



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

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

Second Quarter Report
Three and Six Months Ended
December 31, 2007

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 quarterly report, Cengage Learning Holdings II L.P. was not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended. Consequently, this quarterly 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 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 quarterly 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 December 31, 2007 (Successor) and
for the Three Months Ended December 31, 2007 (Successor),
the Period July 5, 2007 to December 31, 2007 (Successor),
the Period July 1, 2007 to July 4, 2007 (Predecessor) and
the Three and Six Months Ended December 31, 2006 (Predecessor)
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CENGAGE LEARNING HOLDINGS II L.P.
(AS SUCCESSOR TO THOMSON LEARNING)
Consolidated Balance Sheet at December 31, 2007 (Successor)
and Combined Balance Sheet at June 30, 2007 (Predecessor)
(UNAUDITED)
(in thousands of U.S. dollars unless otherwise indicated)

	<u>Successor</u> <u>December 31,</u> <u>2007</u>	<u>Predecessor</u> <u>June 30,</u> <u>2007</u>
Assets		
Cash and cash equivalents	\$ 252,392	\$ 18,774
Accounts receivable, net	371,386	236,693
Notes receivable from TOC (Predecessor)	-	23,820
Inventories	167,353	185,476
Deferred tax assets	-	57,461
Prepaid expenses and other current assets	54,106	40,611
Total current assets	<u>845,237</u>	<u>562,835</u>
Property, equipment and capitalized software for internal use, net	161,593	150,306
Pre-publication costs, net	212,684	233,862
Author advances, net	32,617	24,809
Identifiable intangible assets, net	3,137,736	572,325
Goodwill	4,248,625	1,387,943
Deferred tax assets	-	4,760
Deferred financing costs	84,636	-
Other non-current assets	22,999	17,817
Total assets	<u>\$ 8,746,127</u>	<u>\$ 2,954,657</u>
Liabilities and Owners' Equity		
Accounts payable and accrued expenses	\$ 327,096	\$ 241,186
Accrued interest	64,680	-
Deferred revenue	158,649	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	17,241	12,355
Other current liabilities	46,661	22,136
Total current liabilities	<u>648,727</u>	<u>1,164,270</u>
Long-term debt	5,600,130	14,915
Deferred tax liabilities	823,360	310,949
Other non-current liabilities	78,853	10,760
Total liabilities	<u>7,151,070</u>	<u>1,500,894</u>
Commitments, contingencies and guarantees (Note 14)		
Net investment of TOC (Predecessor)	-	1,402,513
Partners' capital (Successor)	1,681,354	-
Accumulated other comprehensive (loss) income	(86,297)	51,250
Total liabilities and owners' equity	<u>\$ 8,746,127</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 December 31, 2007 (Successor)
and Combined Statement of Operations for the Three Months ended December 31, 2006 (Predecessor)
(UNAUDITED)
(In thousands of U.S. dollars unless otherwise indicated)

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>December 31,</u> <u>2007</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>December 31,</u> <u>2006</u>
Revenues:		
Products	\$ 393,835	\$ 380,009
Services and other	102,430	122,457
Total revenues	<u>496,265</u>	<u>502,466</u>
Cost of revenues, excluding depreciation stated below:		
Products	183,621	174,501
Services and other	27,137	22,766
Amortization of pre-publication costs	32,839	33,210
Total cost of revenues, excluding depreciation stated below	<u>243,597</u>	<u>230,477</u>
Selling, general & administrative, excluding depreciation stated below	104,629	112,756
Allocation of management costs from TOC (Note 20)	-	14,307
Depreciation	14,882	14,395
Amortization and impairment of identifiable intangible assets	55,653	13,460
Total costs and expenses	<u>418,761</u>	<u>385,395</u>
Operating income	77,504	117,071
Gain on sale of equity investee	844	-
Gain on nonmonetary transaction	-	1,289
Interest expense with TOC	-	(4,615)
Interest income	2,604	12
Interest expense	<u>(145,047)</u>	<u>(1,362)</u>
(Loss) income before taxes	(64,095)	112,395
Provision for income taxes	(10,913)	(44,689)
Equity losses of investees, net of taxes	(645)	(1,355)
Net (loss) income	<u>\$ (75,653)</u>	<u>\$ 66,351</u>

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CENGAGE LEARNING HOLDINGS II L.P.
(AS SUCCESSOR TO THOMSON LEARNING)
Consolidated Statement of Operations for the Period July 5, 2007 to December 31, 2007 (Successor) and
Combined Statement of Operations for the Period July 1, 2007 to July 4, 2007 (Predecessor)
and the Six Months ended December 31, 2006 (Predecessor)
(UNAUDITED)
(In thousands of U.S. dollars unless otherwise indicated)

	<u>Successor</u>	<u>Predecessor</u>	
	<u>Period</u> <u>July 5, 2007 to</u> <u>December 31,</u> <u>2007</u>	<u>Period</u> <u>July 1, 2007 to</u> <u>July 4,</u> <u>2007</u>	<u>Six Months</u> <u>Ended</u> <u>December 31,</u> <u>2006</u>
Revenues:			
Products	\$ 916,329	\$ 16,249	\$ 888,042
Services and other	211,401	2,427	232,112
Total revenues	<u>1,127,730</u>	<u>18,676</u>	<u>1,120,154</u>
Cost of revenues, excluding depreciation stated below:			
Products	388,744	7,099	378,456
Services and other	55,803	1,002	48,237
Amortization of pre-publication costs	76,950	862	79,389
Total cost of revenues, excluding depreciation stated below	<u>521,497</u>	<u>8,963</u>	<u>506,082</u>
Selling, general & administrative, excluding depreciation stated below	201,636	5,001	216,631
Allocation of management costs from TOC (Note 20)	-	821	25,887
Depreciation	28,452	641	27,984
Amortization and impairment of identifiable intangible assets	110,945	308	23,472
Total costs and expenses	<u>862,530</u>	<u>15,734</u>	<u>800,056</u>
Operating income	265,200	2,942	320,098
Gain on sale of equity investee	844	-	-
Gain on nonmonetary transaction	-	-	1,289
Interest income (expense) with TOC	-	6	(15,625)
Interest income	3,507	3	24
Interest expense	<u>(276,742)</u>	<u>-</u>	<u>(2,888)</u>
(Loss) income before taxes	(7,191)	2,951	302,898
Provision for income taxes	(12,512)	(1,095)	(118,629)
Equity losses of investee, net of taxes	(2,017)	(63)	(2,933)
Net (loss) income	<u>\$ (21,720)</u>	<u>\$ 1,793</u>	<u>\$ 181,336</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 December 31, 2007 (Successor) and
Combined Statement of Cash Flows for the Period July 1, 2007 to July 4, 2007 (Predecessor)
and the Six Months ended December 31, 2006 (Predecessor)
(UNAUDITED)
(In thousands of U.S. dollars unless otherwise indicated)

	<u>Successor</u>	<u>Predecessor</u>	
	<u>Period July 5, 2007 to December 31, 2007</u>	<u>Period July 1, 2007 to July 4, 2007</u>	<u>Six Months Ended December 31, 2006</u>
Cash Flows from Operating Activities			
Net (loss) income	\$ (21,720)	\$ 1,793	\$ 181,336
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Amortization of pre-publication costs	76,950	862	79,389
Depreciation	28,452	641	27,984
Amortization of identifiable intangible assets	110,945	308	23,472
Amortization of debt discounts and deferred financing costs	32,977	-	-
Non-cash interest on Senior Bridge Loan Facility	36,226	-	-
Non-cash interest on interest rate swaps	3,694	-	-
Provision for deferred taxes	261	826	34,326
Equity losses of investees, net of taxes	2,017	63	2,933
Gain on sale of equity investee	(844)	-	-
Changes in working capital and other items, net of acquisitions	113,166	3,565	32,541
Increase in author advances	(7,793)	-	(8,555)
Other, net	2,874	(91)	953
Net cash provided by operating activities	<u>377,205</u>	<u>7,967</u>	<u>374,379</u>
Cash Flows from Investing Activities			
Acquisitions of business, less cash therein	(7,209,210)	-	(20,399)
Proceeds from sale of equity investee	2,000	-	-
Capital infusion into equity investee	-	-	(5,222)
Additions to pre-publication costs	(56,116)	(8)	(63,441)
Additions to property, equipment and capitalized software for internal use	(18,636)	-	(26,987)
Proceeds from disposition of property, equipment and capitalized software for internal use	204	-	16
Other, net	(20)	-	(84)
Net cash used by investing activities	<u>(7,281,778)</u>	<u>(8)</u>	<u>(116,117)</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 other debt and capital lease obligation	(34,622)	-	(15,019)
Capital contribution	1,703,074	-	-
Change in cash overdrafts	(15,902)	(6,908)	6,509
Repayments from notes payable/receivable to TOC, net	-	(5,186)	(252,933)
Increase in net investment of TOC	-	392	12,925
Net cash provided (used) by financing activities	<u>7,141,841</u>	<u>(11,702)</u>	<u>(248,518)</u>
Impact on Cash and Cash Equivalents from Change in Foreign Currency	<u>93</u>	<u>-</u>	<u>1,362</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>237,361</u>	<u>(3,743)</u>	<u>11,106</u>
Cash and Cash Equivalents			
Beginning of period	15,031	18,774	24,950
End of period	<u>\$ 252,392</u>	<u>\$ 15,031</u>	<u>\$ 36,056</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 Statement of Owners' Equity and Comprehensive Income
for the Six Months Ended December 31, 2006 (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	13,857	-	13,857	
Net income	181,336	-	181,336	\$ 181,336
Foreign currency translation adjustment	-	11,182	11,182	11,182
Unrealized gain on derivative instruments	-	224	224	224
Comprehensive income				<u>\$ 192,742</u>
December 31, 2006	<u>\$ 1,628,724</u>	<u>\$ 45,724</u>	<u>\$ 1,674,448</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 December 31, 2007 (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	Comprehensive Loss
July 5, 2007	\$ -	\$ -	\$ -	\$ -	\$ -	
Capital contribution on July 5, 2007 ⁽¹⁾	-	1,703,074	1,703,074	-	1,703,074	
Net loss	-	(21,720)	(21,720)	-	(21,720)	\$ (21,720)
Foreign currency translation adjustment	-	-	-	8,302	8,302	8,302
Unrealized loss on derivative instruments	-	-	-	(94,599)	(94,599)	(94,599)
Comprehensive loss						<u>\$ (108,017)</u>
December 31, 2007	<u>\$ -</u>	<u>\$ 1,681,354</u>	<u>\$ 1,681,354</u>	<u>\$ (86,297)</u>	<u>\$ 1,595,057</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 December 31, 2007 and the period July 5, 2007 to December 31, 2007) is the successor to Thomson Learning, which was comprised of wholly-owned indirect subsidiaries and divisions of The Thomson Corporation (“TOC”) managed together by a single management team (hereinafter collectively referred to as “Thomson Learning” or “Predecessor” for the six month period ended December 31, 2006 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 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 \$2,000 during the four day period ended July 4, 2007 and the six months ended December 31, 2006, respectively, and have been recorded in “Selling, general & administrative, excluding depreciation”.

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 cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments (the "Acquisition") pursuant to a stock and asset purchase agreement (the "Acquisition Agreement").

The Acquisition was financed through (i) a common equity capital contribution of \$1,703.1 million (the "Equity Contribution") and (ii) \$5,580.2 million in aggregate gross proceeds of debt financing, less \$90.9 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 December 31, 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 (See Note 8. "Property, Equipment and Capitalized Software for Internal Use").

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.

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(AS SUCCESSOR TO THOMSON LEARNING)
Notes to Consolidated and Combined Financial Statements
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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
Transaction costs (a)	58.6
Retirement of U.K. pension obligation (b)	40.2
Total preliminary allocable purchase price	\$ 7,207.7
 Estimated Allocation of Purchase Price⁽¹⁾ (in millions)	
Company net assets as of July 5, 2007	\$ 1,458.2
Assets and liabilities retained by TOC, net (c)	732.2
Deferred tax adjustments (d)	101.4
Historical net investment of TOC as adjusted for assets and liabilities not acquired	2,291.8
Purchase accounting adjustments:	
Reverse historical intangibles and goodwill (e)	(1,962.0)
Deferred taxes relating to purchase accounting (f)	(674.6)
Deferred revenue	36.0
Fair value adjustments to property, equipment and capitalized software for internal use	26.7
Other, net	0.6
	(281.5)
Identifiable intangible assets (g)	3,249.0
Goodwill (h)	4,240.2
	\$ 7,207.7

⁽¹⁾ As of December 31, 2007.

- (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.
- (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.

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Notes to Consolidated and Combined Financial Statements
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- (e) Historical intangibles 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.
- (g) Based on management's estimate including management's consideration of preliminary external valuation of identifiable intangible assets consisting primarily of content and customer relationships with a weighted average life of 19 years.
- (h) Represents the excess purchase price over the estimated fair value of net identifiable assets acquired. Goodwill is attributable to Cengage Learning's three segments. Approximately \$1,394 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 December 31, 2007 and the period July 5, 2007 to December 31, 2007 amounted to approximately \$200 and \$400, 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 December 31, 2007 and the period July 5, 2007 to December 31, 2007 amounted to \$685 and \$1,361, 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 Plans" and Note 17, "Stock-Based Compensation". Post Acquisition, the Company did not retain any obligations under, or liabilities with respect to, these plans.

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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 six months ended December 31, 2007 and 2006, 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.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
Revenue	\$ 496,265	\$ 496,724	\$ 1,146,406	\$ 1,116,519
Operating income	77,504	59,200	265,739	202,941
Net loss	(75,653)	(94,769)	(27,327)	(91,840)

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 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.

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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 electronic resources. Services and other revenues include revenues from the delivery of content in electronic format and administrative services (e.g., distribution, warehousing and payroll). 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: Most of Cengage Learning's accounts receivable are due from universities, bookstores, students, libraries, professionals and corporations. Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Accounts receivable are reflected net of an allowance for doubtful accounts and sales returns of \$180,789 and \$118,028 at December 31, 2007 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.

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

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

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 December 31, 2007 and the period July 5, 2007 to December 31, 2007 exclude the benefit of losses in the United States of America as well as selected foreign jurisdictions in which the Company anticipates providing a full valuation allowance against the loss carry-forward.

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 our tax planning strategies. Assumptions used in estimating our 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

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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. 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 is currently evaluating the impact of this standard on its Financial Statements.

In December 2007, the FASB also issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. This guidance requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. SFAS No. 160 is effective as of the beginning of the first fiscal year after December 15, 2008. Cengage Learning is currently evaluating the impact of this standard on its Financial Statements.

7. INVENTORIES

Inventories consist of the following:

	<u>Successor</u> <u>December 31,</u> <u>2007</u>	<u>Predecessor</u> <u>June 30,</u> <u>2007</u>
Raw materials	\$ 5,669	\$ 7,955
Work-in-progress	2,558	4,534
Finished goods	<u>175,973</u>	<u>234,279</u>
	184,200	246,768
Obsolescence reserve	<u>(16,847)</u>	<u>(61,292)</u>
Inventories, net	<u>\$ 167,353</u>	<u>\$ 185,476</u>

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8. PROPERTY, EQUIPMENT AND CAPITALIZED SOFTWARE FOR INTERNAL USE

During the three months ended December 31, 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>December 31,</u> <u>2007</u>	<u>Predecessor</u> <u>June 30,</u> <u>2007</u>
Purchased and internally-developed software	\$ 77,038	\$ 180,539
Buildings and building improvements	37,244	41,148
Computer hardware	23,862	83,225
Land and land improvements	15,182	1,159
Leasehold improvements	14,374	29,125
Machinery and equipment	13,747	29,537
Furniture and fixtures	5,226	18,632
Office equipment	1,950	6,229
Automobiles	1,099	2,909
Total property, equipment and capitalized software for internal use, gross	189,722	392,503
Less: Accumulated depreciation	(28,129)	(242,197)
Total property, equipment and capitalized software for internal use, net	<u>\$ 161,593</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.

10. IDENTIFIABLE INTANGIBLE ASSETS

A preliminary allocation of the acquisition purchase price (see Note 2, “Acquisition of Thomson Learning”) was performed using information currently available, including preliminary estimates of the fair value of intangible assets. Any final adjustments may change the determination and allocation of identifiable intangible assets.

At the date of the Acquisition, management’s estimate of identifiable intangible assets, which included the consideration of a preliminary external valuation, was \$3,249 million consisting primarily of content and customer relationships with a weighted average life of 19 years.

Amortization expense for identifiable intangible assets was \$55,653 for the three months ended December 31, 2007 and \$110,945 for the period July 5, 2007 to December 31, 2007.

Thomson Learning performed a recoverability analysis of the identifiable intangible assets associated with a product within its Gale segment during the three months ended December 31, 2006 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 and impairment 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>December 31,</u> <u>2007</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>December 31,</u> <u>2007</u>	<u>Predecessor</u> <u>June 30,</u> <u>2007</u>
Senior secured credit facilities:		
Term loan facility	\$ 3,431,400	
Fixed rate notes:		
10.50% Senior Notes due 2015	1,215,600	
Unamortized discount on 10.50% Notes due 2015	(14,504)	
13.25% Senior Subordinated Discount Notes due 2015	519,000	
Unamortized discount on 13.25% Notes due 2015	(93,192)	
Senior Bridge Loan Credit Facility	576,226	
Notes payable, due 2008		\$ 50,000
Unamortized discount on notes payable due 2008		(85)
Total long-term debt	<u>5,634,530</u>	<u>49,915</u>
Less: current portion	<u>(34,400)</u>	<u>(35,000)</u>
	<u>\$ 5,600,130</u>	<u>\$ 14,915</u>

Scheduled payments due on long-term debt as of December 31, 2007, 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>
\$ 17,200	\$ 34,400	\$ 34,400	\$ 34,400	\$ 34,400	\$ 5,587,426	\$ 5,742,226

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 current 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.

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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").

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 December 31, 2007 and the period July 5, 2007 to December 31, 2007 bore interest at an average annual rate of 7.95% and 8.01%, respectively. In addition, during the period July 5, 2007 to December 31, 2007, 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 December 31, 2007. The Company also borrowed and repaid \$6.5 million of swing line loans under the revolver during the period July 5, 2007 to December 31, 2007 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 December 31, 2007 at a cost of 2.75% per annum.

In addition, there is a commitment fee of 0.50% per annum 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 December 31, 2007, 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 Facility as well as the Company's ability to enter into amendments to the senior subordinated discount notes or the Senior Bridge Facility that are materially adverse to the lenders under the Senior Credit Facilities. The Senior Credit Facilities include provisions whereby a portion of excess cash flow, all of the proceeds from any non-permitted debt issuance and a portion of the proceeds from non-ordinary course asset dispositions, subject to certain exceptions and reinvestment rights, would have to be used to partially prepay the term loan. The Senior Credit Facilities also contain certain other customary restrictions, affirmative covenants, negative covenants and events of default.

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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.

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 is included in "Deferred financing costs" on the Consolidated Balance Sheet and is being amortized over the term of the Notes.

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

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

In accordance with regulations issued by the IRS, to the extent the Senior Subordinated Discount Notes are considered applicable high yield discount obligations, 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%. Borrowings under the Senior Bridge Facility for the three months ended December 31, 2007 and the period July 5, 2007 to December 31, 2007 bore interest at an average annual rate of 13.13%. The

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applicable margin increases by 50 basis points on January 5, 2008 and will increase by an additional 50 basis points at the end of every three month interest period, up to a maximum interest rate of 13.75% per annum.

The Company elected to capitalize interest due on the loan in the amount of \$18,910 for the three months ended December 31, 2007 and \$36,226 for the period July 5, 2007 to December 31, 2007, as an increase to the principal amount of the loan through its scheduled rollover date of December 31, 2007. In accordance with regulations issued by the IRS, to the extent these loans are considered applicable high yield discount obligations, the Company must make mandatory principal prepayments and accrued interest beginning in the second half of 2012.

On or after January 6, 2008 and prior to July 5, 2008, the arrangers of the Senior Bridge Facility may request the Company to issue bonds and use the proceeds to repay the loans outstanding under the Senior Bridge Facility. Any such bonds will have the same terms and conditions as the Senior Bridge Loan Credit Facility.

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

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

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 FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. However, certain of these instruments may not qualify for hedge accounting treatment and, accordingly, the results of operations may be exposed to some level of volatility. Volatility to our results of operations will vary with the type and amount of derivative hedges outstanding, as well as fluctuations in the currency and interest rate market during the period.

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 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. 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.

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

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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.

On December 21, 2007, the Company entered into an interest rate basis swap with a 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 our cash flow hedges as of December 31, 2007:

<u>Date of Execution</u>	<u>Commencement Date</u>	<u>Initial Notional Amount</u>	<u>Fixed Interest Rate</u>	<u>Weighted Average Interest Rate</u>	<u>Basis</u>	<u>Maturity</u>	<u>Fair Value Liability</u>
July 24, 2007	September 28, 2007	\$1,375,000	5.314%	5.198%	LIBOR	2011	\$ 47,889
July 26, 2007	September 28, 2007	1,375,000	5.194%	5.197%	LIBOR	2011	43,999
August 23, 2007	September 28, 2007	306,000	4.885%	5.198%	LIBOR	2009	4,918
December 21, 2007	December 31, 2007	3,044,000			LIBOR	2008	1,487
							<u>\$ 98,293</u>

The fair value of our interest rate swap agreements are classified within our Balance Sheets as follows:

	<u>Successor December 31, 2007</u>	<u>Predecessor June 30, 2007</u>
Other current liabilities	\$ 33,592	\$ -
Other non-current liabilities	64,701	-
	<u>\$ 98,293</u>	<u>\$ -</u>

Accumulated Other Comprehensive Loss ("AOCL")

During the period July 5, 2007 to December 31, 2007, a \$98,293 after-tax decrease in the fair value of cash flow hedges was recorded in AOCL while an amount of \$3,694 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 \$94,599 as of December 31, 2007.

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

During the six months ended December 31, 2006, 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 our cash flow hedges during the period, which resulted in an ending unrealized gain position relating to derivative instruments in AOCL of \$224 as of December 31, 2006.

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'

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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").

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 is expected to be completed by June 30, 2008 and all payments are expected to be completed by that time.

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

	<u>Severance</u>
July 5, 2007	\$ 13,940
Additions	-
Utilization	(1,970)
Adjustments	(148)
December 31, 2007	<u>\$ 11,822</u>

In December 2007, additional programs were announced and Cengage Learning recorded additional restructuring costs of \$1,851 (Gale - \$1,236; International - \$615) were recorded for severance costs associated with the elimination of approximately 28 positions throughout the organization, as well as contract cancellation costs and property and equipment impairments. The restructuring is expected to be completed by March 2008 and all payments are expected to be completed by June 30, 2009.

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

	Contract Cancellation Costs and		
	<u>Severance</u>	<u>Other</u>	<u>Total</u>
July 5, 2007	\$ -	\$ -	\$ -
Additions	1,381	470	1,851
Utilization	(135)	(470)	(605)
Adjustments	-	-	-
December 31, 2007	<u>\$ 1,246</u>	<u>\$ -</u>	<u>\$ 1,246</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 and are included in "Selling, general & administrative, excluding depreciation stated below" on the Combined Statement of Operations. 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, are included in "Selling, general & administrative, excluding depreciation stated below" on the Combined Statement of Operations. Such costs included severance and relocation of employees as well as contract cancellation costs associated with the closure of these facilities. The restructuring was completed in 2006 and payments are expected to be completed in 2009.

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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	(1,811)	(282)	(2,093)
Adjustments	-	-	-
December 31, 2006	<u>\$ 769</u>	<u>\$ 1,151</u>	<u>\$ 1,920</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>
July 5, 2007	\$ 155	\$ 920	\$ 1,075
Additions	-	-	-
Utilization	(4)	(248)	(252)
Adjustments	-	-	-
December 31, 2007	<u>\$ 151</u>	<u>\$ 672</u>	<u>\$ 823</u>

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

16. BENEFIT PLANS

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 \$3,749 and \$7,200 for the three and six months ended December 31, 2006, 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 \$430 and \$859 for the three and six months ended December 31, 2006, 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.

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Defined Contribution Plans

Prior to the Acquisition, certain Predecessor employees in the United States of America (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.

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.

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 \$420 and \$841 for the three and six months ended December 31, 2006, 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 months ended September 30, 2006.

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 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.

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18. INCOME TAXES

Cengage Learning's effective income tax rate for the period July 5, 2007 to December 31, 2007 is (174.0%). The effective tax rates for the Predecessor periods July 1, 2007 to July 4, 2007 and the three and six months ended December 31, 2006 were 37.1%, 39.8% and 39.2% 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 December 31, 2007.

Cengage Learning had \$3,058 of unrecognized tax benefits as of December 31, 2007. 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 December 31, 2007	<u>\$ 3,058</u>

If recognized, all of these benefits would favorably affect income tax expense. As of December 31, 2007, Cengage Learning had accrued an aggregate of \$1,712 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 December 31, 2007, 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

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

During the period July 5, 2007 to December 31, 2007, the Company capitalized the interest accrued on its Senior Bridge Loan Facility of \$36,226.

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 working capital

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

	<u>Successor</u>	<u>Predecessor</u>	
	<u>Period</u> <u>July 5, 2007 to</u> <u>December 31,</u> <u>2007</u>	<u>Period</u> <u>July 1, 2007</u> <u>to July 4,</u> <u>2007</u>	<u>Six Months</u> <u>Ended</u> <u>December 31,</u> <u>2006</u>
Accounts receivable, net	\$ (116,667)	\$ (8,894)	\$ (164,207)
Inventories	18,438	812	30,888
Prepaid expenses and other current assets	(1,567)	(1,037)	(3,874)
Accounts payable and accrued expenses	95,811	9,208	128,894
Accrued interest payable	64,680	-	-
Deferred revenue	42,394	3,784	25,490
Current taxes payable	10,927	-	4,184
Other, net	(850)	(308)	11,166
	<u>\$ 113,166</u>	<u>\$ 3,565</u>	<u>\$ 32,541</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 \$138,983 for the period July 5, 2007 to December 31, 2007 and \$2,323 for the six months ended December 31, 2006. 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.

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 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 Thomson Learning’s 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 \$14,307 and \$25,887 for the three and six months ended December 31, 2006, 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 \$3,692 and \$6,446 for the three and six months ended December 31, 2006, respectively.

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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.

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 \$4,861 for the three months ended December 31, 2007 and the period July 5, 2007 to December 31, 2007, respectively, which is included in “Selling, general and administrative expense, excluding depreciation” in the Consolidated Statements of Operations. The accrued advisory fees and accrued interest of \$182 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 our exclusive authorized distributor for sale and /or distribution of print and electronic 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.

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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 \$6,147 and \$15,474 for the three months ended December 31, 2007 and the period July 5, 2007 to December 31, 2007, respectively. The amount due from Nelson of \$3,427 at December 31, 2007 is included in "Accounts receivable, net" on the Consolidated Balance Sheet.

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 reporting line item. 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", which is operating income before the allocation of corporate management costs from TOC (Predecessor) and amortization and impairment 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 and impairment 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 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		Three Months Ended	
	December 31, 2007		December 31, 2006	
	Segment Operating		Segment Operating	
	Revenues	Profit (Loss)	Revenues	Profit (Loss)
Academic & Professional	\$ 304,561	\$ 108,630	\$ 300,976	\$ 114,902
Gale	91,436	32,428	93,579	28,610
International	105,249	18,252	103,180	22,187
Segment totals	501,246	159,310	497,735	165,699
Corporate and other ¹	(4,981)	(26,153)	4,731	(20,861)
Total	<u>\$ 496,265</u>	<u>\$ 133,157</u>	<u>\$ 502,466</u>	<u>\$ 144,838</u>

	Successor		Predecessor			
	Period		Period		Six Months	
	July 5, 2007 to		July 1, 2007 to		Ended	
	December 31, 2007		July 4, 2007		December 31, 2006	
	Segment Operating Profit		Segment Operating Profit		Segment Operating Profit	
	Revenues	(Loss)	Revenues	(Loss)	Revenues	(Loss)
Academic & Professional	\$ 776,725	\$ 334,776	\$ 14,573	\$ 6,668	\$ 754,408	\$ 324,543
Gale	165,895	56,452	1,426	(157)	174,309	53,882
International	189,410	26,942	2,542	(307)	179,376	28,044
Segment totals	1,132,030	418,170	18,541	6,204	1,108,093	406,469
Corporate and other ¹	(4,300)	(42,025)	135	(2,133)	12,061	(37,012)
Total	<u>\$ 1,127,730</u>	<u>\$ 376,145</u>	<u>\$ 18,676</u>	<u>\$ 4,071</u>	<u>\$ 1,120,154</u>	<u>\$ 369,457</u>

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

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

	<u>Successor</u> <u>Three Months</u> <u>Ended</u> <u>December 31, 2007</u>	<u>Predecessor</u> <u>Three Months</u> <u>Ended</u> <u>December 31, 2006</u>
Segment operating profit	\$ 133,157	\$ 144,838
Less: Allocation of management costs from TOC	-	(14,307)
Less: Amortization and impairment of identifiable intangible assets	(55,653)	(13,460)
Operating income	<u>\$ 77,504</u>	<u>\$ 117,071</u>

	<u>Successor</u> <u>Period</u> <u>July 5, 2007 to</u> <u>December 31, 2007</u>	<u>Predecessor</u> <u>Period</u> <u>July 1, 2007 to</u> <u>July 4, 2007</u>	<u>Six Months</u> <u>Ended</u> <u>December 31, 2006</u>
Segment operating profit	\$ 376,145	\$ 4,071	\$ 369,457
Less: Allocation of management costs from TOC	-	(821)	(25,887)
Less: Amortization and impairment of identifiable intangible assets	(110,945)	(308)	(23,472)
Operating income	<u>\$ 265,200</u>	<u>\$ 2,942</u>	<u>\$ 320,098</u>

22. SUBSEQUENT EVENTS

As discussed in Note 2, "Acquisition of Thomson Learning", the Acquisition purchase price of \$7,108.9 million was subject to working capital purchase price adjustments. On January 31, 2008, Cengage Learning and TOC entered into a settlement agreement whereby the parties agreed to a reduction in the purchase price of \$17.3 million, which was remitted to the Company on February 1, 2008.

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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 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 electronic 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 continuing effect of purchase accounting on deferred revenue relating to the Acquisition and corporate costs under a segment reporting line item 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 electronic 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 continuing effect of purchase accounting on deferred revenue relating to the Acquisition.

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 electronic 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 electronic;
- selling, general and administrative expenses, which are the salaries and related costs for our sales staff and our other employees and the marketing and administrative costs of operating our business; and
- depreciation and amortization, which represent the depreciation of our property, equipment and capitalized software for internal use as well as the amortization of our identifiable intangible assets.

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 cash consideration of \$7,108.9 million, subject to working capital purchase price adjustments (the "Acquisition").

The Acquisition was financed through a common equity capital contribution of \$1,703.1 million and \$5,580.2 million in aggregate gross proceeds of 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 a plan to increase our own internal capabilities in the future to reduce our reliance on TOC for these services.

We incurred costs under the Transition Services Agreement of approximately \$200 for the three months ended December 31, 2007 and \$400 for the period July 5, 2007 to December 31, 2007.

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.

We incurred costs under the Human Resources Services Agreement of \$685 for the three months ended December 31, 2007 and \$1,361 for the period July 5, 2007 to December 31, 2007.

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 quarterly 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 quarterly 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 \$14,307 and \$25,887 for the three and six months ended December 31, 2006, 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.

We are currently finalizing the terms and conditions of our stock based compensation program which may result in an expense in future periods.

Change of Fiscal Year End

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

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Results of Operations

The results for the period July 5, 2007 through December 31, 2007 relate to Cengage Learning and the financial results for the three and six months ended December 31, 2006 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 December 31, 2007 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 December 31, 2007", is not a U.S. GAAP measure.

The Three Months Ended December 31, 2007 Compared With The Three Months Ended December 31, 2006

(Dollars in millions)	Three Months Ended December 31,		Percentage
	2007	2006	Change
Statement of Operations			
Revenues:			
Academic & Professional	\$ 304.6	\$ 301.0	1.2%
Gale	91.4	93.6	-2.4%
International	105.2	103.2	1.9%
Corporate and other	(4.9)	4.7	NM
Total revenues	<u>496.3</u>	<u>502.5</u>	-1.2%
Cost of revenues, excluding depreciation stated below:			
Products	183.6	174.5	5.2%
Services and other	27.1	22.7	19.4%
Amortization of pre-publication costs	32.9	33.2	-0.9%
Total cost of revenues, excluding depreciation stated below	<u>243.6</u>	<u>230.4</u>	5.7%
Selling, general & administrative, excluding depreciation stated below	104.6	112.8	-7.3%
Allocation of management costs from TOC	-	14.3	NM
Depreciation	14.9	14.4	3.5%
Amortization and impairment of identifiable intangible assets	55.7	13.5	NM
Total costs and expenses	<u>418.8</u>	<u>385.4</u>	8.7%
Operating income	77.5	117.1	-33.8%
Gain on sale of equity investee	0.8	-	NM
Gain on nonmonetary transaction	-	1.3	NM
Interest expense with TOC	-	(4.6)	NM
Interest income	2.6	-	NM
Interest expense	(145.0)	(1.4)	NM
(Loss) income before taxes	(64.1)	112.4	NM
Provision for income taxes	(10.9)	(44.7)	-75.6%
Equity losses of investees, net of taxes	(0.7)	(1.4)	-50.0%
Net (loss) income	<u>\$ (75.7)</u>	<u>\$ 66.3</u>	NM

NM = Not meaningful

Revenues decreased 1.2% primarily from lower revenues within Gale and Corporate and other, partially offset by growth in our Academic & Professional and International segments and the favorable impact of foreign currency translation of 1.3%. Included in the second quarter of fiscal 2008 is (i) an \$11.8 million reduction of revenue reported in our Corporate

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and other segment associated with purchase accounting adjustments to deferred revenue and (ii) \$6.2 million of revenue during the three months ended December 31, 2007 on transactions with a former affiliate of Thomson Learning which was 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 December 31, 2006 by \$7.5 million.

Our Academic & Professional segment revenue increased 1.2% for the three months ended December 31, 2007 on higher sales of math, nutrition, business and computing technology & information system ("CTIS") titles, offset by softness in career education and technology & trade publications and lower school sales as result of fewer adoption opportunities. In addition, revenue was impacted by additional returns reserve charges in Latin America, the impact of lower sales in Mexico due to a local tax law change, the cessation of sales to certain non-U.S. distributors, as well as timing, reflecting the cessation of significant discounting practices to accelerate sales into December. Lastly, the change reflects the recognition of \$6.0 million of revenue on transactions with a former affiliate of Thomson Learning which was 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 December 31, 2006 by \$7.2 million.

Gale's revenue decline of 2.4% during the three months ended December 31, 2007 reflects continued print attrition and the continuing decline in film products, partially offset by growth in digital products, such as digital archives and virtual reference libraries.

International revenues increased 1.9% during the three months ended December 31, 2007 mainly from the impact of foreign currency translation of 6.3% and growth in our English language training business in Asia and EMEA. Partially offsetting this growth was a decline in library reference sales in Australia and EMEA, lower school sales in Australia and softness in higher education sales in the United Kingdom and Australia largely associated with market conditions in those countries and the cessation of sales to distributors. The change reflects the recognition of \$0.2 million of revenue during the three months ended December 31, 2007 on transactions with a former affiliate of Thomson Learning which was 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 December 31, 2006 by \$0.3 million.

Our Corporate and other revenue decrease during the three months ended December 31, 2007 reflects an \$11.8 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.

Cost of revenues, excluding depreciation increased 5.7% 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 costs. During the three months ended December 31, 2006, \$7.5 million was included in products cost of revenues as a reduction of costs, relating to such transactions. The remaining increase in products cost of revenues during the period arose from growth in 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 electronic and service related products. The increase of \$4.4 million primarily represents an increase of these indirect costs which do not correlate directly with the related revenue recognized.

Amortization of pre-publication costs decreased 0.9% due to reduced print sales in our Gale business as well as lower historical pre-publication spending, partially offset by growth in our Academic & Professional group and international businesses.

Selling, general & administrative expense, excluding depreciation decreased 7.3% reflecting lower expenses from fewer employees, lower travel and entertainment costs and improved cost control, partially offset by \$2.5 million of advisory fees and costs incurred to establish our own internal support infrastructure previously provided by TOC.

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

Depreciation increased 3.5% reflecting higher additions to property, equipment and computer software for internal use across the Company as well as the impact of purchase accounting adjustments to the fair value of buildings and building improvements of \$9.8 million, and purchased and internally-developed software of \$2.8 million.

Amortization and impairment of identifiable intangible assets increased as a result of the valuation of amortizable identifiable intangible assets established in purchase accounting for the Acquisition, partially offset by an impairment charge of \$2.9 million recorded during the three months ended December 31, 2006.

Gain on sale of equity investee resulted from the sale of our investment in Universitas 21 Global ("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 three months ended December 31, 2006.

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.

Provision for income taxes decreased 75.6% due to lower income before taxes and the impact of projected loss-making jurisdictions for the full year that are not expected to realize the associated tax benefits. For those jurisdictions, no tax provision or benefit is recorded in any period and due to seasonality of income before taxes, these jurisdictions are profitable in the three months ended December 31, 2007, but no tax provision has been recorded.

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 decreased 50.0% due the sale of our investment in U21 in November 2007, partially offset by equity in losses of another investee.

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The Period July 5, 2007 to December 31, 2007 and the Period July 1, 2007 to July 4, 2007 (together, the "Cumulative Period Ended December 31, 2007") Compared With The Six Months Ended December 31, 2006

(Dollars in millions)	Cumulative Period Ended December 31, 2007	Six Months Ended December 31, 2006	Percentage Change
Statement of Operations			
Revenues:			
Academic & Professional	\$ 791.3	\$ 754.4	4.9%
Gale	167.3	174.3	-4.0%
International	192.0	179.4	7.0%
Corporate and other	(4.2)	12.1	NM
Total revenues	<u>1,146.4</u>	<u>1,120.2</u>	2.3%
Cost of revenues, excluding depreciation stated below:			
Products	395.8	378.5	4.6%
Services and other	56.8	48.2	17.8%
Amortization of pre-publication costs	77.8	79.4	-2.0%
Total cost of revenues, excluding depreciation stated below	<u>530.4</u>	<u>506.1</u>	4.8%
Selling, general & administrative, excluding depreciation stated below	206.6	216.6	-4.6%
Allocation of management costs from TOC	0.8	25.9	-96.9%
Depreciation	29.1	28.0	3.9%
Amortization and impairment of identifiable intangible assets	111.3	23.5	NM
Total costs and expenses	<u>878.2</u>	<u>800.1</u>	9.8%
Operating income	268.2	320.1	-16.2%
Gain on sale of equity investee	0.8	-	NM
Gain on nonmonetary transaction	-	1.3	NM
Interest expense with TOC	-	(15.6)	NM
Interest income	3.5	-	NM
Interest expense	(276.7)	(2.9)	NM
(Loss) income before taxes	(4.2)	302.9	NM
Provision for income taxes	(13.6)	(118.6)	-88.5%
Equity losses of investee, net of taxes	(2.1)	(3.0)	-30.0%
Net (loss) income	<u>\$ (19.9)</u>	<u>\$ 181.3</u>	NM

NM = Not meaningful

Revenues increased 2.3% on growth within our Academic & Professional and International segments, and the favorable impact of foreign currency translation of 1.1%, partially offset by a decline within Gale and Corporate and other revenues. Included in the current period is (i) a \$19.8 million reduction of revenue reported in our Corporate and other segment during the Cumulative Period Ended December 31, 2007 associated with purchase accounting adjustments to deferred revenue and (ii) \$15.5 million of revenue during the Cumulative Period Ended December 31, 2007 on transactions with a former affiliate

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of Thomson Learning which was reported as a reduction of expenses in periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the six months ended December 31, 2006 by \$18.5 million.

Our Academic & Professional segment revenue increased 4.9% for the Cumulative Period ended December 31, 2007 on higher sales of healthcare, technology & trade, math, and CTIS titles, partially offset by lower school sales as a result of fewer adoption opportunities. In addition, revenue was impacted by additional returns reserve charges in Latin America, the impact of lower sales in Mexico due to a local tax law change, the cessation of sales to certain non-U.S. distributors, as well as timing, reflecting the cessation of significant discounting practices to accelerate sales into December. Foreign currency translation had a nominal impact. Lastly, the change reflects the recognition of \$15.1 million of revenue on transactions with a former affiliate of Thomson Learning which was reported as a reduction of expenses in periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the six months ended December 31, 2006 by \$18.0 million. Included within the \$791.3 million revenue for the Cumulative Period Ended December 31, 2007 is \$14.6 million recognized during the period July 1, 2007 to July 4, 2007.

Gale's revenue decline of 4.0% during the Cumulative Period Ended December 31, 2007 reflects continued print attrition, reduced circulating volume and the continuing decline in film products, partially offset by growth in digital products, such as digital archives and virtual reference libraries. Included within the \$167.3 million revenue for the Cumulative Period Ended December 31, 2007 is \$1.4 million recognized during the period July 1, 2007 to July 4, 2007.

International revenues increased 7.0% during the Cumulative Period Ended December 31, 2007 mainly from the impact of foreign currency translation of 6.4% and growth in our English language training business in Asia and EMEA. Partially offsetting this growth was a decline in library reference sales in Australia and EMEA, lower school sales in Australia and softness in higher education sales in the United Kingdom and Australia largely related to market conditions in those countries, and the cessation of sales distributors. The change also reflects the recognition of \$0.4 million of revenue during the Cumulative Period Ended December 31, 2007 on transactions with a former affiliate of Thomson Learning which was reported as a reduction of expenses in periods prior to July 5, 2007. Such transactions with the former affiliate reduced expenses for the six months ended December 31, 2006 by \$0.5 million. Included within the \$192.0 million revenue for the Cumulative Period Ended December 31, 2007 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 December 31, 2007 reflects a \$19.8 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 December 31, 2007 is \$0.1 million recognized during the period July 1, 2007 to July 4, 2007.

Cost of revenues, excluding depreciation increased 4.8% 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 expenses. During the six months ended December 31, 2006, \$18.5 million was included in products cost of revenues relating to such transactions. The increase in products cost of revenues primarily reflects the impact of this inclusion, 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 December 31, 2007 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 electronic and service related products. The increase of \$8.6 million primarily represents an increase of these indirect costs as well as an increase in variable costs associated with the increase in service and other related revenue, before the purchase accounting impact on deferred revenue of \$19.8 million. Included within services and other costs of revenues for the Cumulative Period Ended December 31, 2007 is \$1.0 million incurred during the period July 1, 2007 to July 4, 2007.

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The decrease of 2.0% in amortization of pre-publication costs was due primarily to reduced print sales in our Gale business as well as the impact of lower historical pre-publication spending, partially offset by higher sales and growth in our Academic & Professional group and international businesses. Included within amortization of pre-publication costs for the Cumulative Period Ended December 31, 2007 is \$0.9 million incurred during the period July 1, 2007 to July 4, 2007.

Selling, general & administrative expense, excluding depreciation decreased by 4.6%, reflecting lower expenses from fewer employees, lower travel and entertainment costs and better expense management, offset by \$4.9 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 December 31, 2007 is \$5.0 million incurred during the period July 1, 2007 to July 4, 2007.

Allocation of management costs from TOC decreased 96.9%, 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 December 31, 2007 is \$0.8 million incurred during the period July 1, 2007 to July 4, 2007.

Depreciation increased 3.9% reflecting higher additions to property, equipment and computer software for internal use across the Company as well as the impact of purchase accounting adjustments to the fair value of buildings and building improvements of \$9.8 million, and purchased and internally-developed software of \$2.8 million. 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 three months ended December 31, 2006.

Amortization and impairment of identifiable intangible assets increased reflecting 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 2006 period. Included within amortization of identifiable intangible assets expense for the Cumulative Period Ended December 31, 2007 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 88.5% due to lower income before taxes and the impact of projected loss-making jurisdictions for the full year that are not expected to realize the associated tax benefits. For those jurisdictions, no tax provision or benefit is recorded in any period and due to seasonality of income before taxes, these jurisdictions are profitable in the Cumulative Period Ended December 31, 2007, but no tax provision has been recorded. Included within the provision for income taxes for the Cumulative Period Ended December 31, 2007 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 30.0% resulting from the sale of our investment in U21 in November 2007, partially offset by equity in losses of another investee. Included within the equity losses of investees, net of taxes for the Cumulative Period Ended December 31, 2007 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 December 31, 2007 and for the six months ended December 31, 2006 (Thomson Learning). As discussed above, the Cumulative Period Ended December 31, 2007 is provided to enhance the reader's understanding of the results of operations for the periods presented and is not a GAAP measure.

(Dollars in millions)	Cumulative Period Ended December 31, 2007	Six Months Ended December 31, 2006
Other Financial Data		
Additions to property, equipment and capitalized software		
for internal use	\$ 18.6	\$ 27.0
Additions to pre-publication costs	56.1	63.4
Statements of Cash Flows		
Net cash provided by operating activities	\$ 385.2	\$ 374.4
Net cash used by investing activities	(7,281.8)	(116.1)
Net cash provided (used) by financing activities	7,130.1	(248.5)
Impact on cash and cash equivalents		
from change in foreign currency	0.1	1.3
Net increase in cash and cash equivalents	<u>\$ 233.6</u>	<u>\$ 11.1</u>

Cash Flows

Operating activities. Net cash provided by operating activities for the Cumulative Period Ended December 31, 2007 increased by \$10.8 million, or approximately 2.9%. This increase was attributable primarily to improved operating results before amortization of identifiable intangibles and favorable working capital movements, partially offset by net cash interest payments of \$136.7 million.

Investing activities. Net cash used by investing activities for the Cumulative Period Ended December 31, 2007 was \$7,281.8 million as compared to \$116.1 million for the six months ended December 31, 2006, primarily reflecting the impact of the Acquisition, offset by reduced additions to pre-publication costs and property, equipment and capitalized software for internal use.

Financing activities. Net cash provided by financing activities for the Cumulative Period Ended December 31, 2007 was \$7,130.1 million as compared to net cash used by financing activities of \$248.5 million for the six months ended December 31, 2006, 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 \$8.6 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 December 31, 2007, our total cash and cash equivalents were \$252.4 million and we had total indebtedness of approximately \$5,634.5 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. Management expects 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, 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 FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. However, certain of these instruments may not qualify for hedge accounting treatment and, accordingly, 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.