) | (10,297) |
| Operating loss | <u>\$ (71,244)</u> | <u>\$ (57,422)</u> |

| | <u>Successor</u> | <u>Predecessor</u> | |
|--|------------------------|------------------------|-----------------------|
| | <u>Period</u> | <u>Period</u> | <u>Nine Months</u> |
| | <u>July 5, 2007 to</u> | <u>July 1, 2007 to</u> | <u>Ended</u> |
| | <u>March 31, 2008</u> | <u>July 4, 2007</u> | <u>March 31, 2007</u> |
| Segment operating profit | \$ 356,055 | \$ 4,071 | \$ 333,929 |
| Less: Allocation of management costs from TOC | - | (821) | (37,484) |
| Less: Amortization of identifiable intangible assets | (162,099) | (308) | (33,769) |
| Operating income | <u>\$ 193,956</u> | <u>\$ 2,942</u> | <u>\$ 262,676</u> |

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Throughout this document, references to “we”, “our”, the “Company” and “Cengage Learning” refer to Cengage Learning Holdings II L.P. and its consolidated subsidiaries, as successor to Thomson Learning, which was comprised of certain wholly-owned indirect subsidiaries and divisions of Thomson Reuters, previously 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 (hereinafter referred to as “Thomson Learning” for all periods ending prior to July 5, 2007).

The following discussion and analysis of our financial condition and results of operations 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 digital solutions provider of textbooks, reference materials and other educational resources for the higher education, professional training and library reference markets.

We have historically operated in three reportable segments worldwide: Domestic Higher Education, Domestic Library Reference and International. On October 1, 2007, we restructured our operations into the following three reportable segments:

- *Academic & Professional* - provider of higher-education textbooks and provides tailored learning solutions, including digital learning solutions, for students, faculty, institutions and professionals in the U.S. and Latin America.
- *Gale* - provider of authoritative reference and educational content for libraries, schools, and businesses. With its reference content, Gale creates and maintains databases that are published online, in print and in microfilm.
- *International* - sells our U.S. textbooks into international markets; adapts and translates U.S. textbooks for various international markets; publishes and sells textbooks by non-U.S. authors; and provides learning solutions in various formats to individuals and businesses located outside the U.S. and Latin America, as well as English language training products sold globally, including the U.S. market.

We have restated prior period segment data to conform to this presentation.

We categorize shipping and handling revenue, revenue from administrative services, intersegment elimination, adjustments for the effect of purchase accounting on deferred revenue relating to the Acquisition and corporate costs under a segment referred to as “Corporate and other”.

Sources of Revenue

Products. In our Academic & Professional segment, the primary source of revenue is textbooks sold for use in the higher education marketplace, 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 Gale’s 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.

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Services and other. Services and other revenues include revenues from the delivery of content in digital format, sales of distance learning solutions and administrative services provided to third parties such as distribution, warehousing and payroll. In our Academic & Professional segment, the adoption 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 Gale's market, we attempt to encourage repurchase and up-sell by tracking online usage to demonstrate the product's utility to library end-users.

Services and other revenues also include the effect of purchase accounting on deferred revenue relating to the acquisition of Thomson Learning.

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 royalty payments to our authors, cost of paper, printing and binding costs as well as a component of fixed direct and indirect costs incurred to support delivery of print products;
- services and other cost of revenues, which are costs directly related to our digital services for the Academic & Professional segment and publishing our digital proprietary reference materials such as hosting and subscription services costs and royalty payments to our authors as well as a component of fixed direct and indirect costs incurred to support delivery of digital and service related products;
- 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 digital;
- 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.

In addition, in the normal course of business, we review our businesses, assets and personnel, which may result in changes that could, in the future, result in restructuring charges.

Seasonality

Typically, a greater portion of our revenue, operating profit and operating cash flow is derived in the first half of the fiscal year because customer buying patterns are concentrated during this period, while costs are incurred more evenly throughout the year. As a result, operating margins generally decrease as the fiscal year progresses. For these reasons, the performance of our 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.

The Acquisition and Related Financing Transactions

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 an initial cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments (the "Acquisition"). During the third quarter of fiscal 2008, Cengage Learning and TOC entered into a working capital settlement agreement whereby the parties agreed to a reduction in the purchase price of \$17.3 million, which was remitted to us in February 2008.

The Acquisition was financed through a common equity capital contribution of \$1,703.1 million and \$5,580.2 million in aggregate gross debt financing, less \$90.9 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;
- \$1,215.6 million aggregate principal amount (\$1,200.1 million gross proceeds) of senior notes;

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- \$519.0 million aggregate principal amount at maturity (\$400.1 million gross proceeds) of senior subordinated discount notes, 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.

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. We have developed and are implementing a plan to increase our own internal capabilities to reduce our reliance on TOC for these services.

We incurred costs under the Transition Services Agreement of approximately \$100 for the three months ended March 31, 2008 and \$500 for the period July 5, 2007 to March 31, 2008.

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. Prior to the termination of the contract, we may incur costs to transition from the current arrangement.

We incurred costs under the Human Resources Services Agreement of approximately \$700 for the three months ended March 31, 2008 and \$2,000 for the period July 5, 2007 to March 31, 2008.

Stand-alone Company

Prior to the Acquisition, we 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 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. 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: \$821 during the four day period ended July 4, 2007; and \$11,597 and \$37,484 for the three and nine months ended March 31, 2007, 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.

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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 and Other Matters

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

At March 31, 2008, we had goodwill of \$4,364 million and identifiable intangible assets, net of \$3,132 million included on the Consolidated Balance Sheet. If expectations for revenue and cash flows decline or if market conditions deteriorate, we may not be able to realize the carrying values of our goodwill and identifiable intangible assets and could be required to record a charge for impairment.

We are currently finalizing the terms and conditions of our equity based compensation program. In the quarter of grant, we will incur a compensation expense that will be cumulative from July 5, 2007 through the date the program is put in place, as well as additional expense in future periods.

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Results of Operations

The results for the period July 5, 2007 through March 31, 2008 relate to Cengage Learning and the financial results for the three and nine months ended March 31, 2007 and the period July 1, 2007 through July 4, 2007 relate to Thomson Learning. For comparative purposes, we have aggregated the periods from July 1, 2007 through March 31, 2008 in our discussion below to enhance the reader's understanding of the results of operations for the periods presented. This aggregation, as presented in the column "Cumulative Period Ended March 31, 2008", is not a GAAP measure.

The Three Months Ended March 31, 2008 Compared With The Three Months Ended March 31, 2007

| (Dollars in millions) | Three Months Ended March 31, | | Percentage |
|--|-------------------------------------|------------------|-------------------|
| | 2008 | 2007 | Change |
| Statement of Operations | | | |
| Revenues: | | | |
| Academic & Professional | \$ 157.6 | \$ 134.3 | 17.3% |
| Gale | 61.9 | 65.5 | -5.5% |
| International | 67.3 | 61.5 | 9.4% |
| Corporate and other | (0.6) | 5.2 | NM |
| Total revenues | <u>286.2</u> | <u>266.5</u> | 7.4% |
| Cost of revenues, excluding depreciation stated below: | | | |
| Products | 140.6 | 124.6 | 12.8% |
| Services and other | 18.1 | 23.0 | -21.3% |
| Amortization of pre-publication costs | 26.8 | 22.0 | 21.8% |
| Total cost of revenues, excluding depreciation stated below | 185.5 | 169.6 | 9.4% |
| Selling, general & administrative, excluding depreciation stated below | 105.7 | 118.5 | -10.8% |
| Allocation of management costs from TOC | - | 11.6 | NM |
| Depreciation | 15.1 | 13.9 | 8.6% |
| Amortization of identifiable intangible assets | 51.2 | 10.3 | NM |
| Total costs and expenses | <u>357.5</u> | <u>323.9</u> | 10.4% |
| Operating loss | (71.3) | (57.4) | 24.2% |
| Interest expense with TOC | - | (4.5) | NM |
| Interest income | 2.5 | - | NM |
| Interest expense | (138.2) | (0.5) | NM |
| Loss before taxes | (207.0) | (62.4) | NM |
| Benefit from income taxes | 11.7 | 23.1 | -49.4% |
| Equity losses of investees, net of taxes | - | (1.7) | NM |
| Net loss | <u>\$ (195.3)</u> | <u>\$ (41.0)</u> | NM |

NM = Not meaningful

Revenues increased 7.4% primarily from growth in our Academic & Professional and International segments, including the favorable impact of foreign currency translation of 1.8%, partially offset by lower revenues within Gale and Corporate and other. Included in the third quarter of fiscal 2008 is (i) a \$5.1 million reduction of revenue reported in our Corporate and

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other segment associated with purchase accounting adjustments to deferred revenue and (ii) \$1.7 million of revenue during the three months ended March 31, 2008 on transactions with a former affiliate of Thomson Learning which were reported as a reduction of expenses for all periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the three months ended March 31, 2007 by \$1.4 million.

Our Academic & Professional segment revenue increased 17.3% for the three months ended March 31, 2008 on increased sales of career and higher-education textbooks in the U.S. following the cessation of significant discounting practices which, in prior years, accelerated sales into December, as well as the successful expansion of sales programs in the for-profit sector. In the professional market, increased focus on sales through this channel are beginning to show benefits, while increased revenue from acquisitions of 2.8% and foreign currency translation of 0.4% are also contributing to the growth. In addition, the change reflects the recognition of \$0.8 million of revenue on transactions with a former affiliate of Thomson Learning which were reported as a reduction of expenses in periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the three months ended March 31, 2007 by \$0.3 million.

Gale's revenue decline of 5.5% during the three months ended March 31, 2008 reflects continued print attrition and decline in film products, partially offset by growth in digital products.

International revenues increased 9.4% during the three months ended March 31, 2008 from the impact of foreign currency translation of 7.5% and growth in higher education sales in Asia, as well as all channels in Australia, offset by lower library reference and distance learning sales in EMEA and English language training sales in Asia. The change also reflects the recognition of \$0.9 million of revenue during the three months ended March 31, 2008 on transactions with a former affiliate of Thomson Learning which were reported as a reduction of expenses in periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the three months ended March 31, 2007 by \$1.1 million.

Our Corporate and other revenue decrease during the three months ended March 31, 2008 primarily reflects a \$5.1 million reduction of revenue for purchase accounting adjustments to deferred revenue in connection with the Acquisition.

Cost of revenues, excluding depreciation increased 9.4% for the reasons described below.

Our products cost of revenues predominantly include author royalties, paper, printing and binding costs, all of which vary as revenues increase or decrease, as well as a component of fixed direct and indirect costs incurred to support delivery of print products. In addition, prior to July 5, 2007, income on transactions with a former affiliate of Thomson Learning was reported as a reduction of these costs. During the three months ended March 31, 2007, \$1.4 million was included in products cost of revenues relating to such transactions. The increase in products cost of revenues of 12.8%, or \$16.0 million, arose primarily as a result of sales growth of print products.

Our services and other cost of revenues include the variable cost of royalties and hosting as well as a component of fixed direct and indirect costs incurred to support delivery of digital and service related products. The decrease of 21.3%, or \$4.9 million, primarily reflects a shift in the mix of sales to products with higher average royalty costs and indirect costs which do not necessarily correlate directly with the related revenue recognized.

Pre-publication costs are amortized upon publication of a title over its estimated expected operating life cycle. The amortization expense increase of 21.8% is attributable to the timing of publication releases and the volume of sales generated from individual titles or programs during the period, partially offset by lower historical pre-publication spending.

Selling, general & administrative expense, excluding depreciation decreased 10.8% reflecting the absence of \$9.5 million of costs associated with employee retention bonuses and professional services fees incurred during the three months ended March 31, 2007, as well as lower expenses from fewer employees, lower travel and entertainment costs and improved cost control. Partially offsetting this decreases are \$2.5 million of advisory fees and costs incurred to establish our own internal support infrastructure previously provided by TOC.

Allocation of management costs from TOC decreased 100% reflecting the cessation of allocated costs from TOC as a result of the Acquisition.

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Depreciation increased 8.6% primarily reflecting higher historical spending on purchased and internally-developed software as well as the impact of purchase accounting adjustments to the fair value of buildings and building improvements and purchased and internally-developed software, partially offset by declining investment in other property and equipment in prior periods.

Amortization of identifiable intangible assets increased as a result of the valuation of amortizable identifiable intangible assets established in purchase accounting associated with the Acquisition.

Interest expense with TOC decreased 100% as notes payable with TOC were not acquired by Cengage Learning in connection with the Acquisition.

Interest income increased as a result of interest earned on cash investments held with third party financial institutions. Prior to the Acquisition, cash investments were held with TOC.

Interest expense increased as a result of new debt issued in connection with the Acquisition.

Benefit from income taxes decreased 49.4%. In the prior year, our tax deductible interest expense and identifiable intangible assets amortization were significantly lower, and as a result, our effective tax rate was much higher on a federal, state and international jurisdictional level. Further, in the three months ended March 31, 2008, for jurisdictions that are projected to be loss-making for the full year, no tax provision has been recorded as such jurisdictions are not expected to realize the associated tax benefits in the future.

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 investees, net of taxes from the three months ended March 31, 2007 represents investment losses related to our investment in U21, which was sold in November 2007.

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The Period July 5, 2007 to March 31, 2008 and the Period July 1, 2007 to July 4, 2007 (together, the "Cumulative Period Ended March 31, 2008") Compared With The Nine Months Ended March 31, 2007

| (Dollars in millions) | Cumulative Period Ended March 31, 2008 | Nine Months Ended March 31, 2007 | Percentage Change |
|--|---|---|----------------------|
| Statement of Operations | | | |
| Revenues: | | | |
| Academic & Professional | \$ 948.9 | \$ 888.7 | 6.8% |
| Gale | 229.3 | 239.8 | -4.4% |
| International | 259.3 | 240.8 | 7.7% |
| Corporate and other | (4.8) | 17.3 | NM |
| Total revenues | <u>1,432.7</u> | <u>1,386.6</u> | 3.3% |
| Cost of revenues, excluding depreciation stated below: | | | |
| Products | 536.4 | 503.1 | 6.6% |
| Services and other | 74.9 | 71.2 | 5.2% |
| Amortization of pre-publication costs | 104.6 | 101.4 | 3.2% |
| Total cost of revenues, excluding depreciation stated below | <u>715.9</u> | <u>675.7</u> | 5.9% |
| Selling, general & administrative, excluding depreciation stated below | 312.4 | 335.1 | -6.8% |
| Allocation of management costs from TOC | 0.8 | 37.5 | -97.9% |
| Depreciation | 44.2 | 41.9 | 5.5% |
| Amortization of identifiable intangible assets | 162.4 | 33.8 | NM |
| Total costs and expenses | <u>1,235.7</u> | <u>1,124.0</u> | 9.9% |
| Operating income | 197.0 | 262.6 | -25.0% |
| Gain on sale of equity investee | 0.8 | - | NM |
| Gain on nonmonetary transaction | - | 1.3 | NM |
| Interest expense with TOC | - | (20.1) | NM |
| Interest income | 6.0 | - | NM |
| Interest expense | (415.0) | (3.4) | NM |
| (Loss) income before taxes | <u>(211.2)</u> | <u>240.4</u> | NM |
| Provision for income taxes | (1.9) | (95.5) | -98.0% |
| Equity losses of investee, net of taxes | (2.1) | (4.7) | -55.3% |
| Net (loss) income | <u>\$ (215.2)</u> | <u>\$ 140.2</u> | NM |

NM = Not meaningful

Revenues increased 3.3% on growth within our Academic & Professional and International segments, including the favorable impact of foreign currency translation of 1.2%, partially offset by a decline within Gale and Corporate and other revenues. Included in the current period is (i) a \$25.0 million reduction of revenue reported in our Corporate and other segment during the Cumulative Period Ended March 31, 2008 associated with purchase accounting adjustments to deferred revenue and (ii) \$17.2 million of revenue during the Cumulative Period Ended March 31, 2008 on transactions with a former

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affiliate of Thomson Learning which were reported as a reduction of expenses in periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the nine months ended March 31, 2007 by \$19.9 million.

Our Academic & Professional segment revenue increased 6.8% for the Cumulative Period ended March 31, 2008 on modest growth in higher education, revenue from acquisitions of 1.0% and increased sales in the career market, which are benefiting from the successful expansion of sales programs in the for-profit sector. In the professional market, increased focus on sales through this channel is beginning to show benefits. Partially offsetting this growth was the impact of additional returns reserve charges and the cessation of sales to certain distributors, both in Latin America. Foreign currency translation had a nominal impact. In addition, the change reflects the recognition of \$15.9 million of revenue on transactions with a former affiliate of Thomson Learning which were reported as a reduction of expenses in periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the nine months ended March 31, 2007 by \$18.3 million. Included within the \$948.9 million revenue for the Cumulative Period Ended March 31, 2008 is \$14.6 million recognized during the period July 1, 2007 to July 4, 2007.

Gale's revenue decline of 4.4% during the Cumulative Period Ended March 31, 2008 reflects continued print attrition and the decline in film products, partially offset by growth in digital products. Included within the \$229.3 million revenue for the Cumulative Period Ended March 31, 2008 is \$1.4 million recognized during the period July 1, 2007 to July 4, 2007.

International revenues increased 7.7% during the Cumulative Period Ended March 31, 2008 reflecting the favorable impact of foreign currency translation of 6.7%, strength in our English language training businesses in EMEA, distance learning sales in Australia, and higher education and library reference sales in Asia, offset by a decline in distance learning in EMEA and higher education in EMEA and Australia, and the cessation of sales to certain distributors. The change also reflects the recognition of \$1.3 million of revenue during the Cumulative Period Ended March 31, 2008 on transactions with a former affiliate of Thomson Learning which were reported as a reduction of expenses in periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the nine months ended March 31, 2007 by \$1.6 million. Included within the \$259.3 million revenue for the Cumulative Period Ended March 31, 2008 is \$2.5 million recognized during the period July 1, 2007 to July 4, 2007.

Our Corporate and other revenue decrease during the Cumulative Period Ended March 31, 2008 reflects a \$25.0 million reduction of revenue for purchase accounting adjustments to deferred revenue, in connection with the Acquisition, partially offset by increased revenue from shipping and handling activities and administrative services. Included within the revenue for the Cumulative Period Ended March 31, 2008 is \$0.1 million recognized during the period July 1, 2007 to July 4, 2007.

Cost of revenues, excluding depreciation increased 5.9% for the reasons described below.

Our products cost of revenues predominantly include author royalties, paper, printing and binding costs, all of which vary as revenues increase or decrease, as well as a component of fixed direct and indirect costs incurred to support delivery of print products. In addition, prior to July 5, 2007, income on transactions with a former affiliate of Thomson Learning was reported as a reduction of these expenses. During the nine months ended March 31, 2007, \$19.9 million was included in products cost of revenues relating to such transactions. The increase in products cost of revenues arose primarily as a result of the impact of these transactions as well as from sales growth in print products, partially offset by a reduction in fixed costs attributable to the delivery of print products. Included within products costs of revenues for the Cumulative Period Ended March 31, 2008 is \$7.1 million incurred during the period July 1, 2007 to July 4, 2007.

Our services and other cost of revenues include the variable cost of royalties and hosting as well as a component of fixed direct and indirect costs incurred to support delivery of digital and service related products. The increase of 5.2% primarily represents an increase of these indirect costs as well as the impact of a shift in the mix of sales to products with higher average royalty costs. Included within services and other costs of revenues for the Cumulative Period Ended March 31, 2008 is \$1.0 million incurred during the period July 1, 2007 to July 4, 2007.

Pre-publication costs are amortized upon publication of a title over its estimated expected operating life cycle. The amortization expense increase of 3.2% is attributable to the timing of publication releases and the volume of sales generated from individual titles or programs during the period, partially offset by lower historical pre-publication spending. Included

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within amortization of pre-publication costs for the Cumulative Period Ended March 31, 2008 is \$0.9 million incurred during the period July 1, 2007 to July 4, 2007.

Selling, general & administrative expense, excluding depreciation decreased by 6.8%, reflecting the absence of \$11.5 million of costs associated with employee retention bonuses and professional services fees incurred during the nine months ended March 31, 2007, as well as lower expenses from fewer employees, lower travel and entertainment costs and better expense management. Partially offsetting this decreases are \$7.4 million of advisory fees and costs incurred as we establish our own internal support infrastructure previously provided by TOC. Included within selling, general & administrative expense, excluding depreciation for the Cumulative Period Ended March 31, 2008 is \$5.0 million incurred during the period July 1, 2007 to July 4, 2007.

Allocation of management costs from TOC decreased 97.9%, reflecting the cessation of allocated costs from TOC as a result of the Acquisition. Included within allocation of management costs from TOC for the Cumulative Period Ended March 31, 2008 is \$0.8 million incurred during the period July 1, 2007 to July 4, 2007.

Depreciation increased 5.5% primarily reflecting higher historical spending of purchased and internally-developed software as well as the impact of purchase accounting adjustments to the fair value of buildings and building improvements and purchased and internally-developed software, partially offset by declining investments in other property and equipment in prior periods. Included within depreciation expense is \$0.6 million incurred during the period July 1, 2007 to July 4, 2007.

Gain on sale of equity investee resulted from the sale of our investment in U21 in November 2007. The Company accounted for U21 using the equity method and recognized a gain as a result of equity losses recognized since July 5, 2007.

Gain on nonmonetary transaction reflects a non-monetary exchange of book titles and content with another publisher we completed during the nine months ended March 31, 2007.

Amortization of identifiable intangible assets increased due to the fair valuation of amortizable identifiable intangible assets established in purchase accounting for the Acquisition, partially offset by an impairment charge of \$2.9 million recorded in the prior year period. Included within amortization of identifiable intangible assets expense for the Cumulative Period Ended March 31, 2008 is \$0.3 million incurred during the period July 1, 2007 to July 4, 2007.

Interest expense with TOC decreased 100% due to the Acquisition, as notes payable with TOC were not acquired by Cengage Learning.

Interest income increased as a result of interest earned on cash investments held with third party financial institutions. Prior to the Acquisition, cash investments were held with TOC. Interest income of less than \$0.1 million was earned during the period July 1, 2007 to July 4, 2007.

Interest expense increased resulting from new debt incurred in connection with the Acquisition. Interest expense of less than \$0.1 million was incurred during the period July 1, 2007 to July 4, 2007.

Provision for income taxes decreased 98.0%. In the prior year, our tax deductible interest expense and identifiable intangible assets amortization were significantly lower, and as a result, our effective tax rate was much higher on a federal, state and international jurisdictional level. Further, in the Cumulative Period Ended March 31, 2008, for jurisdictions that are projected to be loss-making for the full year, no tax provision has been recorded as such jurisdictions are not expected to realize the associated tax benefits in the future. Included within the provision for income taxes for the Cumulative Period Ended March 31, 2008 is \$1.1 million incurred during the period July 1, 2007 to July 4, 2007.

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 investees, net of taxes decreased 55.3% resulting from the sale of our investment in U21 in November 2007, partially offset by equity losses of another investee. Included within the equity losses of investees, net of taxes for the Cumulative Period Ended March 31, 2008 is \$0.1 million incurred during the period July 1, 2007 to July 4, 2007.

Liquidity and Capital Resources

The following table sets forth other financial data and our cash flows from operating, investing and financing activities for the Cumulative Period Ended March 31, 2008 and for the nine months ended March 31, 2007 (Thomson Learning). As discussed above, the Cumulative Period Ended March 31, 2008 is provided to enhance the reader's understanding of the results of operations for the periods presented but is not a GAAP measure.

| (Dollars in millions) | Cumulative Period Ended March 31, 2008 | Nine Months Ended March 31, 2007 |
|--|---|---|
| Other Financial Data | | |
| Additions to pre-publication costs | \$ 88.9 | \$ 89.2 |
| Additions to property, equipment and capitalized software for internal use | 27.3 | 33.6 |
| Statements of Cash Flows | | |
| Net cash provided by operating activities | \$ 343.7 | \$ 372.1 |
| Net cash used by investing activities | (7,306.8) | (174.4) |
| Net cash provided (used) by financing activities | 7,121.6 | (185.8) |
| Impact on cash and cash equivalents from change in foreign currency | 0.3 | 1.6 |
| Net increase in cash and cash equivalents | <u>\$ 158.8</u> | <u>\$ 13.5</u> |

Cash Flows

Operating activities. Net cash provided by operating activities for the Cumulative Period Ended March 31, 2008 decreased by \$28.4 million, or approximately 7.6%. This decrease was attributable primarily to the change in net cash interest payments of \$271.0 million, partially offset by improved operating results before depreciation, amortization of identifiable intangible assets and pre-publication costs as well as favorable working capital movements.

Investing activities. Net cash used by investing activities for the Cumulative Period Ended March 31, 2008 was \$7,306.8 million as compared to \$174.4 million for the nine months ended March 31, 2007, primarily reflecting the impact of the Acquisition, offset by a reduction in expenditures for property, equipment and capitalized software for internal use, as well as proceeds from the sale of an equity investment.

Financing activities. Net cash provided by financing activities for the Cumulative Period Ended March 31, 2008 was \$7,121.6 million as compared to net cash used by financing activities of \$185.8 million for the nine months ended March 31, 2007, primarily reflecting the Financing Transactions and the cessation of financing activities with TOC. Also included in current period financing activities is a principal payment of \$17.2 million on our long-term debt and the settlement of our capital lease obligation associated with the property located in Farmington Hills, Michigan of \$26.0 million.

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Cash Position, Indebtedness and Liquidity

As of March 31, 2008, our total cash and cash equivalents were \$177.5 million and we had total indebtedness of approximately \$5,659.1 million. As of June 30, 2007, we had total cash and cash equivalents of \$18.8 million and total indebtedness of \$769.8 million, including Notes payable to TOC and Notes payable due in 2008 totaling \$743.8 million that we did not assume as part of the Acquisition.

Prior to the Acquisition, our principal sources of liquidity were our existing cash, internally generated cash flow from operations and borrowings under our arrangements with TOC. We periodically lent to or borrowed money from various subsidiaries of TOC as part of TOC's overall cash management and capitalization program. Certain of these arrangements were subject to written loan agreements specifying repayment terms and interest payments. These notes were reflected separately in the Combined Balance Sheet based on their legal form. Since these notes were part of TOC's overall capitalization of us, changes in the notes' balances were reflected as financing activities in the Combined Statement of Cash Flows.

As a result of the Acquisition and related Financing Transactions, we are highly leveraged and are incurring significant interest expense. See Note 11, "Debt" to the accompanying consolidated and combined interim financial statements (the "Financial Statements") for a detailed description of our indebtedness. In addition, we have entered into an agreement with Houghton Mifflin Company to purchase the assets of Houghton Mifflin's College Division ("HM College") for \$750 million in cash, subject to working capital and cash flow adjustments. The purchase agreement contains customary representations, warranties and covenants. We expect to finance the acquisition through approximately \$625 million of term loan borrowings under the Senior Secured Credit Facilities, with the remainder financed through equity contributions to us. The acquisition is expected to close by June 30, 2008 upon satisfaction of regulatory approvals and other customary closing conditions.

Post-Acquisition, our principal uses of cash are to fund the payment of interest and principal on our outstanding debt, the acquisition of HM College, as well as operating costs and capital expenditures, including investments in products and technology offerings. We expect our cash flows from operations, combined with availability under our revolving credit facility, to provide sufficient liquidity to fund our current obligations, debt service requirements, projected working capital requirements, restructuring obligations, debt principal repayments and capital spending for the foreseeable future. The seasonality of our business is such that a greater portion of revenue and operating cash flow is derived in the first half of the fiscal year, while costs are incurred more evenly throughout the fiscal year. Accordingly, as the fiscal year progresses, the likelihood of seasonal borrowings under our revolver increases.

Our liquidity and our ability to service our debt, as well as fund the acquisition of HM College and other purchase commitments, operating leases, operating costs, working capital and capital expenditure 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 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. However, the current state of the credit markets may limit or prevent our ability to obtain additional liquidity on terms acceptable to us or at all.

Application of Critical Accounting Policies and Estimates

In preparing the 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 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. These significant accounting policies should be read in conjunction with similar disclosures made in our Transition Report for The Six Months Ended June 30, 2007 and Annual Report for The Years Ended December 31, 2006, 2005 and 2004 (the "Transition Report"). For a detailed discussion of the application of these accounting policies, refer to Note 5, "Critical Accounting Policies" to the Financial Statements, as well as our Transition Report.

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In accordance with our accounting policy, we have performed a preliminary allocation related to the purchase price of the Acquisition, and the fair valued the net assets acquired of Thomson Learning. The remaining excess cost of the Acquisition over the fair values attributed to underlying net tangible assets and identifiable intangible assets has been assigned to goodwill. As discussed in Note 2, "Acquisition of Thomson Learning" to the Financial Statements, this preliminary allocation reflects our estimates and may be subject to change.

There have been no changes in the application of critical accounting policies since June 30, 2007.

Off-Balance Sheet Transactions

Although we generally do not utilize off-balance sheet arrangements in our operations, in the ordinary course of business we may engage in financial transactions that are not recorded on the balance sheet, or may be recorded on the balance sheet in amounts that are different than the full contract or notional amount of the transactions, including operating leases and derivative instruments. See Note 12, "Financial Instruments" to the Financial Statements.

Recent Accounting Pronouncements

Please refer to Note 6, "Recent Accounting Pronouncements" to the 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.

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Quantitative and Qualitative Disclosures about Market Risk

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 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 our earnings and cash flow volatility resulting from shifts in market rates. As permitted, we designate certain of these derivative contracts for hedge accounting treatment under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. However, certain of these instruments may not qualify for hedge accounting treatment and, accordingly, the results of our operations may be exposed to some level of volatility. Volatility in 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.

Periodically we may 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, and foreign currency spot, forward, swap and option contracts to manage foreign currency exposures. The fair market values of all these 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. Our policy is to deal with counterparties having a single A or better credit rating. We manage credit risk through the continuous monitoring of exposures to such counterparties.

See Note 12, "Financial Instruments" to the Financial Statements for a detailed description of interest rate swaps we have entered into to hedge the variable interest rate component of certain of our indebtedness.