CAMBIUM LEARNING GROUP, INC.
Form 10-Q
August 10, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission File Number: 001-34575

Cambium Learning Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**27-0587428**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
17855 North Dallas Parkway, Suite 400, Dallas, Texas	**75287**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (214) 932-9500

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Smaller reporting company ¨
Non-accelerated filer x (Do not check if a smaller reporting company)	Accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares of the registrant s common stock, $0.001 par value per share, outstanding as of July 31, 2012 was 48,997,025.

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Part I. Financial Information

Item 1. Financial Statements.

Cambium Learning Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net revenues	$ 40,429	$ 57,191	$ 68,284	$ 87,886
Cost of revenues:				
Cost of revenues	14,397	17,819	25,563	28,786
Amortization expense	6,579	6,844	12,949	13,462
Total cost of revenues	20,976	24,663	38,512	42,248
Research and development expense	2,652	2,515	5,984	4,894
Sales and marketing expense	12,041	12,874	23,937	23,777
General and administrative expense	5,061	5,529	10,806	11,341
Shipping and handling costs	954	817	1,281	1,151
Depreciation and amortization expense	1,591	1,748	3,250	3,484
Goodwill impairment	14,700		14,700	
Embezzlement and related expense (recoveries)	44	40	(41)	(2,396)
Impairment of long-lived assets	320		3,111	
Total costs and expenses	58,339	48,186	101,540	84,499
Income (loss) before interest, other income (expense) and income taxes	(17,910)	9,005	(33,256)	3,387
Net interest expense	(4,627)	(4,882)	(9,404)	(9,287)
Other income, net	37	2	73	365
Income (loss) before income taxes	(22,500)	4,125	(42,587)	(5,535)
Income tax benefit (expense)	23	(318)	(154)	(415)
Net income (loss)	$ (22,477)	$ 3,807	$ (42,741)	$ (5,950)
Other comprehensive income (loss):				
Amortization of net pension loss	8		17	
Comprehensive income (loss)	$ (22,469)	$ 3,807	$ (42,724)	$ (5,950)
Net income (loss) per common share:				
Basic net income (loss) per common share	$ (0.45)	$ 0.09	$ (0.86)	$ (0.14)
Diluted net income (loss) per common share	$ (0.45)	$ 0.09	$ (0.86)	$ (0.14)
Average number of common shares and equivalents outstanding:				
Basic	49,941	43,610	49,944	43,979
Diluted	49,941	44,431	49,944	43,979

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

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Cambium Learning Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(In thousands, except per share data)

	June 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 31,603	$ 63,191
Accounts receivable, net	25,299	13,485
Inventory	20,760	21,561
Deferred tax assets	2,800	2,829
Restricted assets, current	4,388	1,393
Assets held for sale	2,847	2,727
Other current assets	4,664	4,735
Total current assets	92,361	109,921
Property, equipment and software at cost	32,086	42,878
Accumulated depreciation and amortization	(11,175)	(12,968)
Property, equipment and software, net	20,911	29,910
Goodwill	99,597	114,297
Acquired curriculum and technology intangibles, net	22,310	26,996
Acquired publishing rights, net	22,227	26,861
Other intangible assets, net	16,381	18,111
Pre-publication costs, net	10,956	10,034
Restricted assets, less current portion	7,399	11,082
Other assets	21,843	22,468
Total assets	$ 313,985	$ 369,680

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

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Cambium Learning Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(In thousands, except per share data)

	June 30, 2012 (unaudited)	December 31, 2011
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of capital lease obligations	$ 1,255	$ 826
Accounts payable	4,478	3,024
Contingent value rights, current	1,717	
Accrued expenses	22,422	21,203
Deferred revenue, current	31,814	38,984
Total current liabilities	61,686	64,037
Long-term liabilities:		
Long-term debt	174,246	174,165
Capital lease obligations, less current portion	3,603	12,294
Deferred revenue, less current portion	4,698	4,304
Contingent value rights, less current portion	5,074	6,684
Other liabilities	17,241	18,126
Total long-term liabilities	204,862	215,573
Commitments and contingencies (See Note 13)		
Stockholders equity:		
Preferred stock ($.001 par value, 15,000 shares authorized, zero shares issued and outstanding at June 30, 2012 and December 31, 2011)		
Common stock ($.001 par value, 150,000 shares authorized, 51,208 and 51,162 shares issued, and 49,124 and 49,518 shares outstanding at June 30, 2012 and December 31, 2011, respectively)	51	51
Capital surplus	281,840	281,240
Accumulated deficit	(227,400)	(184,659)
Treasury stock at cost (2,084 and 1,644 shares at June 30, 2012 and December 31, 2011, respectively)	(5,440)	(4,931)
Other comprehensive income (loss):		
Pension and postretirement plans	(1,615)	(1,632)
Net unrealized gain on securities	1	1
Accumulated other comprehensive income (loss)	(1,614)	(1,631)
Total stockholders equity	47,437	90,070
Total liabilities and stockholders equity	$ 313,985	$ 369,680

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these statements

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Cambium Learning Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(unaudited)	
Operating activities:		
Net loss	$ (42,741)	$ (5,950)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	16,199	16,946
Goodwill impairment	14,700	
Loss (Gain) from recovery of property held for sale	380	(2,727)
Amortization of note discount and deferred financing costs	869	639
Impairment of long-lived assets	3,111	
Change in fair value of contingent value rights obligation	107	520
Loss on disposal of assets	66	
Stock-based compensation and expense	205	604
Changes in operating assets and liabilities:		
Accounts receivable, net	(11,814)	(4,210)
Inventory	801	(2,911)
Other current assets	71	146
Other assets	(163)	625
Restricted assets	688	2,535
Accounts payable	1,454	(1,528)
Accrued expenses	1,219	2,500
Deferred revenue	(6,776)	(5,975)
Other long-term liabilities	(444)	(558)
Net cash (used in) provided by operating activities	(22,068)	656
Investing activities:		
Cash paid for acquisitions		(1,993)
Expenditures for property, equipment, software and pre-publication costs	(8,427)	(6,718)
Net cash used in investing activities	(8,427)	(8,711)
Financing activities:		
Proceeds from debt		174,024
Repayment of debt		(152,130)
Deferred financing costs		(7,980)
Principal payments under capital lease obligations	(584)	(181)
Borrowings under revolving credit agreement		10,000
Payment of revolving credit facility		(10,000)
Stock repurchases	(509)	(4,931)
Net cash (used in) provided by financing activities	(1,093)	8,802

Increase (decrease) in cash and cash equivalents	(31,588)	747
Cash and cash equivalents, beginning of period	63,191	11,831
Cash and cash equivalents, end of period	$ 31,603	$ 12,578

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

Cambium Learning Group, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

Note 1 Basis of Presentation

Presentation. The Condensed Consolidated Financial Statements include the accounts of Cambium Learning Group, Inc. and subsidiaries (the Company) and are unaudited. The condensed balance sheet as of December 31, 2011 has been derived from audited financial statements. All intercompany transactions are eliminated.

As permitted under the Securities and Exchange Commission (SEC) requirements for interim reporting, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted. The Company believes that these financial statements include all necessary and recurring adjustments for the fair presentation of the interim period results. These financial statements should be read in conjunction with the Consolidated Financial Statements and related notes included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2011. Due to seasonality, the results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the year ending December 31, 2012.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Subsequent actual results may differ from those estimates.

Nature of Operations. The Company operates as three reportable business segments with separate management teams and infrastructures: Voyager Learning, a comprehensive intervention business; Sopris Learning, a supplemental solutions education business; and Cambium Learning Technologies, a technology-based education business.

Note 2 Accounts Receivable

Accounts receivable are stated net of allowances for doubtful accounts and estimated sales returns. The allowance for doubtful accounts and estimated sales returns totaled $0.9 million at June 30, 2012 and December 31, 2011. The allowance for doubtful accounts is based on a review of the outstanding balances and historical collection experience. The reserve for sales returns is based on historical rates of return as well as other factors that in the Company s judgment could reasonably be expected to cause sales returns to differ from historical experience.

Note 3 Stock-Based Compensation and Expense

The total amount of pre-tax expense for stock-based compensation recognized in the quarters ended June 30, 2012 and 2011 and the six month periods ended June 30, 2012 and 2011 was $(20) thousand, $0.3 million, $0.2 million, and $0.6 million, respectively. The decline in stock-based compensation in the second quarter of 2012 is primarily due to a decline in the fair value of outstanding warrants partially offset by expense recognized for other equity awards. The stock-based compensation expense recorded was allocated as follows:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Cost of revenues	$ 13	$ 15	$ 25	$ 30
Research and development expense	30	33	60	65
Sales and marketing expense	26	40	56	78
General and administrative expense	(89)	226	64	431
Total	$ (20)	$ 314	$ 205	$ 604

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On February 8, 2012, the Company granted 195,000 options under the Cambium Learning Group, Inc. 2009 Equity Incentive Plan (the Plan) with a total grant date fair value, net of forecasted forfeitures, of $0.1 million. On April 16, 2012, the Company granted an additional 15,000 options under the Plan with a total grant date fair value, net of forecasted forfeitures, of $6 thousand. On May 14, 2012, the Company granted 25,000 options under the Plan with a total grant date fair value, net of forecasted forfeitures, of $5 thousand. These options have a per-share exercise price equal to $4.50 and vest equally over a four year service period. The term of the options is ten years from the date of grant. The following assumptions were used in the Black-Scholes option-pricing model to estimate the fair value of these awards:

	2012	2011
Expected stock volatility	35.00%	35.00%
Risk-free interest rate	1.02 -1.17%	2.50%
Expected years until exercise	6.25	6.25
Dividend yield	0.00%	0.00%

Due to a lack of exercise history or other means to reasonably estimate future exercise behavior, the Company used the simplified method as described in applicable accounting guidance for stock-based compensation to estimate the expected years until exercise on new awards.

During the quarter ended June 30, 2012, 35,668 of the options granted on January 27, 2010, 3,901 of the options granted on February 1, 2011 and 10,000 of the options granted on August 11, 2011 were forfeited. During the six months ended June 30, 2012, 140,926 of the options granted on January 27, 2010, 16,140 of the options granted on February 1, 2011 and 10,000 of the options granted on August 11, 2011 were forfeited.

Restricted common stock awards of 46,295 shares were issued during the six months ended June 30, 2012, in connection with the Company s Board of Directors compensation program. The restrictions on the common stock awards will lapse on the one-year anniversary of the grant date or upon a change in control of the Company. These awards were valued based on the Company s closing stock price on the date of grant, February 8, 2012.

During the quarter and six months ended June 30, 2012, the related restrictions lapsed on restricted common stock awards of 10,150 shares and 46,234 shares, respectively.

Note 4 Net Income (Loss) per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period, including the potential dilution that could occur if all of the Company s outstanding stock awards that are in-the-money were exercised, using the treasury stock method. A reconciliation of the weighted-average number of common shares and equivalents outstanding used in the calculation of basic and diluted net income (loss) per common share is shown in the table below for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Shares in thousands)	2012	2011	2012	2011
Basic	49,941	43,610	49,944	43,979
Dilutive effect of awards		821		
Diluted	49,941	44,431	49,944	43,979
Antidilutive securities:				
Options	4,136	3,807	4,136	3,807
Warrants	188		188	141
Restricted stock	49		49	49
Subscription rights				6,645

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Note 5 Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability (exit price), in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques are based on observable or unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s market assumptions. These two types of inputs have created the following fair value hierarchy:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant value drivers are observable.

Level 3 Valuations derived from valuation techniques in which significant value drivers are unobservable.

Applicable guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

As of June 30, 2012, financial instruments include $31.6 million of cash and cash equivalents, restricted assets of $11.8 million, collateral investments of $2.0 million, $174.2 million of senior secured notes, $0.2 million of warrants, assets held for sale of $2.8 million, and $6.8 million in contingent value rights (CVRs). As of December 31, 2011, financial instruments include $63.2 million of cash and cash equivalents, restricted assets of $12.5 million, collateral investments of $2.0 million, $174.2 million of senior secured notes, $0.5 million of warrants, assets held for sale of $2.7 million, and $6.7 million in CVRs. The fair market values of cash equivalents and restricted assets are equal to their carrying value, as these investments are recorded based on quoted market prices and/or other market data for the same or comparable instruments and transactions as of the end of the reporting period. The fair values of the properties acquired by the Company as a result of its recovery efforts in connection with the employee embezzlement matter described in Note 16 were determined by an independent appraisal conducted by a licensed realtor based on the values of similar properties in the area. The fair values of the warehouse equipment held for sale in connection with the restructuring and reengineering initiative as described in Note 11was determined based on management s best estimate of the net realizable value of these assets.

As of June 30, 2012, the fair value of the senior secured notes was $161.2 million based on quoted market prices in active markets for these debt instruments when traded as assets.

Assets and liabilities measured at fair value on a recurring basis are as follows:

(in thousands)		Fair Value at Reporting Date Using			
Description	**As of June 30, 2012**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Year-to-Date Total Gains (Losses)**
Restricted Assets:					
Money Market	$ 11,787	$ 11,787	$	$	$
Collateral Investments:					
Money Market	902	902			
Certificate of Deposit	1,066	1,066			
Warrant	177		177		395
Assets held for sale:					
Recovered Properties	2,347		2,347		(380)
Warehouse Equipment	500			500	

CVRs	6,791	6,791	(107)

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(in thousands)		Fair Value at Reporting Date Using			
Description	**As of December 31, 2011**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Year-to-Date Total Gains (Losses)**
Restricted Assets:					
Money Market	$ 12,475	$ 12,475	$	$	$
Collateral Investments:					
Money Market	902	902			
Certificate of Deposit	1,065	1,065			
Warrant	456		456		70
Assets held for sale:					
Recovered Properties	2,727		2,727		
CVRs	6,684			6,684	(1,308)

The warrant was valued using the Black-Scholes pricing model. Due to the low exercise price of the warrants, the model assumptions do not significantly impact the valuation.

Goodwill Impairment

In accordance with applicable accounting guidance, goodwill and other indefinite-lived intangible assets are not amortized but are instead reviewed for impairment at least annually and if a triggering event is determined to have occurred in an interim period. The Company s annual impairment testing is performed as of December 1 of each year. During the quarter ended June 30, 2012, significant sustained sales declines in the Company s Kurzweil and IntelliTools product lines within the CLT segment (KI) caused the Company to re-evaluate the forecasts for this reporting unit. The Company determined that future sales for KI are not expected to achieve previous forecasts. This adverse change in expected future cash flows triggered the need for an interim goodwill impairment analysis for this reporting unit.

The applicable accounting guidance requires that a two-step impairment test be performed on goodwill. In the first step, the fair value of the reporting unit is compared to its carrying value. If the fair value of the reporting unit exceeds the carrying value of that unit, goodwill is not impaired and no further testing is required. If the carrying value of the reporting unit exceeds the fair value of that unit, then a second step must be performed to determine the implied fair value of the reporting entity s goodwill. If the carrying value of the reporting unit s goodwill exceeds its implied fair value, then an impairment loss equal to the difference is recorded.

Determining the fair value of a reporting unit is judgmental in nature, and involves the use of significant estimates and assumptions. These estimates and assumptions may include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, and determination of appropriate market comparables. In addition, the Company makes certain judgments and assumptions in allocating shared assets and liabilities to determine the carrying values of its reporting units.

In the first step of the impairment test performed on the KI reporting unit as of June 30, 2012, the fair market value of the reporting unit was determined using a weighted income and market approach. The income approach was dependent on multiple assumptions and estimates, including future cash flow projections with a terminal value multiple and the discount rate used to determine the expected present value of the estimated future cash flows. Future cash flow projections were based on management s best estimates of economic and market conditions over the projected period, including industry fundamentals such as the state of educational funding, revenue growth rates, future costs and operating margins, working capital needs, capital and other expenditures, and tax rates. The discount rate applied to the future cash flows was a weighted-average cost of capital and took into consideration market and industry conditions, returns for comparable companies, the rate of return an outside investor would expect to earn, and other relevant factors. The fair value of the reporting unit also took into consideration a market approach, based on historical and projected multiples of certain guideline companies. The first step of impairment testing as of June 30, 2012 showed that the carrying value of the KI reporting unit exceeded its respective fair value and that the second step of testing was required.

The second step requires the allocation of the fair value of the reporting unit to all of the assets and liabilities of that reporting unit as if the reporting unit had been acquired in a business combination. As a result of the second step of our interim impairment test, the goodwill balance for the KI reporting unit was determined to be partially impaired, and an impairment charge of $14.7 million was recorded as of June 30, 2012. The goodwill impairment charge was primarily the result of lowered forecasts of future sales.

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Although management has included its best estimates of the impact of these and other factors in our cash flow projections, the projection of future cash flows is inherently uncertain and requires a significant amount of judgment. Actual results that are significantly different than these cash flow projections or a change in the discount rate could significantly affect the fair value estimates used to value the reporting unit in step one of the goodwill analysis or the fair values of our other asset and liability balances used in step two of the goodwill analysis, and could result in future goodwill impairments.

Contingent Value Rights

The fair value of the liability for the CVRs is determined using a probability weighted cash flow analysis which takes into consideration the likelihood, amount and timing of cash flows of each element of the pool of assets and liabilities included in the CVR. The determination of fair value of the CVRs involves significant assumptions and estimates, which are reviewed at each quarterly reporting date. As of June 30, 2012, a fair value of $6.8 million has been recorded as a liability for the remaining CVR payments.

During the six months ended June 30, 2012, a loss of $0.1 million was recorded in general and administrative expense to reflect an increase in the estimated fair value of the CVR liability. The ultimate value of the remaining CVR payments is not known at this time; however, it could range from zero to a maximum possible value of approximately $7.5 million. Future changes in the estimate of the fair value of the CVRs will impact results of operations and could be material.

The first and second CVR payment dates were in September 2010 and June 2011, with $1.1 million and $2.0 million, respectively, distributed to the escrow agent at those times for distribution to holders of the CVRs. The next scheduled distribution, if any, is expected to be paid in the second quarter of 2013, but no later than October 2013, and relates to a potential tax indemnity obligation. Additionally, as described in Note 13, any amounts due to CVR holders as a result of refunds received related to the Michigan tax payment will be distributed upon the final resolution of this agreed contingency.

A detail of the elements included in the CVR is as follows:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) CVRs *(In thousands)*		
		Loss (Gain) for	
	Estimated Fair Value as of December 31, 2011	Changes in Estimated CVR Liability	Estimated Fair Value as of June 30, 2012
Components of CVR Total:			
Tax refunds received before closing of the merger	$ 1,583	$	$ 1,583
Other specified tax refunds	4,797		4,797
Tax indemnity obligation	1,717		1,717
Legal receivable	2,400		2,400
Michigan state tax liability	(252)	107	(145)
Other specified tax related liabilities	(53)		(53)
Costs incurred to collect tax refunds and by stockholders representative	(409)		(409)
Estimated total of CVR value	9,783	107	9,890
Payments to holders of CVRs			3,099
Remaining estimated CVR liability			$ 6,791

As of June 30, 2012, the remaining CVR liability of $6.8 million was comprised of $5.1 million related to the Michigan state tax agreed upon contingency and $1.7 million related to a potential tax indemnity obligation. Restricted assets in an escrow account for the benefit of the CVRs were $3.0 million for the potential tax indemnity obligation noted above, which, if such obligation is not triggered, will benefit the CVRs by

$1.9 million with the remainder reverting back to general cash of the Company.

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Note 6 Other Current Assets

Other current assets at June 30, 2012 and December 31, 2011 consisted of the following:

	As of	
(in thousands)	June 30, 2012	December 31, 2011
Prepaid expenses	$ 2,402	$ 1,503
Deferred costs	2,262	2,714
Other current assets		518
Total	$ 4,664	$ 4,735

Note 7 Other Assets

Other assets at June 30, 2012 and December 31, 2011 consisted of the following:

	As of	
(in thousands)	June 30, 2012	December 31, 2011
Tax receivables	$ 11,275	$ 11,039
Deferred financing costs	6,918	7,706
Collateral investments	1,968	1,967
Other	1,682	1,756
Total	$ 21,843	$ 22,468

Tax receivables include the $11.3 million receivable from the state of Michigan as discussed in Note 13 to the Condensed Consolidated Financial Statements. The deferred financing costs represent costs incurred in connection with the issuance of the $175 million aggregate principal amount of 9.75% senior secured notes as described in Note 14 to the Condensed Consolidated Financial Statements.

Note 8 Accrued Expenses

Accrued expenses at June 30, 2012 and December 31, 2011 consisted of the following:

	As of	
(in thousands)	June 30, 2012	December 31, 2011
Salaries, bonuses and benefits	$ 8,008	$ 7,688
Accrued interest	6,494	6,503
Accrued royalties	1,993	1,689
Pension and post-retirement medical benefits	1,222	1,221
Other	4,705	4,102
Total	$ 22,422	$ 21,203

Accrued interest primarily relates to our 9.75% senior secured notes. The notes require semi-annual interest payments in arrears on each February 15 and August 15 over the life of the notes.

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Note 9 Other Liabilities

Other liabilities at June 30, 2012 and December 31, 2011 consisted of the following:

	As of	
(in thousands)	June 30, 2012	December 31, 2011
Pension and post-retirement medical benefits, long-term portion	$ 10,760	$ 11,110
Long-term deferred tax liability	3,092	3,121
Deferred rent	1,739	1,931
Long-term income tax payable	828	803
Long-term deferred compensation	495	544
Other	327	617
Total	$ 17,241	$ 18,126

Note 10 Pension Plan

The net pension costs of the Company s defined benefit pension plan were comprised solely of interest costs and totaled $0.1 million for the three month periods ended June 30, 2012 and 2011 and $0.3 million for the six month periods ended June 30, 2012 and 2011. The net pension costs for the three and six months ended June 30, 2012, also included accumulated net loss amortization of $9 thousand and $17 thousand, respectively.

Note 11 Restructuring

In late 2011, the Company launched a reengineering and restructuring initiative to align its organizational and cost structure to its strategic goals. The financial goal of these actions is to provide savings to both improve earnings and to fund re-investment in growth areas of the business. The majority of these costs are expected to be incurred by the end of 2012. Reengineering and restructuring activities will be assessed and enacted throughout 2012 and are expected to include:

Obtaining new leadership and employee skill sets that support the transformation of the Company to focus more heavily on technology solutions and services and other strategic objectives;

Outsourcing warehouse operations to a third party logistics provider, which will allow the Company to take advantage of a lower and more variable cost structure for its print based products, as well as locate operations closer to the geographic center of its nationwide customer base;

Rationalizing facilities space by consolidating facilities and subleasing entire or partial facilities where feasible;

Assessing and implementing projects to improve cost efficiencies and enhance the customer experience throughout the order to cash, service delivery, and procurement processes;

Reduction of job positions that do not support the Company s key strategic goals; and

Other reductions as needed to improve the Company s cost structure.

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The total expense for all reengineering and restructuring initiatives from the fourth quarter of 2011 through the end of 2012 is expected to be approximately $7.5 million, including both cash and non-cash items, and capital expenditures are expected to be between $0.6 and $0.7 million. The following table summarizes the amounts incurred and expected to be incurred in connection with the reengineering and restructuring initiative:

(in thousands)	Total Amount Expected to be Incurred	Total Incurred as of June 30, 2012	Incurred in Six Months Ended June 30, 2012	Incurred in Year Ended December 31, 2011
One-time termination benefits	$ 2,927	$ 2,777	$ 1,588	$ 1,189
Impairment of long-lived assets	3,111	3,111	3,111	
Warehouse transition costs	959	959	959	
Facility rationalization costs	378	18	18	
Process reengineering costs	150	73	73	
	$ 7,525	$ 6,938	$ 5,749	$ 1,189

The change in the reengineering and restructuring accrual for the six months ended June 30, 2012 is as follows:

(in thousands)	One-time Termination Benefits	Warehouse Outsourcing Costs	Facility Rationalization Costs	Process Reengineering Costs
Balance as of December 31, 2011	$ 1,133	$	$	$
Accrual changes	1,588	959	18	73
Payments made	(1,240)	(806)	(7)	(72)
Balance as of June 30, 2012	$ 1,481	$ 153	$ 11	$ 1

The reengineering and restructuring charges are recorded in unallocated shared services.

Assets held for sale in the Condensed Consolidated Balance Sheets include warehouse equipment of $0.5 million related to this initiative. The fair values of these assets are based on management s best estimate of the net realizable value of the equipment.

The estimates of future reengineering and restructuring charges and the calculated impairment of long lived assets represent expectations or beliefs concerning various future events. These expectations involve a number of risks and uncertainties including potential changes to the time and cost required to sublease facility space, the ultimate sublease rentals received for the facility space, the time and cost necessary to transfer to the services of the third party logistics provider, and whether, when and how successfully the Company enacts other actions that could favorably impact its cost structure. In the event these assumptions change in the future the Company could be required to record additional impairment of long lived assets or incur additional costs to complete the initiative.

Note 12 Uncertain Tax Positions

The Company recognizes the financial statement impacts of a tax return position when it is more likely than not, based on technical merits, that the position will ultimately be sustained. For tax positions that meet this recognition threshold, the Company applies judgment, taking into account applicable tax laws, experience managing tax audits and relevant GAAP, to determine the amount of tax benefits to recognize in its financial statements. For each position, the difference between the benefit realized on the Company s tax return and the benefit reflected in its financial statements is recorded on the condensed consolidated balance sheet as an unrecognized tax benefit (UTB). The Company updates its UTBs at each financial statement date to reflect the impacts of audit settlements and other resolution of audit issues, expiration of statutes of limitation, developments in tax law and ongoing discussions with tax authorities. The balance of UTBs was $7.1 million at June 30, 2012 and December 31, 2011.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. All U.S. tax years prior to 2008 related to acquired entities in a 2009 merger have been audited by the Internal Revenue Service. VSS-Cambium Holdings II Corp. and its subsidiaries have been examined by the Internal Revenue Service through the end of 2006. Various state tax authorities are in the process of examining income tax returns for various tax years through 2007.

Note 13 Commitments and Contingencies

The Company is involved in various legal proceedings incidental to its business. Management believes that the outcome of these proceedings will not have a material adverse effect upon the Company s consolidated operations or financial condition and the Company has recognized appropriate liabilities as necessary based on facts and circumstances known to management. The Company expenses legal costs related to legal contingencies as incurred.

The Company had a potential contingent liability related to state income taxes and related interest that had been assessed against a former subsidiary. On August 27, 2010, the former subsidiary received a decision and order of determination from the Michigan taxing authority. According to the determination of the Michigan taxing authority, the former subsidiary was liable to the State of Michigan for unpaid taxes and interest in the amount of approximately $10.4 million. In order to expedite resolution of this matter and access the Michigan Court of Claims, the Company paid this liability to the state of Michigan on behalf of the former subsidiary on September 7, 2010 and filed an action in the Michigan Court of Claims to pursue a refund of the assessment. On November 16, 2011, the Court of Claims in Michigan ruled in favor of the Company s motion for summary judgment. The Michigan state taxing authority has since appealed the decision of the Court of Claims to the Michigan Court of Appeals.

As management believes it is more likely than not that the Company s position will ultimately be upheld, a tax receivable for the expected refund plus statutory interest is recorded in other assets on the Condensed Consolidated Balance Sheets totaling $11.3 million and $11.0 million as of June 30, 2012 and December 31, 2011, respectively.

This liability was identified as an agreed contingency for purposes of the CVRs issued as part of a 2009 merger. In accordance with the terms of the merger agreement, dated June 20, 2009, fifty percent (50%) of any amount that is paid or due and payable with respect to each agreed contingency would offset payments due under the CVRs from an amount held for such payments by Wells Fargo Bank, N.A., as escrow agent, in an escrow account. Upon payment of the approximately $10.4 million, the Company requested a disbursement to the Company from the escrow account in an amount equal to fifty percent (50%) of the payment, or approximately $5.2 million. This cash disbursement was received by the Company during the third quarter of 2010. On September 20, 2010, the Company amended the merger agreement and the escrow agreement to extend the term of the escrow agreement until the later of the full distribution of the escrow funds or the final resolution of the agreed contingency. The final resolution of the tax litigation or potential settlement could result in a total refund from the taxing authority to the Company ranging from zero to approximately $11.3 million as of June 30, 2012, and 50% of any such refund would in turn be payable to the holders of the CVRs. As of June 30, 2012, the Company has recorded $5.1 million as a component of the CVR liability related to this agreed upon contingency, which is an estimate of the fair value based on a probability-weighted cash flow analysis using management assumptions related to the likelihood of the ultimate cash outflows. If the former subsidiary s position is not ultimately upheld, the Company could incur non-cash charges of up to $10.4 million of indemnification expense and a $0.9 million reduction in interest income in future periods on its Condensed Statements of Operations, partially offset by the related $5.1 million reduction to the CVRs liability.

The Court of Claims in Michigan also ruled in the Company s favor on two other tax matters that could result in a refund of up to $0.8 million, plus statutory interest. These potential tax refunds would be retained by the Company and are not subject to payment to the holders of the CVRs.

From time to time, the Company may enter into firm purchase commitments for printed materials included in inventory which the Company expects to use in the ordinary course of business. These commitments are typically for terms less than one year and require the Company to buy minimum quantities of materials with specific delivery dates at a fixed price over the term. As of June 30, 2012, these open purchase commitments totaled $1.1 million.

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The Company has letters of credit outstanding as of June 30, 2012 in the amount of $2.9 million to support workers compensation insurance coverage, certain credit card programs, the build-to-suit lease, and performance bonds for certain contracts. The Company maintains a $1.1 million certificate of deposit as collateral for the workers compensation insurance and credit card program letters of credit and for Automated Clearinghouse (ACH) programs. The Company also maintains a $0.9 million money market fund investment as collateral for a travel card program. The certificate of deposit and money market fund investment are recorded in other assets.

Note 14 Long-Term Debt

Long-term debt consists of the following at June 30, 2012 and December 31, 2011:

(in thousands)	June 30, 2012	December 31, 2011
$175.0 million of 9.75% senior secured notes due February 15, 2017, interest payable semiannually	$ 175,000	$ 175,000
Less: Unamortized discount	(754)	(835)
Total long-term debt	$ 174,246	$ 174,165

In February 2011, the Company closed an offering of $175 million aggregate principal amount of 9.75% senior secured notes due 2017 (the Notes) and entered into an asset-based revolving credit facility with potential for up to $40 million in borrowing capacity. Deferred financing costs are capitalized in other assets in the condensed consolidated balance sheets, net of accumulated amortization, and are to be amortized over the term of the related debt using the effective interest method. Unamortized capitalized deferred financing costs at June 30, 2012 and December 31, 2011 were $6.9 million and $7.7 million, respectively.

Interest on the Notes will accrue at a rate of 9.75% per annum from the date of original issuance and will be payable semi-annually in arrears on each February 15 and August 15, to the holders of record of the Notes on the immediately preceding February 1 and August 1. No principal repayments are due until the maturity date of the Notes.

The Notes are secured by (i) a first priority lien on substantially all of the Company s assets (other than inventory and accounts receivable and related assets of the ABL Credit Parties in connection with the ABL Facility (each as defined and discussed below) and subject to certain exceptions), including capital stock of the guarantors (which are certain of the Company s subsidiaries), and (ii) a second-priority lien on substantially all of the inventory and accounts receivable and related assets of the ABL Credit Parties, in each case, subject to certain permitted liens. The Notes also contain customary covenants, including limitations on the Company s ability to incur debt, and events of default as defined by the agreement. The Company may, at its option, redeem the Notes prior to their maturity based on the terms included in the agreement.

ABL Facility. In February 2011, the Company s wholly owned subsidiary, Cambium Learning, Inc. (together with its wholly owned subsidiaries, the ABL Credit Parties), entered into a credit facility (the ABL Facility) pursuant to a Loan and Security Agreement (the ABL Loan Agreement), by and among the ABL Credit Parties, Harris N.A., individually and as Agent (the Agent) for any ABL Lender (as hereinafter defined) which is or becomes a party to said ABL Loan Agreement, certain other lenders party thereto (together with Harris N.A. in its capacity as a lender, the ABL Lenders), Barclays Bank PLC, individually and as Collateral Agent, and BMO Capital Markets and Barclays Capital, as Joint Lead Arrangers and Joint Book Runners. The ABL Facility consists of a four-year $40.0 million revolving credit facility, which includes a $5.0 million subfacility for swing line loans and a $5.0 million subfacility for letters of credit. In addition, the ABL Facility provides that the ABL Credit Parties may increase the aggregate principal amount of the ABL Facility by up to an additional $20.0 million, subject to the consent of the Agent (whose consent shall not be unreasonably withheld) and subject to the satisfaction of certain other conditions.

The interest rate for the ABL Facility will be, at the ABL Credit Parties option, either an amount to be determined (ranging from 2.75% to 3.25%, depending upon the ABL Credit Parties fixed charge coverage ratio at the time) above the London Interbank Offered Rate (LIBOR) or at an amount to be determined (ranging from 1.75% to 2.25%, depending upon the ABL Credit Parties fixed charge coverage ratio at the time) above the base rate. On any day, the base rate will be the greatest of (i) the Agent s then-effective prime commercial rate, (ii) an average federal funds rate plus 0.50% and (iii) the LIBOR quoted rate plus 1.00%. The ABL Facility is, subject to certain exceptions, secured by a first-priority lien on the ABL Credit Parties inventory and accounts receivable and related assets and a second-priority lien (junior to the lien securing the ABL Credit Parties obligations with respect to the Notes) on substantially all of the ABL Credit Parties other assets.

As of June 30, 2012, the balances of accounts receivable and inventory collateralizing the ABL Facility were $25.3 million and $20.8 million, respectively. As of June 30, 2012, the Company had a borrowing base under the ABL Loan Agreement of up to $31.4 million.

Revolving loans under the ABL Facility may be used solely for (i) the satisfaction of existing indebtedness of the ABL Credit Parties under their prior senior secured credit facility and outstanding pursuant to their prior existing senior unsecured notes, (ii) general operating capital needs of the ABL Credit Parties in a manner consistent with the provisions of the ABL Facility and all applicable laws, (iii) working capital and other general corporate purposes in a manner consistent with the provisions of the ABL Facility and all applicable laws, (iv) the payment of certain fees and expenses incurred in connection with the ABL Facility and/or the Notes, and (v) other purposes permitted under the ABL Loan Agreement.

The ABL Facility contains a financial covenant that generally requires the ABL Credit Parties to maintain, on a consolidated basis, either (i) excess availability of at least the greater of $8 million and 15% of the revolver commitment or (ii) a fixed charge coverage ratio of 1.1 to 1.0. The ABL Credit Parties will be required to pay, quarterly in arrears, an unused line fee equal to the product of (x) either 0.375% or 0.50% (depending upon the ABL Credit Parties fixed charge coverage ratio at the time) and (y) the average daily unused amount of the revolver. As of June 30, 2012, we were in compliance with this covenant.

Note 15 Segment Reporting

The Company has three reportable segments with separate management teams and infrastructures that offer various products and services, as follows:

Voyager Learning:

Voyager Learning offers systemic solutions in reading, math, and services including turnaround and online courseware targeted towards the at-risk and special education student populations. Voyager Learning provides strategic and intensive comprehensive interventions that are adaptive to the needs of diverse populations. Voyager Learning s research-based instructional materials, support services and educational technology help accelerate struggling students to grade-level proficiency, with the goal to increase graduation rates.

Sopris Learning:

Sopris Learning supplemental products focus on the full spectrum of academic support utilizing print and technology based supplemental solutions including assessments, literacy and mathematics interventions, positive behavior supports, and professional development. Whether implemented in a single classroom, school-wide, or district-wide, Sopris Learning supplements have been proven to strengthen core instruction and to quickly and positively impact the academic achievement of students in all key areas of instruction. When compared to products offered by the Company s other business units, Sopris Learning products tend to be more tightly tailored to specific skills and target a smaller, more specific audience.

Cambium Learning Technologies:

Cambium Learning Technologies utilizes technology to deliver subscription-based websites, online libraries, software and equipment designed to help students reach their potential in grades K through 12 and beyond. Cambium Learning Technologies products are offered under four different industry leading brands: Learning A-Z, ExploreLearning, Kurzweil Educational Systems and IntelliTools.

Other:

This consists of unallocated shared services, such as accounting, legal, human resources and corporate related items. Depreciation and amortization expense, goodwill impairment, interest income and expense, other income and expense, and income taxes are also included in other, as the Company and its chief operating decision maker evaluate the performance of operating segments excluding these captions.

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The following table represents the revenue, operating expenses and income (loss) from operations which are used by the Company s chief operating decision maker to measure the segment s operating performance. The Company does not track assets directly by segment and the chief operating decision maker does not use assets or capital expenditures to measure a segment s operating performance, and therefore this information is not presented.

	Voyager Learning	Sopris Learning	Cambium Learning Technologies	Other	Consolidated
Quarter Ended June 30, 2012					
Net revenues	$ 21,222	$ 6,647	$ 12,560	$	$ 40,429
Cost of revenues	10,025	2,344	1,165	863	14,397
Amortization				6,579	6,579
Total cost of revenues	10,025	2,344	1,165	7,442	20,976
Other operating expenses	8,074	2,019	6,217	4,398	20,708
Goodwill impairment				14,700	14,700
Embezzlement and related expense (recoveries)					