



CENGAGE LEARNING HOLDINGS II, L.P.

**Second Quarter Report
Three and Six Months Ended December 31, 2011**

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 indenture, dated as of October 31, 2008, among Cengage Learning Holdco, Inc. (a direct 100% wholly owned subsidiary of the Company), the Company, as guarantor, and Wells Fargo Bank, National Association, as trustee, governing the 13.75% Senior PIK Notes due 2015, and 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, governing the 13.25% Senior Subordinated Discount Notes due 2015 and the 10.50% Senior Notes due 2015, 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 and other 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 terms of the indenture governing the 13.75% Senior PIK Notes and the presentation of financial information in the Cengage Learning Acquisitions, Inc. Offering Memorandum, dated June 22, 2007, relating to the 10.50% Senior Notes due 2015 and the 13.25% Senior Subordinated Discount Notes due 2015 and as otherwise provided in the Company’s agreements relating to its debt and securities. This report is made available pursuant to such obligations and should be read in conjunction with the Company’s Annual Report for the fiscal year ended June 30, 2011.

“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. Our actual results, performance or achievements may be different from any future results, performance and anticipated achievements expressed or implied by forward-looking statements because of known and unknown risks, uncertainties and factors including the following important factors and those factors described in this quarterly report and in other publically available reports of the Company, including the Company’s Annual Report for the fiscal year ended June 30, 2011:

- The impact of competition from established competitors and new businesses that have not traditionally participated in our markets, including the impact of new and enhanced product and service offerings and technology, acquisitions by competitors, the ability to adapt more quickly to new or emerging technologies and market conditions and other activities;
- The impact of the used textbook and rental markets and our ability to compete with and within them;
- The effect of increased accessibility of free or relatively inexpensive information resources on demand and prices we can charge for our products and services;
- Our ability to successfully implement our business strategy;
- The impact of technology developments and our ability to continue to make effective investments in our technology infrastructure;
- Our ability to adequately protect our intellectual property and the adequacy of protections of our intellectual property under applicable laws;
- Liabilities resulting from, and costs of defending against, litigation including intellectual property infringement claims;
- The impact of changes to laws and regulations applicable to us and our customers;
- The impact of decreases or delays in government funding for students and libraries;
- Our ability to attract and retain key authors, content providers and employees;
- Our ability and willingness to maintain licensing agreements with third party content providers;
- Failures or disruptions of our and our third party providers’ hosting facilities and electronic delivery systems for our products and services;
- Our reliance on third party providers of outsourced services and any failure of such providers to provide services effectively on a timely basis;
- Our ability to adequately manage and evolve our operational and managerial systems and processes including our enterprise resource planning software;
- The impact of increases in paper prices and the availability of sufficient supplies of paper in the marketplace;
- Our ability to successfully expand our operations outside the U.S. where we may face difficulties in: penetrating new markets, developing products and services that are tailored to local needs, obtaining payment in a timely manner, gaining recognition and acceptance of our products and brands, forging successful joint ventures, partners, completing acquisitions, conducting business during periods of political, legal, regulatory or economic instability or change;
- The effect of fluctuations between foreign currencies and the U.S. dollar;
- Our ability to identify, complete and successfully integrate acquisitions;
- Adverse changes in domestic and global economic conditions, related availability of credit, government and private loans for students and consequential decline in consumer demand for our products;
- We could be required to record future charges for impairment;
- Consolidation in the markets in which we operate could have a negative impact on our competitive position;
- We have a substantial amount of indebtedness which could limit our ability to raise additional capital, limit our ability to react to changes in the economy or our industry, or expose us to interest rate risk and prevent us from fulfilling our obligations under our outstanding debt agreements;
- Changes in our credit ratings or macroeconomic conditions may affect our liquidity, increasing borrowing costs and limiting our financing options;
- Our debt agreements limit our flexibility in operating our business including, among other things, our ability under certain circumstances to engage in mergers or consolidations, sell assets, pay distributions to our equity owners, and/or buy back debt; and
- We are owned by investment funds associated with or designated by Apax Partners which is able to appoint a majority of our board of directors, determine our corporate strategy, management and policies. The interests of Apax may not coincide with our interests.

These factors are by no means exhaustive but are presented to identify important factors that may impact the Company’s performance and results. 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.

CENGAGE LEARNING HOLDINGS II, L.P.
SECOND QUARTER REPORT
THREE AND SIX MONTHS ENDED DECEMBER 31, 2011

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CENGAGE LEARNING HOLDINGS II, L.P.
Condensed Consolidated Balance Sheets
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

	<u>December 31, 2011</u>	<u>June 30, 2011</u>	<u>December 31, 2010</u>
Assets			
Cash and cash equivalents	\$ 137.0	\$ 34.2	\$ 185.7
Accounts receivable, net	279.2	329.6	270.5
Inventories	201.4	195.0	195.3
Current deferred tax assets	48.0	41.4	82.7
Prepaid expenses and other current assets	48.8	41.8	46.6
Total current assets	<u>714.4</u>	<u>642.0</u>	<u>780.8</u>
Property, equipment and capitalized software for internal use, net	188.0	180.9	151.1
Pre-publication costs, net	298.1	269.3	248.0
Author advances	36.2	23.3	31.1
Identifiable intangible assets, net	2,629.7	2,695.7	2,775.0
Goodwill	3,542.5	3,539.6	3,537.6
Non-current deferred tax assets	6.6	6.7	9.7
Deferred financing costs	31.1	38.1	44.0
Other non-current assets	4.5	4.9	6.8
Total assets	<u><u>\$ 7,451.1</u></u>	<u><u>\$ 7,400.5</u></u>	<u><u>\$ 7,584.1</u></u>
Liabilities and Partners' Equity			
Accounts payable and accrued expenses	\$ 403.4	\$ 354.1	\$ 391.5
Deferred revenue	146.6	116.0	123.1
Current portion of long-term debt	112.8	40.7	40.7
Revolving credit facility	-	24.0	-
Current taxes payable	16.1	3.8	12.3
Current fair value of derivative instruments	32.4	49.5	57.1
Other current liabilities	26.8	4.7	10.7
Total current liabilities	<u>738.1</u>	<u>592.8</u>	<u>635.4</u>
Long-term debt	5,348.1	5,625.8	5,634.8
Non-current deferred tax liabilities	847.0	846.4	888.7
Non-current fair value of derivative instruments	29.0	35.1	39.7
Other non-current liabilities	66.7	50.9	35.3
Total liabilities	<u>7,028.9</u>	<u>7,151.0</u>	<u>7,233.9</u>
Partners' equity	506.6	345.9	460.0
Accumulated other comprehensive loss	(84.4)	(96.4)	(109.8)
Total partners' equity	<u>422.2</u>	<u>249.5</u>	<u>350.2</u>
Total liabilities and partners' equity	<u><u>\$ 7,451.1</u></u>	<u><u>\$ 7,400.5</u></u>	<u><u>\$ 7,584.1</u></u>

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

CENGAGE LEARNING HOLDINGS II, L.P.
Condensed Consolidated Statements of Operations
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

	Three Months		Six Months	
	Ended December 31,		Ended December 31,	
	2011	2010	2011	2010
Revenues	\$ 456.2	\$ 442.2	\$ 1,148.1	\$ 1,084.0
Cost of revenues, excluding amortization of pre-publication costs and depreciation stated below	184.6	177.4	421.6	402.9
Amortization of pre-publication costs	36.1	30.0	91.2	72.8
Total cost of revenues, excluding depreciation stated below	220.7	207.4	512.8	475.7
Selling, general & administrative, excluding depreciation stated below	96.6	94.4	202.7	191.9
Restructuring charges	-	0.9	-	3.4
Depreciation	12.7	11.0	26.1	21.7
Amortization of identifiable intangible assets	41.2	42.0	82.1	83.9
Total costs and expenses	371.2	355.7	823.7	776.6
Operating income from continuing operations	85.0	86.5	324.4	307.4
Gain on early extinguishment of debt	-	-	42.2	1.9
Mark-to-market of derivative instruments	12.7	17.6	12.7	29.5
Interest expense, net	(104.5)	(120.3)	(202.8)	(244.2)
(Loss) income from continuing operations before taxes and equity losses of affiliates	(6.8)	(16.2)	176.5	94.6
Provision for income taxes	(3.3)	(2.9)	(16.0)	(8.2)
Equity losses of affiliates, net of taxes	(0.9)	(0.3)	(2.3)	(1.0)
(Loss) income from continuing operations	(11.0)	(19.4)	158.2	85.4
Loss from discontinued operations, net of tax	-	(3.6)	-	(3.8)
Net (loss) income	\$ (11.0)	\$ (23.0)	\$ 158.2	\$ 81.6

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

CENGAGE LEARNING HOLDINGS II, L.P.
Condensed Consolidated Statements of Cash Flows
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

	Six Months Ended December 31,	
	2011	2010
Cash Flows from Operating Activities		
Net income	\$ 158.2	\$ 81.6
Loss from discontinued operations, net of tax	-	3.8
Income from continuing operations	158.2	85.4
Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:		
Amortization of pre-publication costs	91.2	72.8
Depreciation	26.1	21.7
Amortization of identifiable intangible assets	82.1	83.9
Amortization of debt discounts and deferred financing costs	8.2	8.3
Interest capitalized on long-term debt	0.7	8.5
Non-cash interest on derivative instruments	10.6	28.7
Repayments of long-term debt, in lieu of interest	(35.0)	(4.4)
Non-cash equity-based compensation expense	2.6	4.0
Restructuring charges	-	3.4
Cash payments for restructuring	(1.1)	(4.1)
Mark-to-market of derivative instruments	(12.7)	(29.5)
Gain on early extinguishment of debt	(42.2)	(1.9)
Benefit from deferred taxes	(2.6)	(3.0)
Equity losses of affiliates, net of taxes	2.3	1.0
Changes in operating assets and liabilities	150.3	100.7
Other, net	(0.4)	(1.3)
Net cash provided by operating activities of continuing operations	438.3	374.2
Net cash used in operating activities of discontinued operations	-	(0.5)
Net cash provided by operating activities	438.3	373.7
Cash Flows from Investing Activities		
Acquisitions of businesses, less cash therein	(72.0)	(6.8)
Disposal of businesses, net of cash contribution	-	(5.0)
Proceeds from settlement of derivative instruments	1.4	0.2
Payments on settlement of derivative instruments	(1.2)	(1.5)
Additions to pre-publication costs	(79.4)	(76.5)
Additions to property, equipment and capitalized software for internal use	(29.8)	(31.3)
Proceeds from disposition of property, equipment and capitalized software for internal use	0.2	0.2
Other, net	0.2	0.1
Net cash used in investing activities of continuing operations	(180.6)	(120.6)
Net cash used in investing activities of discontinued operations	-	(0.2)
Net cash used in investing activities	(180.6)	(120.8)
Cash Flows from Financing Activities		
Repayments of long-term debt	(130.3)	(28.4)
Borrowings under the revolving credit facility	265.0	145.0
Repayments under the revolving credit facility	(289.0)	(211.0)
Other, net	-	(0.4)
Net cash used in financing activities of continuing operations	(154.3)	(94.8)
Impact on Cash and Cash Equivalents from Changes in Foreign Currency	(0.6)	0.6
Net Increase in Cash and Cash Equivalents	102.8	158.7
Cash and Cash Equivalents		
Beginning of period	34.2	27.0
End of period	\$ 137.0	\$ 185.7

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

CENGAGE LEARNING HOLDINGS II, L.P.
Notes to Condensed Consolidated Financial Statements
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

1. BASIS OF PRESENTATION

Basis of Presentation

Cengage Learning Holdings II, L.P., together with its consolidated subsidiaries, is hereinafter collectively referred to as “Cengage Learning”, “we”, “us”, “our”, or the “Company”. We are controlled by investment funds associated with or designated by Apax Partners, L.P. (“Apax”), together with OMERS Private Equity, Inc. (“OMERS”), hereinafter collectively referred to as our “Sponsors”.

We have prepared the accompanying condensed consolidated interim financial statements in accordance with the accounting policies described in our Annual Report for the Fiscal Year Ended June 30, 2011 (the “2011 Annual Report”). Certain information and note disclosures normally included in our annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted. You should read these financial statements in conjunction with the consolidated financial statements included in the 2011 Annual Report. Certain historical amounts have been reclassified to conform with the current period’s presentation.

In the opinion of management, our condensed consolidated financial statements and accompanying notes (the “Financial Statements”) include all adjustments (consisting of normal recurring adjustments) considered necessary by management to fairly state the financial position, results of operations and cash flows for the interim period presented. Interim results of operations are not necessarily indicative of the results for the full year.

In fiscal 2011, we determined that certain deferred tax balances associated with our Australia and Asia businesses had not been properly recorded as of July 5, 2007 related to the Thomson Learning acquisition, and as a result, goodwill was understated. Subsequently, when goodwill was impaired in Asia in fiscal 2009 and in Australia for the period July 5, 2007 to June 30, 2008, the related impairment charges were understated by \$11.1 and \$7.4, respectively. In addition, certain amounts presented on our Condensed Consolidated Balance Sheet as of December 31, 2010, have been revised to reflect a correction of our current and non-current deferred tax assets, deferred tax valuation allowances and non-current deferred tax liabilities. These revisions had the effect of decreasing both total assets and total liabilities and partners’ equity by \$13.0. We have determined that it was not probable that the judgment of a reader of the financial statements would have changed or been influenced by these errors and, therefore, adjustments to correct the errors are not material to the Financial Statements. However, in order to enhance year-on-year comparability, we have revised the December 31, 2010 balance sheet for these errors.

New Accounting Standards

In December 2011, the Financial Accounting Standards Board (“FASB”) issued an update of the new accounting guidance issued in June 2011, relating to the presentation of comprehensive income. This update indefinitely defers the guidance relating to the presentation of reclassification adjustments. We currently expect to adopt this guidance on July 1, 2012, excluding those aspects that were deferred by the current update. Because these amendments only change how other comprehensive income is presented within these consolidated financial statements rather than changing whether an item must be reported in other comprehensive income or when an item of other comprehensive income is reclassified to earnings, we do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In December 2011, the FASB issued new accounting guidance that amends Accounting Standard Codification Topic 210 “Balance Sheet – Offsetting”. The update provides new requirements for disclosures about financial and derivative instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. In addition, the standard requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. This standard, for which we are currently assessing the impact, will become effective on July 1, 2013, with required disclosures made retrospectively for all comparative periods presented.

CENGAGE LEARNING HOLDINGS II, L.P.
Notes to Condensed Consolidated Financial Statements
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

Seasonality and Comparability

Our revenues, operating profit and operating cash flows are impacted by the inherent seasonality of the academic calendar. In addition, changes in customers' ordering patterns may impact the comparison of our results in a quarter with the same quarter of the previous year due to customers shifting the timing of material orders for a number of reasons, including, but not limited to, changes in academic semester start dates or changes in inventory management practices. For these reasons, the December 31, 2010 Condensed Consolidated Balance Sheet is presented for comparative purposes.

2. ACQUISITION

On August 1, 2011, we completed the acquisition of National Geographic Society's School Publishing Unit for an aggregate purchase price of \$80.0, consisting of \$72.0 in cash using funds borrowed under our revolving credit facility, and \$8.0 in deferred consideration which is included in "Other current liabilities" in the Condensed Consolidated Balance Sheet. The purchase consideration was subject to working capital adjustments which the parties finalized subsequent to December 31, 2011 and, as a result, additional consideration of \$2.6 was paid to National Geographic Society in January 2012.

In connection with the acquisition, we also agreed to pay additional consideration in the event that predefined annual revenue targets are exceeded for the first four calendar years following the consummation date of the acquisition. We estimate the fair value of this contingent consideration to be \$17.7.

The assets acquired represent National Geographic's print and digital school publishing unit, including its English language teaching products, the National Geographic Science series, National Geographic Explorer! magazines and Hampton Brown's literacy and language programs. Through this acquisition, we have expanded our rights to distribute National Geographic Society's content, including images, maps, videos and articles in the academic and library markets worldwide. The acquired net assets and results from operations have been included within our Domestic segment since the date of acquisition. Pro forma and other supplemental information are not presented as this acquisition was not determined to be a material business combination.

During the six months ended December 31, 2010, we acquired McGraw Hill's Australia Secondary School Business.

3. DISCONTINUED OPERATIONS

On November 30, 2010, we completed the sale of certain non-strategic distance learning businesses located in Australia and New Zealand. Pursuant to the terms of the arrangement, we contributed \$5.0 cash to the businesses upon closing. The loss on the sale was \$4.0. These businesses had previously been classified as assets held for sale and reported as discontinued operations.

Included in the loss from discontinued operations, net of tax in the Condensed Consolidated Statements of Operations are the following:

	Three Months Ended December 31, 2010	Six Months Ended December 31, 2010
Revenues	\$ 2.9	\$ 7.1
Loss from discontinued operations, before tax	(3.6)	(3.8)

CENGAGE LEARNING HOLDINGS II, L.P.
Notes to Condensed Consolidated Financial Statements
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

4. COMPREHENSIVE (LOSS) INCOME

Comprehensive income consists of the following:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2011	2010	2011	2010
Net (loss) income	\$ (11.0)	\$ (23.0)	\$ 158.2	\$ 81.6
Foreign currency translation adjustments	0.9	5.0	(9.1)	19.5
Unrealized gains (losses) on derivative instruments	-	6.9	10.5	(20.2)
Unrealized losses on derivative instruments reclassified into earnings	10.6	14.4	10.6	28.7
Comprehensive income	<u>\$ 0.5</u>	<u>\$ 3.3</u>	<u>\$ 170.2</u>	<u>\$ 109.6</u>

5. INVENTORIES

Inventories consist of the following:

	December 31,	June 30,	December 31,
	2011	2011	2010
Raw materials	\$ 3.3	\$ 2.9	\$ 4.4
Work-in-progress	-	0.4	1.9
Finished goods, net	198.1	191.7	189.0
Inventories	<u>\$ 201.4</u>	<u>\$ 195.0</u>	<u>\$ 195.3</u>

6. OTHER BALANCE SHEET ACCOUNTS

The sales returns reserve and allowance for doubtful accounts were as follows:

	December 31,	June 30,	December 31,
	2011	2011	2010
Sales returns reserve	\$ 178.0	\$ 108.3	\$ 185.0
Allowance for doubtful accounts	10.5	10.5	9.7
	<u>\$ 188.5</u>	<u>\$ 118.8</u>	<u>\$ 194.7</u>

Accounts payable and accrued expenses consist of the following:

	December 31,	June 30,	December 31,
	2011	2011	2010
Accounts payable	\$ 71.0	\$ 99.4	\$ 67.4
Accrued interest payable	85.5	87.8	87.9
Accrued royalties	156.2	79.9	143.1
Accrued bonuses	27.5	24.9	28.0
Other accrued expenses	63.2	62.1	65.1
	<u>\$ 403.4</u>	<u>\$ 354.1</u>	<u>\$ 391.5</u>

CENGAGE LEARNING HOLDINGS II, L.P.
Notes to Condensed Consolidated Financial Statements
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

7. RESTRUCTURING

The following is a summary of activity relating to on-going restructuring programs:

	Severance and Related Costs	Facility Consolidation Costs and Related Asset Impairments	Total
	Business Integration ⁽¹⁾	Boston Relocation ⁽²⁾	
	Integration ⁽¹⁾	Relocation ⁽²⁾	
Balance as of June 30, 2011	\$ 0.4	\$ 0.9	\$ 1.3
Cash payments	(0.4)	(0.7)	(1.1)
Balance as of December 31, 2011	<u>\$ -</u>	<u>\$ 0.2</u>	<u>\$ 0.2</u>
Balance as of June 30, 2010	\$ 3.1	\$ 6.2	\$ 9.3
Restructuring provision	3.4	-	3.4
Cash payments	(2.7)	(1.4)	(4.1)
Balance as of December 31, 2010	<u>\$ 3.8</u>	<u>\$ 4.8</u>	<u>\$ 8.6</u>

⁽¹⁾ In July 2010, we consolidated our former Academic & Professional and Gale businesses into one operating group. In connection with this restructuring, we recorded \$3.1 in our Domestic segment for employee severance and related costs for the year ended June 30, 2010. During the six months ended December 31, 2010, we recorded an additional liability for this program of \$3.4. The restructuring payments were completed as of September 30, 2011.

⁽²⁾ In November 2008, we consolidated our office facilities in Boston, MA and entered into an operating lease arrangement for a new office facility, also within Boston, MA. The remaining restructuring-related payments are expected to be completed by December 2014, the termination date of the original lease.

Our liability for the remaining life of the lease, less estimated sublease income, was recognized and measured at its fair value using a discounted future cash flow valuation at June 30, 2011. This methodology applies various observable inputs, including estimated sublease rentals based on market prices for similar leased properties, discount rates and our fixed rental obligation under the existing lease, and estimated continued operating expenses based on historical data, which we determined to be Level 2 inputs under the fair value hierarchy.

CENGAGE LEARNING HOLDINGS II, L.P.
Notes to Condensed Consolidated Financial Statements
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

8. DEBT

Our debt consists of the following:

	<u>December 31, 2011</u>	<u>June 30, 2011</u>	<u>December 31, 2010</u>
Senior Secured Credit Facility:			
Term loan	\$ 3,293.8	\$ 3,311.0	\$ 3,328.2
Incremental term loan	603.1	606.3	609.4
Unamortized discount on incremental term loan	(6.1)	(7.3)	(8.5)
Revolving credit facility	-	24.0	-
Fixed rate notes:			
10.50% Senior Notes due 2015	1,215.6	1,215.6	1,215.6
Unamortized discount on 10.50% Notes due 2015	(6.1)	(7.2)	(8.3)
13.25% Senior Subordinated Discount Notes due 2015	233.6	407.7	407.7
13.75% Senior PIK Notes due 2015	127.0	140.4	131.4
Total debt	<u>5,460.9</u>	<u>5,690.5</u>	<u>5,675.5</u>
Less: Current portion of long-term debt	(112.8)	(64.7)	(40.7)
Total long-term debt	<u>\$ 5,348.1</u>	<u>\$ 5,625.8</u>	<u>\$ 5,634.8</u>

Revolving Credit Facility

The weighted average interest rate on the outstanding balance of the revolving credit facility was 1.92% at June 30, 2011. The following is a summary of our borrowings and repayments that are included in our Condensed Consolidated Statements of Cash Flows:

	Six Months Ended December 31,	
	<u>2011</u>	<u>2010</u>
Borrowings	\$ 265.0	\$ 145.0
Repayments	(289.0)	(211.0)
	<u>\$ (24.0)</u>	<u>\$ (66.0)</u>

Under this revolving credit facility, up to \$150.0 is available for the issuance of letters of credit. Letters of credit outstanding and the interest rates on outstanding amounts are as follows:

	<u>December 31, 2011</u>	<u>June 30, 2011</u>	<u>December 31, 2010</u>
Amount outstanding	\$ 2.6	\$ 2.6	\$ 6.3
Interest Rate	1.75%	1.75%	1.75%

Senior Subordinated Discount Notes

During the six months ended December 31, 2011, we purchased \$174.1 of 13.25% Senior Subordinated Discount Notes due 2015 that resulted in a net gain of \$38.6. Of the purchased notes, \$133.6 are being held, but not retired, and the remaining \$40.5 were retired. Following the debt purchases, our net mandatory principal redemptions due in July 2012 are \$29.6, which are calculated in accordance with the applicable high yield discount obligation (“AHYDO”) regulations issued by the U.S. Internal Revenue Service (“IRS”).

CENGAGE LEARNING HOLDINGS II, L.P.
Notes to Condensed Consolidated Financial Statements
(UNAUDITED)
(In millions of U.S. dollars unless otherwise indicated)

Senior PIK Notes

During the six months ended December 31, 2011, we purchased \$14.1 of 13.75% Senior PIK Notes due 2015 (“Senior PIK Notes”), which are being held, but not retired, resulting in a net gain of \$3.6. During the six months ended December 31, 2010, we purchased and retired \$14.7 of the Senior PIK Notes resulting in a net gain of \$1.9. Following the fiscal 2012 debt purchases, our net mandatory principal redemptions due in July 2012 are \$42.5, which are calculated in accordance with AHYDO regulations issued by the IRS.

9. FINANCIAL INSTRUMENTS

Derivative Financial Instruments

We use derivative financial instruments to manage exposure to market risks arising from changes in foreign currency exchange rates and interest rates. We recognize derivative instruments as either assets or liabilities and measure those instruments at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. For a derivative instrument designated as a cash flow hedge, the effective portion of the derivative’s mark-to-market gain or loss is initially reported as a component of “Accumulated Other Comprehensive Loss” (“AOCL”) and subsequently reclassified into earnings when the hedged transactions occur and affect earnings. The ineffective portion of the gain or loss is reported in earnings immediately. For derivative instruments that are not designated as accounting hedges, changes in fair value are recognized in earnings in the period of change. In addition, the de-designation of a cash flow hedge will result in existing unrealized gains or losses at the time of de-designation, recorded in AOCL, to be amortized into earnings to correspond with the recognition of the underlying hedged item. At inception of a hedge transaction and on an on-going basis, we assess whether the derivative in the hedging transaction has been highly effective in offsetting changes in fair value or cash flows of the hedged item and whether the derivative is expected to continue to be highly effective.

Interest Rate Risk Management

We use interest rate swap agreements to manage interest rate exposure 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.

Foreign Currency Derivatives

We periodically hedge the potential impact resulting from changes in exchange rates on select foreign currency-denominated net asset or liability positions through the use of forward contracts that may or may not be designated as accounting hedges. The gains and losses on these derivatives are largely expected to offset transaction losses and gains on the underlying foreign currency-denominated assets and liabilities.

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Derivative Instruments Summary

The following is a summary of our derivative instruments:

	December 31, 2011		June 30, 2011		December 31, 2010	
	Interest Rate Swaps	Foreign Exchange Contracts	Interest Rate Swaps	Foreign Exchange Contracts	Interest Rate Swaps	Foreign Exchange Contracts
Notional amount	\$ 2,100.0	\$ 14.6	\$ 2,100.0	\$ 14.9	\$ 3,500.0	\$ 22.9
Basis	LIBOR	Various	LIBOR	Various	LIBOR	Various
The notional amounts consist of the following:						
Non-amortizing aggregate notional amount	\$ 2,100.0	\$ 14.6	\$ 2,100.0	\$ 14.9	\$ 2,100.0	\$ 22.9
Maturity (calendar year)	2013	2012	2013	2011	2013	2011
Amortizing aggregate notional amount	\$ -	\$ -	\$ -	\$ -	\$ 1,400.0	\$ -
Maturity (calendar year)	N/A	N/A	N/A	N/A	2011	N/A

The following is a summary of the fair value liabilities relating to our interest rate contracts included in our Condensed Consolidated Balance Sheets:

	December 31, 2011	June 30, 2011	December 31, 2010
Fair value liabilities of derivative instruments not designated for hedge accounting:			
Current portion	\$ 32.4	\$ -	\$ 34.0
Non-current portion	29.0	-	-
	61.4	-	34.0
Fair value liabilities of derivative instruments designated for hedge accounting:			
Current portion	-	49.5	23.1
Non-current portion	-	35.1	39.7
	-	84.6	62.8
	\$ 61.4	\$ 84.6	\$ 96.8

Effective October 1, 2011, we elected to apply the one-month LIBOR interest rate instead of the three-month LIBOR interest rate associated with interest payments for borrowings under the term loan of our Senior Secured Credit Facility. As a result, we de-designated our interest rate swaps for cash flow hedge accounting purposes. Subsequent changes in the fair value of these derivative instruments are and will be reflected in earnings. At the time of de-designation, existing unrealized losses on these derivative instruments, net of tax, of \$74.1, were recorded in AOCL, of which \$42.3 are expected to be reclassified to earnings during the next twelve months and will be included in "Interest Expense, net" in the Condensed Consolidated Statements of Operations.

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The following is a summary of the impact of our derivative instruments in our Condensed Consolidated Statements of Operations:

	Three Months Ended December 31,				Six Months Ended December 31,			
	2011		2010		2011		2010	
	Interest Rate Contracts	Foreign Exchange Contracts	Interest Rate Contracts	Foreign Exchange Contracts	Interest Rate Contracts	Foreign Exchange Contracts	Interest Rate Contracts	Foreign Exchange Contracts
Impact of derivative instruments not designated for hedge accounting:								
Selling, general & administrative, excluding depreciation	\$ -	\$ 0.3	\$ -	\$ (0.8)	\$ -	\$ 0.2	\$ -	\$ (1.3)
Mark-to-market of derivative instruments	12.7	-	17.6	-	12.7	-	29.5	-
Interest expense, net	(23.3)	-	(33.3)	-	(23.3)	-	(65.6)	-
Impact of derivative instruments designated for hedge accounting:								
Interest expense, net	\$ -	\$ -	\$ -	\$ -	\$ (13.5)	\$ -	\$ -	\$ -
Weighted average interest rate:								
Paid	2.77%		5.25%		2.77%		5.25%	
Received	0.37%		0.29%		0.31%		0.41%	

Included in AOCL is the following:

	December 31, 2011	June 30, 2011	December 31, 2010
Beginning accumulated unrealized loss on derivative instruments	\$ (84.6)	\$ (99.5)	\$ (99.5)
Unrealized gains (losses) on derivative instruments	10.5	(42.1)	(20.2)
Unrealized losses on derivative instruments reclassified into earnings *	10.6	57.0	28.7
Ending accumulated unrealized loss on derivative instruments	<u>\$ (63.5)</u>	<u>\$ (84.6)</u>	<u>\$ (91.0)</u>

* Represents the portion reclassified into earnings for previously de-designated cash flow hedges.

Measurement of Fair Value

We utilize the market approach to measure the fair value for our derivative financial instruments. The market approach uses pricing models that rely on market observable inputs such as yield curves, currency exchange rates, forward prices, counterparty credit risk adjustments and non-performance risk, and therefore our derivative financial instruments have been classified as Level 2 in the fair value hierarchy.

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Fair Value of Other Financial Instruments:

The estimated carrying and fair values of our other financial instruments, excluding derivative instruments, were as follows:

	December 31, 2011		June 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 137.0	\$ 137.0	\$ 34.2	\$ 34.2	\$ 185.7	\$ 185.7
Senior secured credit facility:						
Term loan	3,293.8	2,804.3	3,311.0	2,971.6	3,328.2	3,135.8
Incremental term loan ⁽¹⁾	597.0	560.1	599.0	605.1	600.9	612.0
Revolving credit facility	-	-	24.0	21.6	-	-
10.50% Senior Notes due 2015 ⁽²⁾	1,209.5	863.1	1,208.4	1,119.1	1,207.3	1,259.7
13.25% Senior Subordinated Discount Notes due 2015	233.6	150.1	407.7	378.9	407.7	420.5
13.75% Senior PIK Notes due 2015 ⁽³⁾	127.0	81.6	140.4	112.9	131.4	126.1

⁽¹⁾ The carrying amount for the incremental term loan is presented net of the unamortized discount of \$6.1, \$7.3, and \$8.5 as of December 31, 2011, June 30, 2011 and December 31, 2010, respectively.

⁽²⁾ The carrying amount for the 10.50% Senior Notes due 2015 is presented net of the unamortized discount of \$6.1, \$7.2, and \$8.3 as of December 31, 2011, June 30, 2011 and December 31, 2010, respectively.

⁽³⁾ The carrying amount for the Senior PIK Notes included accrued interest of \$8.4 and \$7.8 as of June 30, 2011, and December 31, 2010, respectively.

10. INCOME TAXES

Our effective income tax rates for the three and six months ended December 31, 2011 were 48.5% and (9.1)% , respectively. Our effective income tax rates for the three and six months ended December 31, 2010 were 17.9% and (8.7)% , respectively. The increase in the effective income tax rate for the three months ended December 31, 2011 compared to the three months ended December 31, 2010 is attributable primarily to higher taxable income within state taxing jurisdictions where we have fully utilized our prior period losses or where the loss utilization is limited by local statute, and higher income in jurisdictions that are included in our effective income tax rate and lower income in jurisdictions that are not included in our effective income tax rate. Entities within certain jurisdictions are excluded from our effective income tax rate if they are projected to generate a loss for the year and the tax benefits of such losses are not anticipated to be realized in the foreseeable future.

11. FAIR VALUE MEASUREMENTS

The following table presents derivative liabilities that have been measured at fair value on a recurring basis. These were measured using Level 2 valuation techniques:

	December 31, 2011	June 30, 2011	December 31, 2010
Derivative liabilities	\$ 61.4	\$ 84.6	\$ 96.8

Our non-financial assets and liabilities, which include goodwill, intangible assets, property and equipment and restructuring liability in connection with the Boston lease, are not required to be measured at fair value on a recurring basis. However, if certain trigger events occur, or if an annual impairment test is required, we evaluate the non-financial assets and

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liabilities for impairment. If an impairment did occur, the asset or liability is required to be recorded at the estimated fair value. During the year ended June 30, 2011, we reduced our lease liability on the original Boston facility by \$2.3 as a result of securing sublessees that changed the amount of estimated sublease income. This liability was measured using Level 2 valuation techniques.

12. SUPPLEMENTAL CASH FLOW INFORMATION

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

	Six Months Ended	
	December 31,	
	2011	2010
Accounts receivable, net	\$ 67.8	\$ 124.3
Inventories	9.5	(13.8)
Prepaid expenses and other current assets	(3.0)	10.9
Accounts payable and accrued expenses	43.7	(31.6)
Accrued interest payable	(2.3)	(0.6)
Deferred revenue	34.7	10.2
Current taxes payable	12.7	2.8
Author advances, net	(13.1)	(3.0)
Other, net	0.3	1.5
	\$ 150.3	\$ 100.7

We accrued and capitalized interest expense on Senior PIK Notes of \$0.7 and \$8.5 for the six months ended December 31, 2011 and 2010, respectively.

We paid cash interest expense of \$185.7 and \$200.0 for the six months ended December 31, 2011 and 2010, respectively. Included within the debt purchases are repayments in lieu of interest of \$35.0 and \$4.4 for the six months ended December 31, 2011 and 2010, respectively.

13. RELATED PARTY TRANSACTIONS

Due to related party relationships, it is possible that the terms of the following transactions are not the same as those that would result from transactions among wholly unrelated parties.

From time to time, we, the Sponsors, entities controlled by our Sponsors or our affiliates may purchase our outstanding debt securities and/or bank loans, in privately negotiated or open market transactions, by tender or otherwise.

Transactions with our Sponsors

We are party to advisory fee agreements with our Sponsors (the “Advisory Fee Agreements”). Under these Advisory Fee Agreements, we are obligated to pay an aggregate annual fee of \$10.7, payable quarterly in advance on the first day of each quarter, in consideration for services to be provided. We are also obligated to pay associated out of pocket expenses incurred by our Sponsors.

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The following is a summary of our activity and balances with our Sponsors, including interest expense and interest payable on debt securities purchased:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2011	2010	2011	2010
Expenses	\$ 3.0	\$ 2.7	\$ 5.7	\$ 5.4
	December 31,	June 30,	December 31,	
	2011	2011	2010	
Accounts payable	\$ 0.4	\$ 0.1	-	

Transactions with Nelson Education, Ltd. (“Nelson”)

In November 2011, we entered into a distribution agreement with Nelson, under which Nelson is our exclusive authorized distributor, subject to certain exceptions, for the sale and distribution of certain Research print and digital products in Canada.

The following is a summary of our activity and balances with Nelson, including interest expense and interest payable on debt securities purchased:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2011	2010	2011	2010
Revenue from Nelson	\$ 6.0	\$ 6.5	\$ 16.3	\$ 17.1
Expenses to Nelson	0.8	0.4	1.5	1.5
	December 31,	June 30,	December 31,	
	2011	2011	2010	
Accounts receivable	\$ 4.4	\$ 8.4	\$ 3.9	
Accounts payable	0.3	0.1	0.3	

14. COMMITMENTS AND CONTINGENCIES

Claims, Disputes and Legal and Regulatory Actions

From time to time, we may become involved in various claims, disputes and legal or regulatory proceedings that arise in the ordinary course of business and related to contractual and other obligations. We assess our potential contingent and other liabilities by analyzing our claims, disputes and legal and regulatory matters using all available information, and develop our views on estimated losses in consultation with our legal and other advisors. We determine whether a loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. If the contingency is not probable or cannot be reasonably estimated, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss may have been incurred. Based on a review of the information available at this time, we do not expect the total cost of resolving current claims, disputes and legal and regulatory proceedings to have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Should developments in any of these matters cause a change in our determination as to an unfavorable outcome and result in the need to recognize a material accrual, or should any of these matters result in a final adverse judgment, settlement or other final resolution involving significant amounts they could have a material adverse effect on our financial position, results of operations and cash flows in the period or periods in which such change occurs.

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Warranties

Under our standard terms and conditions of sale, we warrant ownership of our products and provide certain warranties and indemnifications. We are not aware of any instances that would result in any material payments being made as a result of these warranties and indemnifications, and therefore, no reserve has been recorded in the Financial Statements.

15. SEGMENT INFORMATION

We maintain two reportable business segments:

Domestic - In the U.S., Cengage Learning produces a variety of print and digital educational solutions for students, instructors, educational institutions, libraries and professionals in the academic, career, school and professional markets, and digitally-enabled reference information, certification test preparation, compliance training and other learning and research tools for a broad range of customers. We also provide associated educational services to support the use of our products by our customers.

International - Cengage Learning distributes educational solutions across all major disciplines in multiple countries and territories around the globe. The majority of our revenue is derived from adaptations of domestic resources for various markets throughout the world. We also publish and sell indigenous course materials and provide learning, research and reference solutions in various formats to individuals and businesses located outside the U.S. In addition, we provide English language teaching products to meet the needs of the growing international market. Individual markets are generally defined by country, each with unique customer needs, distribution channels and sales strategies.

We evaluate the performance of our consolidated operating group as one business unit. However, since our domestic and international operating segments have dissimilar long-term economic characteristics, we present two reportable segments: Domestic and International. 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.

We disclose information about our reportable segments based on the measures we use in assessing the performance of those reportable segments. We use Adjusted EBITDA to measure the operating performance of our segments which represents Net income (loss) before: income (loss) from discontinued operations, net of tax; equity losses of affiliates, net of taxes; benefit from (provision for) income taxes; interest expense, net; mark-to-market of derivative instruments; gain on early extinguishment of debt; other (income) expense, net; amortization and impairment of identifiable intangible assets; impairment of goodwill; depreciation; restructuring charges and the amortization of pre-publication costs.

We include equity-based compensation, fees paid under Advisory Fee Agreements and other corporate-related expenses in a reporting line item referred to as "Corporate and other".

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Select financial information for our segments is as follows:

	Three Months Ended December 31,			
	2011		2010	
	Revenues	Adjusted EBITDA	Revenues	Adjusted EBITDA
Domestic	\$ 385.5	\$ 162.2	\$ 376.0	\$ 165.3
International	70.7	16.0	66.2	10.0
Segment totals	456.2	178.2	442.2	175.3
Corporate and other	-	(3.2)	-	(4.9)
Total	<u>\$ 456.2</u>	<u>\$ 175.0</u>	<u>\$ 442.2</u>	<u>\$ 170.4</u>

	Six Months Ended December 31,			
	2011		2010	
	Revenues	Adjusted EBITDA	Revenues	Adjusted EBITDA
Domestic	\$ 1,013.0	\$ 507.6	\$ 958.9	\$ 481.3
International	135.1	24.5	125.1	17.6
Segment totals	1,148.1	532.1	1,084.0	498.9
Corporate and other	-	(8.3)	-	(9.7)
Total	<u>\$ 1,148.1</u>	<u>\$ 523.8</u>	<u>\$ 1,084.0</u>	<u>\$ 489.2</u>

Segment revenues only include revenues from external customers. Total asset information by segment is not shown because it is not provided to or reviewed by our chief operating decision maker.

The following table reconciles Adjusted EBITDA to Net (loss) income per the Condensed Consolidated Statements of Operations:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Adjusted EBITDA	\$ 175.0	\$ 170.4	\$ 523.8	\$ 489.2
Less:				
Amortization of pre-publication costs	(36.1)	(30.0)	(91.2)	(72.8)
Restructuring charges	-	(0.9)	-	(3.4)
Depreciation	(12.7)	(11.0)	(26.1)	(21.7)
Amortization of identifiable intangible assets	(41.2)	(42.0)	(82.1)	(83.9)
Gain on early extinguishment of debt	-	-	42.2	1.9
Mark-to-market of derivative instruments	12.7	17.6	12.7	29.5
Interest expense, net	(104.5)	(120.3)	(202.8)	(244.2)
Provision for income taxes	(3.3)	(2.9)	(16.0)	(8.2)
Equity losses of affiliates, net of taxes	(0.9)	(0.3)	(2.3)	(1.0)
Loss from discontinued operations, net of tax	-	(3.6)	-	(3.8)
Net (loss) income	<u>\$ (11.0)</u>	<u>\$ (23.0)</u>	<u>\$ 158.2</u>	<u>\$ 81.6</u>

16. SUBSEQUENT EVENTS

There were no material subsequent events identified through February 02, 2012, the date these financial statements were issued.

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

The following Management's Discussion and Analysis ("MD&A") is intended to facilitate an understanding of the results of operations and financial condition of Cengage Learning Holdings II, L.P. and its consolidated subsidiaries (hereinafter collectively referred to as "Cengage Learning", "we", "us", "our", or the "Company"). We are controlled by investment funds associated with or designated by Apax Partners, L.P. ("Apax"), together with OMERS Private Equity, Inc. ("OMERS"), hereinafter collectively referred to as our "Sponsors".

This MD&A is provided as a supplement to, and should be read in conjunction with, our condensed consolidated financial statements and the accompanying notes ("Financial Statements") and our Annual Report for the Fiscal Year Ended June 30, 2011 (the "2011 Annual Report"). Certain historical amounts have been reclassified to conform with the current period's presentation. The following discussion and analysis of our financial condition and results of operations may contain 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*". The MD&A includes the following sections:

- Seasonality and Comparability
- Acquisitions
- Restructuring
- Non-GAAP Financial Measures
- Critical Accounting Policies
- Financial Performance
 - Executive Overview
 - Segment Operating Results
 - Consolidated Results of Operations
 - Liquidity and Capital Resources
 - Contractual Obligations and Commitments
 - Reconciliations of Non-GAAP Financial Measures

The Financial Performance discussion of our MD&A begins with an Executive Overview that summarizes our results of operations for the three and six months ended December 31, 2011, followed by a more detailed discussion of our Segment Operating Results and our Consolidated Results of Operations. The analysis of Segment Operating Results focuses primarily on revenues and Adjusted EBITDA, which are our key performance metrics for assessing segment performance. Since we manage the business and make decisions about resource allocations by segment, we believe that this discussion provides useful insights into our operating results consistent with the way we monitor our operations.

We also provide a discussion of our Consolidated Results of Operations, including a comprehensive analysis of our consolidated operating income from continuing operations, with insights into significant changes in the components of our expenses. Our discussion of changes in expenses focuses primarily on changes in the nature of the underlying expenses, and not on the changes in each individual financial statement line item in our Condensed Consolidated Statements of Operations. We believe that this provides better insight into the trends impacting our business than changes in individual financial statement line items since certain expenses are included in more than one line item. We also provide a discussion of significant non-operating income and expenses. We do not provide a separate analysis of changes in our consolidated revenues since these changes are consistent with those discussed in the Segment Operating Results section. Throughout the MD&A, our discussion of revenues includes gross sales measures by markets, which represents amounts invoiced to our customers. Gross sales are before any adjustments for sales returns provision or revenue deferral. We believe this measure provides investors with a more comprehensive understanding of our underlying revenue results and trends by presenting amounts invoiced on a consistent basis. In addition, we discuss 'digital product sales' which represents (i) revenue recognized on the sale of digital products that are not packaged with printed materials and (ii) gross sales, less actual returns, of bundled print and digital products where, we believe, that the value proposition to our customer is driven by the digital offering.

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Seasonality and Comparability

Our revenues, operating profit and operating cash flows are impacted by the inherent seasonality of the academic calendar. In addition, changes in customers' ordering patterns may impact the comparison of our results in a quarter with the same quarter of the previous year due to customers shifting the timing of material orders for a number of reasons, including, but not limited to, changes in academic semester start dates or changes in inventory management practices.

Acquisitions

On August 1, 2011, we completed the acquisition of National Geographic Society's School Publishing Unit ("NGSP") for an aggregate purchase price of \$80.0, consisting of \$72.0 in cash using funds borrowed under our revolving credit facility, and \$8.0 in deferred consideration which is included in "Other current liabilities" in the Condensed Consolidated Balance Sheet. The purchase consideration was subject to working capital adjustments which the parties finalized subsequent to December 31, 2011 and, as a result, additional consideration of \$2.6 was paid to National Geographic Society in January 2012.

In connection with the acquisition, we also agreed to pay additional consideration in the event that predefined annual revenue targets are exceeded for the first four calendar years following the consummation date of the acquisition. We estimate the fair value of this contingent consideration to be \$17.7.

The assets acquired represent National Geographic's print and digital school publishing unit, including its English language teaching products, the National Geographic Science series, National Geographic Explorer! magazines and Hampton Brown's literacy and language programs. Through this acquisition, we have expanded our rights to distribute National Geographic Society's content, including images, maps, videos and articles in the academic and library markets worldwide. The acquired net assets and results from operations have been included within our Domestic segment since the date of acquisition.

During the six months ended December 31, 2010, we acquired McGraw Hill's Australia Secondary School Business.

From time to time, we may complete acquisitions that are complementary to our business initiatives and represent a strategic fit with the vision of our company, but may not have a material impact on our results of operations.

Restructuring

During the six months ended December 31, 2010, we recorded \$3.4 in our Domestic segment for employee severance and related costs in connection with the consolidation of our domestic businesses. The restructuring payments were completed as of September 30, 2011.

See Note 7 "Restructuring" to our Financial Statements for further information.

Non-GAAP Financial Measures

To supplement our Financial Statements presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"), we have presented certain financial measures in addition to our GAAP results. We believe that these non-GAAP financial measures provide useful information for evaluating our business performance. This information should be considered supplemental in nature and should not be considered in isolation or as a substitute for the related financial information prepared in accordance with GAAP. In addition, these non-GAAP financial measures may not be the same as similarly titled measures reported by other companies.

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We present the following non-GAAP financial measures in this report:

Financial Measure	Definition
Adjusted EBITDA	Defined as Net income (loss) before: income (loss) from discontinued operations, net of tax; equity losses of affiliates, net of taxes; benefit from (provision for) income taxes; interest expense, net; mark-to-market of derivative instruments; gain on early extinguishment of debt; other (income) expense, net; amortization and impairment of identifiable intangible assets; impairment of goodwill; depreciation; restructuring charges and the amortization of pre-publication costs. We believe that this performance measure provides a meaningful basis for reviewing the results of our operations by eliminating the effects of financing and investing decisions, as well as excluding the impact of activities not related to our ongoing operating business.
Unlevered Free Cash Flow	Calculated as net cash provided by operating activities of continuing operations excluding net cash paid for interest and debt repayments in lieu of interest, reduced for cash expenditures relating to additions to pre-publication costs and additions to property, equipment and capitalized software for internal use, which we view as investments required to ensure the sustainability and continued growth of our business. We believe that this liquidity measure provides a clearer picture of the cash flow produced and reinvested by the ongoing business, before debt service.

See "Reconciliations of Non-GAAP Financial Measures" for reconciliations to the most directly comparable financial measures prepared in accordance with GAAP.

Critical Accounting Policies

There were no significant changes to our critical accounting policies during the six months ended December 31, 2011. For further information on our critical accounting policies, refer to our 2011 Annual Report.

Financial Performance

Executive Overview

The following section summarizes our results of operations for the three and six months ended December 31, 2011 compared to the three and six months ended December 31, 2010:

- Revenues for the three months ended December 31, 2011 increased by \$14.0, or 3.2%, to \$456.2, including \$21.3 from the acquisition of NGSP. The revenue growth is primarily in our Domestic segment as a result of the acquisition of NGSP, growth of digital product sales in earlier periods, which resulted in incremental recognition of revenue, and higher professional sales, partially offset by declines in career and academic sales. Revenues increased in the International segment across all markets.
- Revenues for the six months ended December 31, 2011 increased by \$64.1, or 5.9%, to \$1,148.1, including \$49.9 from the acquisition of NGSP and a \$3.9 favorable impact from foreign currency translation. The revenue growth is primarily in the Domestic segment as a result of the acquisition of NGSP and higher academic sales attributable to changes in customer ordering patterns and growth of digital product sales in earlier periods, which resulted in incremental recognition of revenue. Revenues increased in the International segment primarily due to growth in the academic market and the favorable impact of foreign currency translation.
- Operating income from continuing operations for the three months ended December 31, 2011 decreased by \$1.5, or 1.7%, to \$85.0, including the benefit from the acquisition of NGSP, primarily due to higher employee-related costs and an increase in amortization of pre-publication costs, partially offset by the contribution from higher revenues.

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- Operating income from continuing operations for the six months ended December 31, 2011 increased by \$17.0, or 5.5%, to \$324.4, including the benefit from the acquisition of NGSP, primarily due to the contribution from higher revenues and lower restructuring charges, partially offset by an increase in amortization of pre-publication costs, employee-related costs and depreciation expenses.
- Adjusted EBITDA for the three months ended December 31, 2011 increased by \$4.6, or 2.7%, to \$175.0. Adjusted EBITDA for the six months ended December 31, 2011 increased by \$34.6, or 7.1%, to \$523.8. The increase in Adjusted EBITDA for both periods includes the benefit from the acquisition of NGSP, contribution from higher revenues, partially offset by higher employee-related costs and higher general operating expenses.
- Net cash provided by operating activities of continuing operations for the six months ended December 31, 2011 increased by \$64.1, or 17.1%, to \$438.3, due to increased income from continuing operations and a higher contribution from working capital, including lower cash interest payments, partially offset by increase in debt payments in lieu of interest.
- Unlevered Free Cash Flow for the six months ended December 31, 2011 increased by \$79.0, or 16.8%, to \$549.8, primarily due to increased income from continuing operations and higher contribution from working capital.
- For the six months ended December 31, 2011, we purchased \$174.1 of the 13.25% Senior Subordinated Discount Notes due 2015 (the "Senior Subordinated Discount Notes") and \$14.1 of the 13.75% Senior PIK Notes due 2015 (the "Senior PIK Notes") resulting in a net gain of \$42.2. During the six months ended December 31, 2010, we purchased \$14.7 of the Senior PIK Notes that resulted in a net gain of \$1.9. See Note 8 "Debt" to our Financial Statements for further information.

Segment Operating Results

	Three Months Ended				Six Months Ended			
	December 31,		Change	Percentage	December 31,		Change	Percentage
	2011	2010			2011	2010		
Revenues:								
Domestic	\$ 385.5	\$ 376.0	\$ 9.5	2.5%	\$ 1,013.0	\$ 958.9	\$ 54.1	5.6%
International	70.7	66.2	4.5	6.8%	135.1	125.1	10.0	8.0%
	<u>\$ 456.2</u>	<u>\$ 442.2</u>	<u>\$ 14.0</u>	3.2%	<u>1,148.1</u>	<u>1,084.0</u>	<u>64.1</u>	5.9%
Adjusted EBITDA*:								
Domestic	\$ 162.2	\$ 165.3	\$ (3.1)	-1.9%	\$ 507.6	\$ 481.3	\$ 26.3	5.5%
International	16.0	10.0	6.0	60.0%	24.5	17.6	6.9	39.2%
Adjusted EBITDA Margin:								
Domestic	42.1%	44.0%	-1.9%		50.1%	50.2%	-0.1%	
International	22.6%	15.1%	7.5%		18.1%	14.1%	4.0%	

*Adjusted EBITDA: The aggregate of our two segments' Adjusted EBITDA does not equal our total Adjusted EBITDA because our segment profit measure of Adjusted EBITDA excludes equity-based compensation, fees paid to our Sponsors under advisory fee agreements and other corporate-related expenses, which are included in a reporting line item referred to as "Corporate and other".

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The Three Months Ended December 31, 2011 Compared with December 31, 2010

Domestic revenues for the three months ended December 31, 2011 increased by \$9.5, or 2.5%, primarily due to:

- \$21.3 from our acquisition of NGSP,
- \$5.2 net contribution from sales of deferrable products in earlier periods, and
- \$3.9 higher professional gross sales reflecting large orders received in the current quarter partially offset by lower sales of the 2011 *National Electrical Code* book that was released last year,

partially offset by:

- \$8.9 lower career gross sales reflecting continued unfavorable enrollment trends,
- \$5.8 lower academic gross sales primarily due to lower orders by our traditional bookstore customers, and
- \$3.5 related to the sales returns provision.

International revenues for the three months ended December 31, 2011 increased by \$4.5, or 6.8%, including a \$0.1 unfavorable impact from foreign currency. The increase comes from higher sales in Australia, reflecting an increase in export sales due to timing and growth in the academic market and higher sales in Asia due to growth primarily in the academic market.

Domestic Adjusted EBITDA for the three months ended December 31, 2011 decreased by \$3.1, or 1.9%, primarily due to \$7.0 increased employee-related costs, higher general operating expenses attributable to the inclusion of NGSP in our results and \$1.0 of NGSP-related integration costs, partially offset by the contribution from higher revenues. The increase in employee-related costs primarily results from the absence of a reversal of accrued incentive compensation in the prior year quarter.

International Adjusted EBITDA for the three months ended December 31, 2011 increased by \$6.0, or 60.0%, including a \$0.3 favorable impact from foreign currency translation. The increase is primarily attributable to the contribution from higher revenues, lower inventory obsolescence and distribution costs, as well as a \$1.1 early lease cancellation benefit, while general operating expenses remained unchanged compared to the prior year quarter.

The Six Months Ended December 31, 2011 Compared with December 31, 2010

Domestic revenues for the six months ended December 31, 2011 increased by \$54.1, or 5.6%, primarily due to:

- \$63.5 higher academic gross sales due to changes in customer ordering patterns at the end of fiscal 2011 and growth of digital product sales,
- \$49.9 from our acquisition of NGSP, and
- \$5.2 higher professional gross sales reflecting large orders received in the current period partially offset by lower sales of the 2011 *National Electrical Code* book that was released last year,

partially offset by:

- \$29.0 increase in sales returns provision reflecting mix of products sold and growth in volume,
- \$12.5 net deferral of revenue relating to deferrable products sales,
- \$9.9 lower career gross sales reflecting continued unfavorable enrollment trends,
- \$6.2 lower school gross sales primarily due to the cyclicity of state adoptions and public funding constraints, partially offset by higher open territory state sales, and
- \$5.6 lower research revenues primarily attributed to lower print sales reflecting the print publishing schedule and lower direct to consumer digital sales that were partially offset by higher e-book sales. These declines primarily reflected the impact of the continued funding challenges facing our customers.

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International revenues for the six months ended December 31, 2011 increased by \$10.0, or 8.0%, including a \$3.9 favorable impact from foreign currency translation primarily due to the Australian dollar, British pound, and Brazilian real. The remaining increase comes from higher sales primarily in Latin America, reflecting the growth in academic and English language teaching products, and higher sales in Asia across all markets, partially offset by a decrease in Australia due to the timing of school orders.

Domestic Adjusted EBITDA for the six months ended December 31, 2011 increased by \$26.3, or 5.5%, including the benefit from the acquisition of NGSP and the contribution from higher revenues. Partially offsetting this increase is \$9.7 higher employee-related costs and higher general operating expenses attributable to the inclusion of NGSP in our results, as well as \$1.0 of NGSP related integration costs. The increase in employee-related costs is also due, in part, to higher severance costs.

International Adjusted EBITDA for the six months ended December 31, 2011 increased by \$6.9, or 39.2%, including a \$1.1 favorable impact from foreign currency translation. The increase is primarily attributable to contribution from higher revenues, lower inventory obsolescence and distribution costs, as well as the \$1.1 early lease cancellation benefit, partially offset by \$2.3 higher employee-related costs.

Consolidated Results of Operations

The Three and Six Months Ended December 31, 2011 Compared with December 31, 2010

	Three Months Ended				Six Months Ended			
	December 31,		Change	Percentage Change	December 31,		Change	Percentage Change
	2011	2010			2011	2010		
Revenues	\$ 456.2	\$ 442.2	\$ 14.0	3.2%	\$ 1,148.1	\$ 1,084.0	\$ 64.1	5.9%
Operating income from continuing operations	85.0	\$ 86.5	(1.5)	-1.7%	324.4	307.4	17.0	5.5%
Gain on early extinguishment of debt	-	-	-	NM	42.2	1.9	40.3	NM
Mark-to-market of derivative instruments	12.7	17.6	(4.9)	-27.8%	12.7	29.5	(16.8)	-56.9%
Interest expense, net	(104.5)	(120.3)	15.8	-13.1%	(202.8)	(244.2)	41.4	-17.0%
Provision for income taxes	(3.3)	(2.9)	(0.4)	13.8%	(16.0)	(8.2)	(7.8)	95.1%
Equity losses of affiliates, net of taxes	(0.9)	(0.3)	(0.6)	NM	(2.3)	(1.0)	(1.3)	NM
(Loss) income from continuing operations	<u>\$ (11.0)</u>	<u>\$ (19.4)</u>	<u>\$ 8.4</u>	-43.3%	<u>\$ 158.2</u>	<u>\$ 85.4</u>	<u>\$ 72.8</u>	85.2%
Adjusted EBITDA	<u>\$ 175.0</u>	<u>\$ 170.4</u>	<u>\$ 4.6</u>	2.7%	<u>\$ 523.8</u>	<u>\$ 489.2</u>	<u>\$ 34.6</u>	7.1%
Adjusted EBITDA Margin	<u>38.4%</u>	<u>38.5%</u>	<u>-0.2%</u>		<u>45.6%</u>	<u>45.1%</u>	<u>0.5%</u>	

NM = Not meaningful

Operating income from continuing operations for the three months ended December 31, 2011 decreased by \$1.5, or 1.7%, to \$85.0 primarily due to:

- \$7.2 higher employee-related costs, primarily relating to the absence of the reversal of accrued incentive compensation in fiscal 2011 and the acquisition of NGSP,
- \$6.1 higher amortization of pre-publication costs as a result of higher revenue, increased investment and amortization of pre-publication costs assumed in connection with the acquisition, and
- \$2.5 higher variable costs and selling costs associated with the higher revenues,

partially offset by:

- \$14.0 higher revenues discussed within our Segment Operating Results.

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Operating income from continuing operations for the six months ended December 31, 2011 increased by \$17.0, or 5.5%, to \$324.4 primarily due to:

- \$64.1 higher revenues discussed within our Segment Operating Results and
- \$3.4 lower restructuring charges,

partially offset by:

- \$18.4 higher amortization of pre-publication costs as a result of higher revenue, increased investment and amortization of pre-publication costs acquired in connection with the acquisition,
- \$15.9 higher variable costs and selling costs associated with the higher revenues,
- \$12.0 higher employee-related costs, primarily due the acquisition and increases in severance, and
- \$4.4 higher depreciation expense primarily due to increased investment in capitalized software for internal use.

Gain on early extinguishment of debt increased by \$40.3 to \$42.2 during the six months ended December 31, 2011, due to the purchase of \$174.1 of the Senior Subordinated Discount Notes and \$14.1 of the Senior PIK Notes resulting in a net gain of \$42.2. During the six months ended December 31, 2010, we purchased and retired \$14.7 of the Senior PIK Notes that resulted in a net gain of \$1.9. See Note 8 "Debt" to our Financial Statements for further information.

Mark-to-market of derivative instruments decreased by \$4.9, or 27.8%, to \$12.7 for the three months ended December 31, 2011, and decreased by \$16.8, or 56.9%, to \$12.7 for the six months ended December 31, 2011. Effective October 1, 2011, we de-designated our interest rate swaps for cash flow hedge accounting purposes. The prior year period reflects six months of unrealized gains compared to only three months for the current year period.

Interest expense, net decreased by \$15.8, or 13.1%, to \$104.5 for the three months ended December 31, 2011, and decreased by \$41.4 or 17.0% to \$202.8 for the six months ended December 31, 2011, primarily due to lower interest on our term loan, reflecting the impact of the lower fixed rate component of our interest rate swaps that went into effect as of July 2011, lower LIBOR interest rates on the un-hedged component of our term loan and a lower non-cash interest associated with the de-designated interest rate swaps, coupled with reduced interest on the Senior Subordinated Discount Notes resulting from the repurchases of such debt in previous periods.

Provision for income taxes for the three and six months ended December 31, 2011 was \$3.3 and \$16.0, respectively. Our provision for income taxes for the three and six months ended December 31, 2010 was \$2.9 and \$8.2, respectively. Our effective income tax rates changed to 48.5% and (9.1)% for the three and six months ended December 31, 2011, respectively, from 17.9% and (8.7)% for the three and six months ended December 31, 2010, respectively.

The increase in our income tax provision and effective income tax rates resulted primarily from the generation of taxable income within state taxing jurisdictions where we have fully utilized our prior period losses or where the loss utilization is limited by local statute, and higher income in jurisdictions that are included in our effective income tax rate and lower income in jurisdictions that are not included in our effective income tax rate. Entities within certain jurisdictions are excluded from our effective income tax rate if they are projected to generate a loss for the year and the tax benefits of such losses are not anticipated to be realized in the foreseeable future.

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Liquidity and Capital Resources

	<u>December 31,</u> <u>2011</u>	<u>June 30,</u> <u>2011</u>	<u>December 31,</u> <u>2010</u>
Cash and cash equivalents	\$ 137.0	\$ 34.2	\$ 185.7
Available under the revolving credit facility	297.4	273.4	293.7
Short-term borrowings and current portion of long-term debt	112.8	64.7	40.7
Long-term debt	5,348.1	5,625.8	5,634.8

Our liquidity and the ability to service our debt, as well as fund future acquisitions, other purchase commitments, operating leases, 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. There can be no assurance that our business will generate sufficient cash flow from operations, that anticipated net sales growth and operating improvements will be realized or that future borrowings will be available under our revolving credit facility, or any other facility, in an amount sufficient to enable us to service our indebtedness or to fund our other liquidity needs.

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, scheduled debt principal repayments, authorized debt purchases and capital spending over the next twelve months. To the extent that additional liquidity is necessary to fund our operations, we expect it would be funded through the incurrence of additional indebtedness, additional equity financings or a combination of these potential sources of liquidity. Our liquidity and the ability to fund our operations, debt service requirements, projected working capital requirements, restructuring obligations, scheduled debt principal repayments and capital spending beyond the next twelve months will be dependent upon our cash flows from operations and the availability of borrowings under our existing revolving credit facility. In addition, we will need to refinance or restructure our current debt obligations, potentially incur new indebtedness, secure additional equity financings or implement a combination of these strategies.

We continue to review the adequacy of our liquidity by performing various stress test scenarios. Furthermore, we continue to closely monitor current events and the financial institutions that support our credit facilities, including monitoring their credit ratings and outlooks, credit default swap levels, capital raising and merger activity. If additional financing were required, however, the credit markets may limit or prevent our ability to obtain additional liquidity on terms acceptable to us, or at all. Adverse changes to our credit ratings may also increase our borrowing costs for future long-term or short-term borrowing facilities and may limit our financing options in the future.

We, our Sponsors, entities controlled by our Sponsors and our affiliates have in the past and may in the future, depending on market conditions and prices, contractual restrictions, our financial liquidity, and other factors, purchase our outstanding debt securities and/or bank loans, in privately negotiated or open market transactions, by tender or otherwise. Any such purchases directly by us may be funded by cash available from operations or incurring new debt, including additional borrowings under our revolving credit facility. In addition, any new debt may require collateralization.

Our operating cash flows are impacted by the inherent seasonality of our business whereby we typically generate operating cash during the first half of our fiscal year and utilize cash for operating activities throughout the second half of our fiscal year. Consequently, in addition to any other liquidity requirements, the borrowings under our revolving credit facility may vary according to this seasonality.

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The following table sets forth our cash flows from operating, investing and financing activities and Unlevered Free Cash Flow:

	Six Months Ended		Change	Percentage Change
	December 31,			
Statements of Cash Flows	2011	2010		
Net cash provided by (used in) continuing operations:				
Net cash provided by operating activities	\$ 438.3	\$ 374.2	\$ 64.1	17.1%
Net cash used in investing activities	(180.6)	(120.6)	(60.0)	49.8%
Net cash used in financing activities	(154.3)	(94.8)	(59.5)	62.8%
Net cash used in discontinued operations	-	(0.7)	0.7	-100.0%
Impact on cash and cash equivalents from changes in foreign currency	(0.6)	0.6	(1.2)	NM
Net increase in cash and cash equivalents	<u>\$ 102.8</u>	<u>\$ 158.7</u>	<u>\$ (55.9)</u>	-35.2%
Unlevered Free Cash Flow	<u>\$ 549.8</u>	<u>\$ 470.8</u>	<u>\$ 79.0</u>	16.8%

NM = Not meaningful

Operating activities. Net cash provided by operating activities of continuing operations for the six months ended December 31, 2011 increased by \$64.1, or 17.1%, due to \$72.8 increased income from continuing operations and \$49.6 higher contribution from working capital, including \$14.3 lower cash interest payments, partially offset by \$30.6 increase in debt repayments in lieu of interest. The higher contribution from working capital was driven by a \$75.3 higher increase in accounts payable and accrued expenses primarily due to higher incentive payments during the six months ended December 31, 2010 and \$20.5 higher increase in accrued royalties, \$24.5 higher increase in deferred revenue and \$23.3 higher decrease in inventory, partially offset by a \$56.5 lower decrease in accounts receivable. The changes in accounts receivable, accrued royalties, deferred revenue and inventory all result from growth and timing of revenues during the six months ended December 31, 2011.

Investing activities. Net cash used in investing activities of continuing operations for the six months ended December 31, 2011 increased by \$60.0. Included in the six months ended December 31, 2011 was the acquisition of NGSP, while included in the six months ended December 31, 2010 was the acquisition of McGraw Hill's secondary school titles and payments associated with the disposal of our distance learning businesses, all located in Australia. Investments in pre-publication costs and property, equipment, and capitalized software for internal use were generally unchanged compared to prior year.

Financing activities. Net cash used in financing activities of continuing operations for the six months ended December 31, 2011 increased by \$59.5, or 62.8%. Included in the six months ended December 31, 2011 were: (i) \$20.3 of principal payments on our term loans, (ii) \$110.0 associated with the purchase of Senior Subordinated Discount Notes and Senior PIK Notes and (iii) borrowings of \$265.0 and repayments of \$289.0 under our revolving credit facility. Included in the six months ended December 31, 2010 were: (i) \$20.3 of principal payments on our term loans, (ii) \$8.1 associated with the purchase of Senior PIK Notes and (iii) borrowings of \$145.0 and repayments of \$211.0 under our revolving credit facility.

Unlevered Free Cash Flow. Unlevered Free Cash Flow increased \$79.0, or 16.8%, to \$549.8 for the six months ended December 31, 2011, primarily due to increased income from continuing operations and higher contribution from working capital.

Covenant Compliance

Under the terms of our debt agreements, we are required to comply with certain customary covenants, including a requirement to maintain specified financial ratios. Our ability to meet these required ratios may be affected by events beyond our control. As of December 31, 2011, we were in compliance with all of these covenants.

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Under our Senior Secured Credit Facility, we have one primary financial maintenance covenant, which requires us to maintain a senior secured leverage ratio of not greater than 7.75. The senior secured leverage ratio is equal to the amount of our Senior Secured Debt divided by our Bank EBITDA, both of which are defined by the terms of the Senior Secured Credit Facility. Senior Secured Debt and Bank EBITDA are not presentations made in accordance with GAAP. They also should not be considered alternatives to GAAP-based profit measures, balance sheet amounts or cash flows or as indicators of the amount of free cash flow available for discretionary use by management. Furthermore, because all companies and their respective debt agreements do not use identical calculations, amounts reflected by us as Senior Secured Debt and Bank EBITDA may not be comparable to similarly titled measures by other companies.

Senior Secured Debt includes all borrowings secured by a lien at December 31, 2011 of \$3,896.9, less the average aggregate cash and cash equivalent balance over the preceding four quarters of \$70.3. At December 31, 2011, our Senior Secured Debt was \$3,826.6. A reconciliation of Net income for the twelve months ended December 31, 2011 to Bank EBITDA for the twelve months ended December 31, 2011, is presented below:

	Twelve Months Ended December 31, 2011
	\$
Net income	39.9
Adjustments:	
Provision for income taxes	45.5
Interest expense	439.7
Interest income	(0.6)
Mark-to-market of derivative instruments	(46.7)
Gain on early extinguishment of debt	(42.2)
Amortization of identifiable intangible assets	165.7
Depreciation	51.7
Amortization of pre-publication costs	160.6
Non-cash equity-based compensation	6.7
Sponsor management fee	10.7
Pro forma run rate cost savings	5.6
Pro forma EBITDA from acquisitions	10.8
Restructuring, integration and business optimization expenses	7.4
Other	3.8
Bank EBITDA	\$ 858.6

Our senior secured leverage ratio was 4.46 at December 31, 2011. A hypothetical 10% decline in our Bank EBITDA, as defined by the terms of our Senior Secured Credit Facility, would reduce Bank EBITDA to \$772.7 and result in a senior secured leverage ratio of 4.95.

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Contractual Obligations and Commitments

During the six months ended December 31, 2011, we purchased \$174.1 of Senior Subordinated Discount Notes and \$14.1 of Senior PIK Notes. Following the debt purchases, our mandatory principal redemptions in July 2012 are \$72.1, which are calculated in accordance with the applicable high yield discount obligation regulations issued by the U.S. Internal Revenue Service. Future mandatory debt principal payments associated with these notes are zero for the remainder of fiscal 2012, \$72.1 for fiscal years 2013-2014, and \$288.5 for fiscal years 2015-2016. As a result of these debt purchases, interest payments on our outstanding debt was reduced by \$11.5 for fiscal 2012, \$44.7 for fiscal years 2013-2014, and \$32.1 for fiscal years 2015-2016.

On August 1, 2011, we completed the acquisition of NGSP. In connection with this acquisition, we recorded \$13.9 in "Other current liabilities" for both the deferred consideration and current portion of contingent consideration. An additional amount of \$11.8 of estimated contingent consideration is included in "Other non-current liabilities".

Reconciliations of Non-GAAP Financial Measures

The following table reconciles Net (loss) income to Adjusted EBITDA:

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2011	2010	2011	2010
Net (loss) income	\$ (11.0)	\$ (23.0)	\$ 158.2	\$ 81.6
Adjustments:				
Loss from discontinued operations, net of tax	-	3.6	-	3.8
Equity losses of affiliates, net of taxes	0.9	0.3	2.3	1.0
Provision for income taxes	3.3	2.9	16.0	8.2
Interest expense, net	104.5	120.3	202.8	244.2
Mark-to-market of derivative instruments	(12.7)	(17.6)	(12.7)	(29.5)
Gain on early extinguishment of debt	-	-	(42.2)	(1.9)
Amortization of identifiable intangible assets	41.2	42.0	82.1	83.9
Depreciation	12.7	11.0	26.1	21.7
Restructuring charges	-	0.9	-	3.4
Amortization of pre-publication costs	36.1	30.0	91.2	72.8
Adjusted EBITDA	<u>\$ 175.0</u>	<u>\$ 170.4</u>	<u>\$ 523.8</u>	<u>\$ 489.2</u>

The following table reconciles net cash provided by operating activities to Unlevered Free Cash Flow:

	Six Months Ended		Change	Percentage Change
	December 31,			
	2011	2010		
Net cash provided by operating activities of continuing operations	\$ 438.3	\$ 374.2	\$ 64.1	17.1%
Add back:				
Net cash interest paid	185.7	200.0	(14.3)	-7.2%
Repayments of long-term debt, in lieu of interest	35.0	4.4	30.6	NM
Additions to pre-publication costs	(79.4)	(76.5)	(2.9)	3.8%
Additions to property, equipment and capitalized software for internal use	(29.8)	(31.3)	1.5	-4.8%
Unlevered Free Cash Flow	<u>\$ 549.8</u>	<u>\$ 470.8</u>	<u>\$ 79.0</u>	16.8%

NM = Not meaningful

CENGAGE LEARNING HOLDINGS II, L.P.

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 in accordance with authoritative guidance. However, certain of these instruments may not qualify for, or we may choose not to elect, 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 markets during the period.

Periodically we may enter into derivative contracts, including interest rate and cross currency interest rate swap agreements and interest rate caps and 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. Our 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 at the time of the execution. We manage credit risk through the continuous monitoring of exposures to such counterparties.

We continue to review liquidity sufficiency by performing various stress test scenarios. Furthermore, we continue to closely monitor current events and the financial institutions that support our credit facility, including monitoring their credit ratings and outlooks, credit default swap levels, capital raising and merger activity.

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CONTROLS AND PROCEDURES

Our management is responsible for the integrity and objectivity of all information presented in this report. The condensed consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America and include amounts based on our best estimates and judgments. We believe the condensed consolidated financial statements fairly reflect the form and substance of transactions and that the financial statements fairly represent our financial position and results of operations.

As of the end of the period covered by this report, we were not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended. Since this report is not filed with the Securities Exchange Commission, we are not required to conduct an evaluation (as required under Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), under the supervision and with the participation of the principal executive officer and principal financial officer, of our “disclosure controls and procedures” (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act).

LEGAL PROCEEDINGS

We know of no material, existing or pending litigation or other legal proceedings against our Company, nor are we involved as a plaintiff in any material proceeding or pending litigation. There is no litigation or other legal proceedings in which any of our directors, officers or affiliates, or any registered or beneficial shareholder, is an adverse party or has a material interest adverse to our interest.

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

	Six Months Ended	
	December 31,	
	2011	2010
Fixed Charges		
Interest expense	\$ 202.9	\$ 244.5
Portion of rental expense which represents interest factor	4.7	3.9
Total fixed charges	\$ 207.6	\$ 248.4
Earnings available for fixed charges		
Earnings ⁽¹⁾	\$ 176.5	\$ 94.6
Add fixed charges ⁽²⁾	207.6	248.4
Total earnings available for fixed charges	\$ 384.1	\$ 343.0
Ratio of earnings to fixed charges	1.85	1.38

⁽¹⁾ Earnings are comprised of income from continuing operations before taxes and equity losses of affiliates.

⁽²⁾ Fixed charges include: interest expense, whether expensed or capitalized, amortization of debt issuance cost and the portion of rental expense representative of the interest factor.

Our earnings in accordance with the SEC definition under Item 503(d) of Regulation S-K were adequate to cover fixed charges for the six months ended December 31, 2011 and 2010.