

10-Q/A 1 y76596e10vqza.htm 10-Q/A: AMENDMENT NO. 1 TO FORM 10-Q

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q/A

Amendment No. 1

(Mark One)

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

For the quarterly period ended September 30, 2008

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: 333-109381

Hights Cross Communications, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
*(State or Other Jurisdiction of
Incorporation)*

13-4087398
*(I.R.S. Employer
Identification Number)*

10 New King Street
White Plains, NY
(Address of Principal Executive Offices)

10604
(Zip Code)

(914) 289-9400

(Registrant's Telephone Number, Including Area Code)

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 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

The registrant had 9,958,112 shares of Common Stock, par value \$0.0003 per share, outstanding as of November 14, 2008.

EXPLANATORY NOTE

Hights Cross Communications, Inc. (the "Company") hereby amends, as set forth below, its Report on Form 10-Q for the quarter ended September 30, 2008 (the "Original Report") with regard to Item 1, Financial Statements of the Original Report and Part II, Item 6, Exhibits, including certifications pursuant to Section 906 of Sarbanes-Oxley Act of 2002, of the Original Report.

Item 1 and Item 6 of the Original Report is hereby amended in its entirety, as set forth below. The Company does not hereby make any other changes to the Original Report.

HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(In thousands)			
Revenue	\$ 49,077	\$ 47,583	\$ 135,087	\$ 128,616
Costs and expenses:				
Cost of goods sold	12,975	12,945	36,641	35,615
Marketing and sales	9,916	9,966	30,910	28,639
Fulfillment and distribution	3,200	3,112	9,938	9,087
General and administrative	7,311	10,846	20,095	22,236
Restructuring charges	19	19	303	57
Amortization of pre-publication costs	4,181	3,671	12,065	10,215
Depreciation expense and amortization of intangibles	1,024	939	3,177	2,773
Total cost and expenses	<u>38,626</u>	<u>41,498</u>	<u>113,129</u>	<u>108,622</u>
Income from operations	10,451	6,085	21,958	19,994
Other (income) expense:				
Interest expense	11,212	14,520	33,353	50,161
Interest income	(242)	(754)	(1,271)	(2,403)
Amortization of deferred financing costs	1,154	871	2,671	2,664
Loss (gain) on troubled debt restructuring	—	(115,595)	32	(115,595)
Other expense (income)	(107)	247	(109)	250
Total other (income) expenses	<u>12,017</u>	<u>(100,711)</u>	<u>34,676</u>	<u>(64,923)</u>
Income (loss) before (provision) benefit for income taxes and discontinued operations	(1,566)	106,796	(12,718)	84,917
(Provision) benefit for income taxes	(215)	(712)	2,639	(3,001)
Income (loss) before discontinued operations	(1,781)	106,084	(10,079)	81,916
Discontinued operations:				
Income (loss) from operations of discontinued operations, net of taxes of \$0.3 million in 2008	1,071	937	290	(1,867)
Income (loss) on disposal of discontinued operations, net of taxes of \$1.2 million in 2008	119	(8)	15,643	(85)
Income (loss) on disposal of discontinued operations	<u>1,190</u>	<u>929</u>	<u>15,933</u>	<u>(1,952)</u>
Net income (loss)	(591)	107,013	5,854	79,964
Gain on recapitalization	—	34,353	—	34,353
Preferred stock dividends and accretion	—	(411)	—	(2,182)
Net income (loss) available to common stockholders	<u>\$ (591)</u>	<u>\$ 140,955</u>	<u>\$ 5,854</u>	<u>\$ 112,135</u>

See accompanying notes to unaudited consolidated financial statements.

HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	<u>September 30,</u> <u>2008 (Unaudited)</u>	<u>December 31,</u> <u>2007 (Audited)</u>
	<u>(In thousands, except share data)</u>	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 40,834	\$ 61,784
Accounts receivable, net	23,941	21,444
Inventory, net	19,531	16,914
Direct response advertising costs	2,768	2,470
Prepaid royalties	5,244	6,005
Prepaid expenses and other current assets	2,198	2,004
Escrow receivable (Note 7)	4,758	—
Assets of discontinued operations	<u>92</u>	<u>51,035</u>
Total current assets	99,366	161,656
Pre-publication costs, net	40,054	36,678
Property and equipment, net	7,077	7,878
Goodwill	115,001	115,001
Intangible assets, net	15,155	16,805
Deferred financing costs, net	6,780	6,499
Other assets	<u>392</u>	<u>255</u>
Total assets	<u>\$ 283,825</u>	<u>\$ 344,772</u>
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 22,037	\$ 25,311
Accrued interest	2,039	8,948
Deferred subscription revenue	4,366	4,798
Current portion of long term debt (Note 12)	—	124,850
Deferred tax liability-current portion	202	—
Liabilities of discontinued operations	<u>1,772</u>	<u>18,773</u>
Total current liabilities	30,416	182,680
Long term liabilities:		
Term loans (Note 12)	108,200	—
11 3/4% senior notes	140,118	171,670
12 1/2% senior discount notes	129,649	118,362
Deferred tax liability-long term	16,606	18,474
Other long term liabilities	<u>123</u>	<u>415</u>
Total long term liabilities	394,696	308,921
Commitments (Note 14)		
Stockholders' deficit:		
Common stock, \$.0003 par value, 30,000,000 shares authorized, 9,958,112 shares issued and outstanding at September 30, 2008 and 9,966,229 shares issued and outstanding at December 31, 2007	3	3
Accumulated other comprehensive income	315	755
Accumulated deficit	<u>(141,605)</u>	<u>(147,587)</u>
Total stockholders' deficit	<u>(141,287)</u>	<u>(146,829)</u>
Total liabilities and stockholders' deficit	<u>\$ 283,825</u>	<u>\$ 344,772</u>

See accompanying notes to unaudited consolidated financial statements.

HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended	
	September 30,	
	2008	2007
	(In thousands)	
Operating activities from Continuing Operations		
Net loss (loss) from continuing operations	\$ (10,079)	\$ 81,916
Adjustments to reconcile net loss from continuing operations to net cash provided by (used in) operating activities:		
Gain on troubled debt restructuring – non cash	—	(115,595)
Non-cash interest expense	11,287	25,059
Allowance for doubtful accounts	2,187	2,044
Allowance for obsolescence	866	2,163
Depreciation and amortization of property and equipment, pre-publication costs and intangibles	15,242	12,988
Amortization of deferred financing costs	2,671	2,931
Amortization of premium on 113/4% senior notes	(352)	(357)
Income tax benefit allocation—non-cash	(5,627)	—
Deferred taxes— non-cash	2,487	3,011
Restricted stock compensation expense	128	1,407
Other non-operating income — non-cash	(1,063)	422
Changes in operating assets and liabilities:		
Accounts receivable	(4,684)	(10,145)
Inventory	(3,505)	(1,664)
Prepaid expenses, royalty advances and other current assets	566	(971)
Direct response advertising costs	(297)	(277)
Other assets	(137)	—
Accounts payable, accrued and other liabilities	(3,946)	1,967
Accrued interest	(6,909)	(5,010)
Deferred subscription revenue	(432)	1,822
Net cash provided by (used in) operating activities from continuing operations	<u>(1,597)</u>	<u>1,711</u>
Investing activities from Continuing Operations		
Additions to pre-publication costs	(15,547)	(14,523)
Additions to property and equipment	(839)	(1,129)
Additions to intangible assets	(24)	(24)
Proceeds from the sale of business	48,716	—
Proceeds from the sale of assets	1,183	6
Net cash used in investing activities from continuing operations	<u>33,489</u>	<u>(15,670)</u>
Financing activities from Continuing Operations		
Transaction cost-troubled debt restructuring and recapitalization	—	(1,932)
Proceeds from issuance of New Term Loan	108,200	—
Repayment of Term Loans	(124,850)	(975)
Repayment of Senior Notes	(31,200)	—
Additions to deferred financing costs	(2,951)	(88)
Net cash used in financing activities from continuing operations	<u>(50,801)</u>	<u>(2,995)</u>
Effect of exchange rates on cash	(296)	132
Cash flows of discontinued operations		
Operating cash flows	(906)	(878)
Investing cash flows	(839)	(3,812)
Net cash used in discontinued operations	<u>(1,745)</u>	<u>(4,690)</u>
Net decrease in cash and cash equivalents	(20,950)	(21,512)
Cash and cash equivalents at beginning of period	61,784	69,847
Cash and cash equivalents at end of period	<u>\$ 40,834</u>	<u>\$ 48,335</u>

See accompanying notes to unaudited consolidated financial statements.

HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, unless noted otherwise, except for per share data)

1. Basis of Presentation

Hights Cross Communications, Inc., a Delaware corporation (together with its subsidiaries, “we,” “our,” the “Company” or “Hights Cross Communications”), whose predecessor was formed in January 1997, is a holding company that conducts all of its operations through its direct and indirect subsidiaries, including, without limitation, its wholly-owned subsidiary Hights Cross Operating Company (“Hights Cross”). Between November 2007 and January 2008, we initiated a sale process for all of our operating businesses. On June 30, 2008 we sold the subsidiary that contained our *Oakstone Publishing* business, which operated our Medical Education segment. On August 27, 2008 we sold the subsidiary that contained our *Sundance Newbridge* business, which operated our K-12 Supplemental Education segment. As a result of these dispositions, the results of *Oakstone Publishing* and *Sundance Newbridge* have been reclassified as discontinued operations for all periods presented in the consolidated financial statements. On July 1, 2008 we announced the suspension of our sale process to offer for sale our *Triumph Learning* and *Recorded Books* businesses.

The Company is a developer and publisher of products for the K-12 Education and library markets. The Company’s products include state-specific test preparation materials, skills assessment and intervention books and unabridged audiobooks. The Company’s products are sold primarily to schools and libraries.

The Company’s business is subject to moderate seasonal fluctuations as a result of many factors, including general economic trends; the traditional cyclical nature of educational material sales; school, library, and consumer purchasing decisions; the unpredictable funding of schools and libraries by federal, state, and local governments; consumer preferences and spending trends; and the timing of introductions of new products. The Company’s revenue and income from operations have historically been higher during the second and third calendar quarters.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The unaudited interim consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary for a fair statement of the consolidated results for the interim periods presented. The unaudited consolidated results of operations of interim periods are not necessarily indicative of results for a full fiscal year. These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included with our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions regarding assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

2. Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 141R, *Business Combinations* (“SFAS 141R”). SFAS 141R establishes revised principles and requirements for how the Company will recognize and measure assets and liabilities acquired in a business combination. SFAS 141R is effective for business combinations completed on or after the beginning of the Company’s 2009 fiscal year. The Company will adopt SFAS 141R at the beginning of its 2009 fiscal year, as required, and is currently evaluating the impact of such adoption on its consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (“SFAS 160”). SFAS 160 establishes accounting and reporting standards for the noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective at the beginning of the Company’s 2009 fiscal year. The Company does not believe that the adoption of SFAS 160 will have an impact on the Company’s consolidated financial statements.

On January 1, 2008, the Company adopted certain provisions of FASB Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* ("SFAS 157"), which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and expands on required disclosures about fair value measurement. The provisions of SFAS 157 adopted on January 1, 2008 relate to financial assets and liabilities as well as other assets and liabilities carried at fair value on a recurring basis. As of September 30, 2008 the Company did not have any fair valued financial item under the scope of SFAS 157 and therefore the provision of SFAS 157 adopted on January 1, 2008 did not have an impact on the Company's consolidated financial statements.

The provisions of SFAS 157 related to other nonfinancial assets and liabilities will be effective for the Company on January 1, 2009, and will be applied prospectively. The Company is currently evaluating the impact, if any, these additional SFAS 157 provisions will have on the Company's consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of SFAS 115* ("SFAS 159"), which permits but does not require us to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. As the Company has not elected to fair value any of its financial instruments under the provisions of SFAS 159, the adoption of this statement does not have any impact on the Company's consolidated financial statements.

3. Recapitalization Transaction

On August 10, 2007, we consummated a recapitalization agreement (the "Recapitalization Agreement"). The recapitalization simplified the Company's capital structure and resolved litigation between certain Preferred B holders of the Company and the Company. As a result of the recapitalization, the preference related to the Company's outstanding shares of preferred stock including the Company's Preferred B shares, which had a mandatory redemption feature, were extinguished improving the Company's financial position and the former holders of the Company's Preferred B shares received approximately 82% of the outstanding shares of Common Stock and thus voting control of the Company.

Under the terms of the Recapitalization Agreement, holders of our previously outstanding Preferred B converted their shares of Preferred B into approximately 82% of our outstanding shares of common stock, holders of our previously outstanding Preferred A, Preferred C and Preferred Warrants converted their shares and warrants into shares of common stock and common stock warrants representing approximately 15% of our outstanding shares of common stock, and certain members of management acquired new shares of common stock for \$0.001 per share under the terms of management stock purchase agreements representing approximately 3% of our outstanding common stock. In connection with the foregoing, all previously outstanding shares of common stock were effectively eliminated through the reclassification into one share of common stock in a reverse split and all outstanding Common Warrants and options to purchase common stock were similarly effectively eliminated by the reverse split of the common stock. As a result of the closing of the transactions contemplated by the Recapitalization Agreement, the Company has only outstanding common stock and common stock warrants, and no shares of Preferred A, Preferred B or Preferred C, or stock options, remain outstanding.

In connection with the recapitalization, each Preferred A share and Preferred C share was reclassified into shares of Common Stock at the rate of one share of Common Stock for each \$31.481 of accrued liquidation value of Preferred A share or Preferred C share as of June 30, 2007. Each Preferred B share was converted into approximately 4.09953 shares of Common Stock.

Pursuant to the management stock purchase agreements, management paid \$0.001 per share to acquire the shares of common stock.

All of the Company's previously outstanding warrants to purchase its Preferred A shares were automatically adjusted to become exercisable to purchase 70,301 shares of the Company's Common Stock at a purchase price of \$0.0003 per share of Common Stock. All of such rights were currently exercisable at the time of the closing of the recapitalization and have expiration dates of December 10, 2011.

At the closing of the Recapitalization Agreement, certain of our beneficial holders entered into a shareholders agreement whereby the only voting provisions contained in such agreement require the parties thereto to vote for the director nominees of certain of the parties. The Company reconstituted its Board of Directors into a new six member Board of Directors composed of Mr. Peter J. Quandt, our then Chairman and Chief Executive Officer, and five persons designated by various former Preferred B and Preferred A holders. Mr. Quandt subsequently resigned his positions with the Company. Effective September 17, 2007, Mr. Christopher Gaffney also resigned from his position on the Board of Directors of the Company, though his shareholder group reserved their right to nominate a board member in the future. On September 21, 2007, Mr. Paul J. Crecca was elected to the Board of Directors. Mr. Crecca also serves as President and Chief Executive Officer of the Company.

Also in connection with the closing of the Recapitalization Agreement, the Company and certain former Preferred B holders entered into a release agreement, pursuant to which, among other things, such holders dismissed a pending legal action filed by them against the Company that asserted claims under 8 Del. Code. § 220 and under a certain Investors Agreement, dated December 10, 1999, seeking access to Hights Cross Communications' books and records.

The closing of the Recapitalization Agreement was subject to the satisfaction of certain stated conditions, including the waiver by the requisite holders of our Term Loans, Senior Notes and Senior Discount Notes of applicable "change of control" covenants that, absent such waiver, might have applied in connection with the conversion of the Preferred C, Preferred B, and Preferred A into common stock. All required waivers were obtained.

In connection with the recapitalization, the Company recorded a gain on troubled debt restructuring of \$115.5 million during the year ended December 31, 2007, based on the difference in carrying value of the Preferred B compared to the fair value, based on an independent appraisal, of the common shares exchanged. The gain includes approximately \$1.9 million in transaction costs and a \$2.8 million benefit from consequential balance sheet write offs, primarily, the unamortized portion of the deferred gain on Preferred B. The recapitalization of the Preferred A and Preferred C also resulted in gains based on their carrying value compared to the fair value of the common shares exchanged, but because of their classification as equity instruments, the gains of \$33.0 million and \$1.3 million, respectively, are reflected as Gain on Recapitalization in the calculation of net income available to common stockholders.

The independent appraisal of the Company's Common Stock was conducted utilizing three approaches: (i) a multi-period income approach, specifically a discounted cash flow method, (ii) a review of industry guideline companies and (iii) a review of industry acquisitions.

The significant assumptions in the discounted cash flow method include the discount rates used, which range from 15 to 17%, the terminal value multiples used and the projected revenues and profits of the Company based on management's estimates and historical performance. The significant assumptions in the industry guideline approach included the selection of similar entities for market value and the determination that earnings multiples were the most indicative measure of value. Under the industry acquisition approach the significant assumptions include the determination of similar transactions for similar entities and a determination of the appropriate valuation multiples.

Once the value from each method was determined and weighted, a range of value was determined and a discount factor based on lack of marketability of 20% was applied to the values.

The adjustment of \$59,746 to the accumulated deficit in our statement of changes in stockholders' deficit for 2007 was calculated based on the fair value of shares issued in the recapitalization less the related legal fees and less the par value of the cancelled Common Stock.

4. Stock Based Compensation

Total stock-based compensation expense is recognized as a "general and administrative expense" in the consolidated statements of operations on a ratable basis over the vesting period for each option. The Company did not issue any form of Stock Options for the three and nine months ended September 30, 2008 and 2007. For the three and nine months ended September 30, 2008 and 2007, compensation expense recorded relating to the grant of stock options was *de minimus*. However as described below Restricted Shares were issued to the directors and related compensation expense was recorded.

In connection with the consummation of the Recapitalization Agreement (See Note 3), our stock option plan was terminated and all outstanding options canceled. We do not intend at this time to grant stock options in the future.

Additionally, pursuant to Management Stock Purchase Agreements dated August 10, 2007, Paul Crecca and Peter Quandt purchased, for \$0.001 per share, 75,000 and 225,000 shares of restricted stock, respectively. Mr. Quandt's 225,000 shares of common stock were deemed to be fully vested at the time of his resignation. Mr. Crecca's restricted shares are subject to a three year vesting period. Each non-employee member of the Board of Directors received a restricted stock award of 8,117 shares of our common stock with the Chairman receiving 12,175 shares. The restricted stock granted pursuant to all of these awards was to vest in February 2008. During the year ended December 31, 2007 for \$0.001 per share director Eugene I. Davis purchased 12,175 shares of restricted stock, and directors John A. McKenna, Jr., Curry E. Ford and T.J. Vigliotta have purchased 8,117 shares of restricted stock each. In January 2008, prior to the vesting of his restricted stock, Mr. Vigliotta elected to forfeit all of his restricted stock. In January 2008, prior to the vesting of his restricted stock, Mr. Ford elected to forfeit all of his restricted stock in exchange for an issuance by the Company to Glenview Capital Management, LLC, of an equivalent amount under the same terms and conditions. Subsequently, we issued to Glenview Capital Management, LLC, which has designated Mr. Ford to serve as our director, a restricted stock award of 8,117 shares. All outstanding restricted stock awards fully vested on February 10, 2008 for issuances to Mr. Davis and Glenview Capital Management, LLC and February 21, 2008 for the issuance to Mr. McKenna. Total stock-based compensation expense is recognized as a "general and administrative expense" in the consolidated statements of operations on a ratable basis over the vesting period.

The compensation expense recorded for these restricted shares was \$0 and \$0.1 million for the three and nine months ended September 30, 2008, respectively and \$1.4 million during the quarter ended September 30, 2007.

5. Inventory

Inventory consists of the following:

	September 30, 2008	December 31, 2007
Raw materials	\$ 1,396	\$ 1,114
Work-in-process	693	429
Finished goods	20,084	17,919
	<u>22,173</u>	<u>19,462</u>
Less allowance for obsolescence	2,642	2,548
Inventory, net	<u>\$ 19,531</u>	<u>\$ 16,914</u>

6. Pre-publication Costs

Pre-publication costs consist of the following:

	September 30, 2008	December 31, 2007
Pre-publication costs	\$ 102,487	\$ 87,519
Less accumulated amortization	(62,433)	(50,841)
Pre-publication costs, net	<u>\$ 40,054</u>	<u>\$ 36,678</u>

7. Dispositions

Oakstone Publishing

On June 30, 2008, the Company sold the *Oakstone Publishing* business, reported within the Medical Education segment. The sale of this business was in accordance with the strategic plan initiated by our Board of Directors upon the completion of our recapitalization in August 2007. The *Oakstone Publishing* business published and marketed to doctors and dentists subscription based continuing education materials on a variety of medical, dental and allied health specialty topics and publishes and markets subscription based wellness information, such as newsletters and calendars, to companies seeking to improve employee awareness of health and wellness issues.

The results of operations of the *Oakstone Publishing* business have been classified as discontinued operations in the accompanying consolidated financial statements for all periods presented.

The operating results of the *Oakstone Publishing* business for the three and nine months ended September 30, 2008 and 2007 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
			(Unaudited)	
Revenue	\$ —	\$ 8,927	\$14,523	\$23,557
Cost of goods sold	—	2,656	4,329	6,785
Marketing and sales	—	2,586	5,290	7,039
Fulfillment and distribution	—	876	1,802	2,466
General and administrative	—	856	1,951	2,580
Amortization of pre-publication costs	—	219	756	909
Depreciation expense	—	237	650	832
Income from operations of <i>Oakstone Publishing</i> before provision for income taxes	—	\$ 1,497	\$ (255)	\$ 2,946
Provision for income taxes	—	—	(313)	(313)
Net income (loss) from operation of <i>Oakstone Publishing</i>	<u>\$ —</u>	<u>\$ 1,497</u>	<u>\$ (568)</u>	<u>\$ 2,633</u>

On June 30, 2008, the assets and liabilities of the *Oakstone Publishing* business were sold for gross proceeds of \$47.5 million, consisting of consideration received from the buyer of \$42.8 million and \$4.8 million placed in an escrow account to satisfy working capital adjustments and indemnification obligations, if any. The escrow account balance is recorded as current asset in the consolidated balance sheet as of September 30, 2008. The Company does not have any future obligations in order to be entitled to these escrow funds and accordingly, the entire sales proceeds of \$47.5 million has been considered in recognizing a gain of \$15.1 million, as shown below, presented as a gain on disposal of discontinued operations, was recorded on the sale. At September 30, 2008, there was \$0.4 million of accrual remaining which represents liabilities of the *Oakstone Publishing* business. The escrow account balance of \$4.8 million is subject to downward purchase price adjustments, up to the full balance, based on adjustments to working capital and the representations and warranties made in the purchase agreement. The Company has recorded a \$0.3 million accrued liability for an estimated working capital adjustment that will be due to the buyer from the escrow account. Such accrual has been recorded as a reduction in earnings from discontinued operations in the accompanying statements of operations. In addition, the Company is in discussions with the buyer concerning a claim made by the buyer on September 16, 2008 against the representation and warranties. Any claims made against the escrow balance for a breach of representations and warranties must exceed the \$0.3 million basket established in the sale agreement. As of November 14, 2008, Management does not believe that is probable that the claim that has been made will exceed the amounts and has determined the full escrow balance less the \$0.3 million working capital adjustment is realizable. The remaining balance of the escrow account is due to be released to the Company on June 30, 2009 unless there are additional working capital adjustments or claims are made based on the Company's representations and warranties in the sales agreement in excess of the basket amounts described above. The carrying amounts of *Oakstone Publishing* assets and liabilities as of June 30, 2008 were as follows:

	<u>June 30, 2008</u> (Unaudited)
Assets and liabilities:	
Working capital, net (excluding cash)	\$ 1,292
Pre-publication costs, net	1,884
Property and equipment, net	1,720
Goodwill	20,565
Intangible assets, net	<u>4,537</u>
Net assets on date of sale	<u>\$ 29,998</u>
Calculation of gain on sale:	
Proceeds	\$ 47,552
Tax provision	(1,001)
Less: transaction costs	(1,457)
Less: book value of net assets sold	<u>(29,998)</u>
Gain on disposal of <i>Oakstone Publishing</i>	<u>\$ 15,096</u>

The gain on disposal of discontinued operations includes the effect of the write-off of deferred tax assets and liabilities associated with *Oakstone Publishing*.

Sundance Newbridge

On August 27, 2008 we sold the assets of the subsidiary that contained our *Sundance Newbridge* business, which operated our K-12 Supplemental Education segment. The *Sundance* imprint publishes supplemental educational materials for shared reading, guided reading, independent reading, phonics, and comprehension skills for students in PreK-8. *Sundance* also markets non-proprietary, supplemental literature products for students in grades K-6. The *Newbridge* imprint publishes nonfiction, guided reading materials, Big Books and teachers' guides in the content areas of standards-based science, social studies, and math for students in PreK-8.

The results of operations of the *Sundance Newbridge* business have been classified as discontinued operations in the accompanying consolidated financial statements for all periods presented.

The operating results of the *Sundance Newbridge* business for the three and nine months ended September 30, 2008 and 2007 were as follows:

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	2008	2007	2008	2007
Revenue	\$ 3,301	\$ 7,176	\$14,079	\$22,309

Cost of goods sold	553	2,323	3,054	7,092
Marketing and sales	596	2,622	3,657	8,945
Fulfillment and distribution	325	873	1,631	2,560
General and administrative	484	826	1,618	2,603
Restructuring charges	72		1,310	—
Amortization of pre-publication costs	164	864	1,720	4,940
Depreciation expense	<u>36</u>	<u>226</u>	<u>231</u>	<u>668</u>
Income (loss) from operations of <i>Sundance Newbridge</i> before provision for income taxes	<u>1,071</u>	<u>\$ (558)</u>	<u>\$ 858</u>	<u>\$ (4,499)</u>
Net income (loss) from operation of <i>Sundance Newbridge</i>	<u>\$ 1,071</u>	<u>\$ (558)</u>	<u>\$ 858</u>	<u>\$ (4,499)</u>

On August 27, 2008, the assets of the *Sundance Newbridge* business were sold for gross proceeds of \$5.9 million. A gain of \$0.8 million, as shown below, presented as a gain on disposal of discontinued operations, was recorded on the sale. At September 30, 2008, there was \$1.8 million of accrual remaining which represents liabilities of the *Sundance Newbridge* business.

	<u>September 30,</u> <u>2008</u>
	<u>(Unaudited)</u>
Calculation of gain on sale:	
Proceeds	\$ 5,912
Tax provision	(159)
Less: transaction costs	(303)
Less: book value of net assets sold	(4,246)
Less: assumed liabilities	(428)
Gain on disposal of <i>Sundance Newbridge</i>	<u>\$ 776</u>

We also entered into a post acquisition service agreement with the purchaser of *Sundance Newbridge* under which *Triumph Learning* provides warehouse, distribution and customer service to the purchaser under an arms length agreement. The revenues and expenses of this arrangement are reported in other income and expense and included \$0.2 million of revenues and \$0.2 million of expense in the quarter ended September 30, 2008.

In addition to gain on the disposal of *Oakstone Publishing* and *Sundance Newbridge*, a \$0.1 and \$0.2 million expense for *Chelsea House* was recorded for three and nine month periods ending September 30, 2008, respectively. *Chelsea House* was discontinued during 2005. Total income on disposal of discontinued operations, for the three and nine month periods ending September 30, 2008 was \$1.2 million and \$15.9 million, respectively.

8. Goodwill

Goodwill and other intangible assets with indefinite lives are tested for impairment annually and more frequently if impairment indicators exist, as required by Statement of Financial Accounting Standard No. 142, "*Goodwill and Other Intangible Assets*" ("SFAS 142"). First, the fair value of the reporting unit is compared to its carrying value. If the fair value is less than the carrying value, a second step is performed. In the second step, an implied goodwill value is determined by deducting the fair value of all tangible and intangible net assets of the reporting unit from the fair value of the reporting unit. If the implied fair value of the goodwill as calculated is less than the carrying amount of the goodwill, an impairment charge is recorded for the difference.

9. Intangibles

Intangible assets consist primarily of customer relationships, non-compete agreements and trademarks. Intangible assets with finite lives are amortized on a straight-line basis to expense over their useful lives of three to ten years. The Company reassesses the estimated remaining useful lives of these assets in accordance with SFAS No. 142 and has determined that such estimated lives are appropriate. A summary of intangible assets is as follows:

	<u>Lives</u>	<u>September 30,</u> <u>2008</u>	<u>December 31,</u> <u>2007</u>
Definite Life Assets			
Customer list	10 years	\$ 20,380	\$ 20,380
Non-compete agreements	3-5 years	850	850
Other	5 years	161	137
		<u>21,391</u>	<u>21,367</u>
Less: accumulated amortization		<u>(8,977)</u>	<u>(7,303)</u>
		12,414	14,064
Trademarks	Indefinite	<u>2,741</u>	<u>2,741</u>
Net intangible assets		<u>\$ 15,155</u>	<u>\$ 16,805</u>

Amortization expense for each of the three-month periods ended September 30, 2008 and 2007 was \$0.6 million and for each of the nine-month periods ended September 30, 2008 and 2007, was \$1.7 million. Accumulated amortization amounts by asset type as of September 30, 2008 were \$8.2 million for customer list, \$0.7 million for non-compete agreements and \$0.1 million for other intangible assets. Accumulated amortization by asset class as of December 31, 2007 was \$6.7 million for customer lists, \$0.5 million for non-compete agreements and \$0.1 million for other intangible assets.

Based on the current amount of intangibles subject to amortization, the estimated amortization expense for each of the succeeding five years is as follows:

	<u>Total</u>
Amortization of intangibles:	
Remainder of 2008	557
2009	2,182
2010	2,050
2011	2,045
2012	2,040
Thereafter	3,540
	<u>\$12,414</u>

10. Restructuring Charges

During the first quarter of 2006, the Company initiated a restructuring project under which it consolidated the Iowa-based warehousing, customer service and order fulfillment functions of its *Buckle Down Publishing* business with our existing shared service facility in Northborough, Massachusetts. The objective of the warehouse consolidation was to reduce payroll costs and avoid expected increases in lease costs, while providing faster and more accurate order and delivery services. The restructuring project resulted in costs associated with the severance of seven employees based in Iowa, the movement of inventory to the new facility and net lease payments that are being made through the end of the lease term. The Company completed the restructuring process during the second quarter of 2006 and incurred a total restructuring charge of approximately \$0.4 million in connection with this effort. Restructuring activity for the warehouse and order fulfillment consolidation relates to *Buckle Down Publishing* and is therefore reported within the Test-prep and Intervention segment.

On September 28, 2007, the Board of Directors authorized a restructuring of *Options Publishing* and *Triumph Learning*, whereas the management of *Options Publishing* was merged into *Triumph Learning* and the warehouse functions of *Options Publishing* would be consolidated into the shared services division; the accounting functions will be taken over by the *Triumph Learning* general accounting group located in New York City; customer services, warehousing and fulfillment will be incorporated in to the shared service facility in Northborough, MA; and the manufacturing and product purchasing functions will be consolidated into a new shared manufacturing group that is being formed in our Iowa City location. The purpose of this restructuring is to save operational costs and to improve the product development process. Furthermore, certain functions of *Triumph Learning* will be moved to other locations to improve processes, leverage shared resources and take advantage of lower cost facilities. The accounts receivable and cash applications functions will be relocated to Northborough, MA; and the manufacturing functions located in NY will be moved into the previously discussed shared manufacturing function in Iowa City. Additionally, as of January 1, 2008, the *Triumph Learning* accounting group took over certain accounting functions from *Sundance Newbridge* related to the shared service facility in Northborough, MA. The Company completed the restructuring process during the first quarter of 2008 and expects to incur a total restructuring charge of approximately \$1.1 million in connection with this effort.

Restructuring activity related to the *Options Publishing* merger with *Buckle Down Publishing* relates to *Options Publishing* and is therefore reported within the Test-prep and Intervention segment.

The cost of the restructuring activity by type of cost for three and nine months ended September 30, 2008 and 2007 is as follows:

	<u>Severance and Related</u>	<u>Lease Terminations Costs</u>	<u>Relocation and Other</u>	<u>Total Consolidation</u>
Buckle Down — Warehouse and Order Fulfillment Consolidation				
Amount expected to be incurred	\$ 65	\$ 180	\$ 162	\$ 407
2007				
Accrued restructuring liability as of December 31, 2006	—	105	—	105
Restructuring expense	—	19	—	19
Cash paid	—	(27)	—	(27)
Accrued restructuring liability as of March 31, 2007	—	97	—	97
Restructuring expense	—	19	—	19
Cash paid	—	(27)	—	(27)
Accrued restructuring liability as of June 30, 2007	—	89	—	89
Restructuring expense	—	19	—	19
Cash paid	—	(28)	—	(28)
Accrued restructuring liability as of September 30, 2007	\$ —	\$ 80	\$ —	\$ 80
2008				
Accrued restructuring liability as of December 31, 2007	—	71	—	71
Restructuring expense	—	19	—	19
Cash paid	—	(28)	—	(28)
Accrued restructuring liability as of March 31, 2008	—	62	\$ —	62
Restructuring expense	—	19	—	19
Cash paid	—	(29)	—	(29)
Accrued restructuring liability as of June 30, 2008	—	52	\$ —	52
Restructuring expense	—	19	—	19
Cash paid	—	(29)	—	(29)
Accrued restructuring liability as of September 30, 2008	\$ —	\$ 42	\$ —	\$ 42
Options Publishing — Consolidation with Buckle Down				
Amount expected to be incurred	\$ 1,000	\$ —	\$ 87	\$ 1,087
2008				
Accrued restructuring liability as of December 31, 2007	626	—	—	626
Restructuring expense	155	—	26	181
Cash paid	(696)	—	(26)	(722)
Accrued restructuring liability as of March 31, 2008	85	—	—	85
Restructuring expense	66	—	—	66
Cash paid	(111)	—	—	(111)
Accrued restructuring liability as of June 30, 2008	40	—	—	40
Restructuring expense	—	—	—	—
Cash paid	(40)	—	—	(40)
Accrued restructuring liability as of September 30, 2008	\$ —	\$ —	\$ —	\$ —

In addition to the severance and related relocation and other cash expenses incurred in connection with the *Options Publishing* consolidation with *Buckle Down Publishing*, an additional \$0.2 million restructuring expense was incurred during the first quarter 2008 due to the write off of accumulated product development costs associated with projects abandoned with the merger.

11. Income Taxes

Effective January 1, 2007, the Company adopted FASB Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in

income taxes recognized in the financial statements by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. As a result of the implementation of FIN 48, the Company did not recognize any adjustments in the liability for unrecognized tax benefits. The Company does not have any accrued interest or penalties associated with unrecognized tax benefits. The Company's continuing policy is to recognize interest and penalties related to income tax matters as tax expense. There were no significant interest and penalty expense related income tax matters recorded during the three and nine months ended September 30, 2008.

The Company files income tax returns in the U.S. federal, state, local and foreign jurisdictions. Income tax returns filed for fiscal years 2003 and earlier are no longer subject to examination by state, local and foreign authorities. Income tax returns filed for fiscal year 2004 and earlier are no longer subject to examination by U.S. federal authorities. Certain income tax returns for fiscal years 2004 through 2007 remain open to examination by state, local and foreign tax authorities and certain income tax returns for fiscal year 2005 through 2007 remain open to examination by U.S. federal tax authorities. Currently none of the federal or state tax returns are under examination. The Company believes that no provisions are required for all income tax uncertainties pertaining to these open tax years.

The continuing operations (provision) benefit for income taxes consists of the following:

	<u>Three Months Ended</u> <u>September 30,</u>		<u>Nine Months Ended</u> <u>September 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Current income tax expense:				
Foreign	\$ (158)	\$ (100)	\$ (501)	\$ (303)
Benefit recognized as a result of the discontinued operations gain	772	—	5,627	—
Deferred income tax expense:				
U.S. Federal	(829)	(612)	(2,487)	(2,698)
Total benefit (provision) for income taxes	<u>\$ (215)</u>	<u>\$ (712)</u>	<u>\$ 2,639</u>	<u>\$ (3,001)</u>

Foreign income tax expense is derived from taxable earnings on sales in the United Kingdom of \$0.5 million and \$0.3 million in the three-month periods ended September 30, 2008 and 2007, respectively and \$1.6 million and \$0.9 million in the nine-month periods ended September 30, 2008 and 2007.

In calculating the provision for income taxes on an interim basis, the Company uses an estimate of the annual effective tax rate based upon facts and circumstances known to the Company. The Company's effective rate is based on expected pretax income or loss, statutory tax rates, changes in the deferred tax asset valuation allowance and permanent differences between financial statement and tax return income applicable to the Company in the various jurisdictions in which the Company operates. The Company has recorded an income tax benefit in continuing operations of \$5.6 million as a result of the gain on the disposal of the *Oakstone Publishing* and *Sundance Newbridge* businesses, included within discontinued operations. The deferred income tax expense reflects the increase in deferred tax liabilities as a result of the amortization for income tax purposes of goodwill and indefinite lived assets not reflected in book income.

Under Section 382 of the Internal Revenue Code, based on the change of control, there could be limitations on the utilization of the Company's NOL deductions in future periods. The annual limitation on utilization of NOL's is expected to be approximately \$20 million. The Company has evaluated the impact of this change of control on the utilization of our NOL's and believes the impact of the 382 limitation will not be significant as built-in gains relating to businesses sold within 5 years of the change in control serve to increase the annual section 382 limitation.

12. Financing Arrangements

Senior Secured Revolving Credit Facility, Term Loans, 11 3/4% Senior Notes

On August 20, 2003, Hights Cross entered into a \$30.0 million Senior Secured Revolving Credit Facility (the "Facility") and a \$100.0 million Senior Secured Term Loan (the "First Term Loan"), and also issued \$140.0 million aggregate principal amount of its 11 3/4% Senior Notes due 2011 ("Senior Notes").

On August 15, 2007, we terminated the Facility, which Hights Cross had never drawn upon and was scheduled to expire by its terms in May 2008.

The First Term Loan matured on August 15, 2008, and was secured by a lien on all of the Company's property and assets (tangible and intangible), including all capital stock of existing and future subsidiaries (except future excluded subsidiaries). The First Term Loan contained customary restrictive covenants and debt incurrence tests. The First Term Loan accrued interest at a variable rate based on the Eurodollar (subject to a 2% floor), plus an applicable margin based on a graduated rate schedule. Beginning on November 15, 2003 and continuing through maturity, the Company was required to make principal payments on the First Term Loan of \$250,000 per quarter.

On December 10, 2004, Hights Cross issued an additional \$30.0 million aggregate principal amount of its Senior Notes under its existing indenture. These Senior Notes are *pari passu* with, of the same series as and vote on any matter submitted to bondholders, the original Senior Notes. In connection with the issuance of the additional Senior Notes, Hights Cross entered into a new \$30.0 million Senior Secured Term Loan (the "Second Term Loan" and, together with the First Term Loan, the "Term Loans"). Amounts borrowed

under the Second Term Loan rank equally with the amounts borrowed under the First Term Loan. The Second Term Loan also matured on August 15, 2008.

The Senior Notes mature on August 15, 2011, and were effectively subordinated to the Term Loans to the extent of the collateral securing the Term Loans. The Senior Notes contain customary restrictive covenants and debt incurrence tests. The Senior Notes bear interest at a fixed rate of 11 3/4% with payments due semi-annually on February 15 and on August 15. Interest payments commenced on February 15, 2004. On August 15, 2008, the Company entered into a new Credit Agreement, repaid its Term Loans in full, and repurchased and retired Senior Notes in the aggregate principal amount of \$31.2 million from certain of the Lenders and their affiliates for a purchase price equal to the aggregate principal amount of the notes retired, plus accrued but unpaid interest, if any.

The Senior Notes are fully and unconditionally guaranteed, jointly and severally, by the Company and each of Hights Cross' existing and future restricted subsidiaries. (See Note 17).

Term Loan Refinancing. On August 15, 2008, Hights Cross entered into a new credit agreement ("Credit Agreement") with DDJ Capital Management LLC, as administrative agent and collateral agent, and certain other lenders (collectively, the "Lenders"). Under the Credit Agreement, Hights Cross borrowed \$108.2 million under a senior secured term loan facility ("New Term Loan"). Hights Cross used a combination of the net proceeds of the New Term Loan and cash on hand, including the net proceeds from its previous sale of its *Oakstone Publishing* business, to repay the Term Loans due August 15, 2008 in full.

Hights Cross Communications and all of its direct and indirect subsidiaries (other than Hights Cross) have guaranteed Hights Cross' obligations under the New Term Loan. The New Term Loan is secured by first-priority liens on, and first-priority security interests in, substantially all of the assets of the Company and all guarantors to the Credit Agreement and a first priority security interest in 100% of the equity issued by Hights Cross' direct and indirect subsidiaries.

The final maturity date for the New Term Loan is May 15, 2011. We are required to apply 75% of our annual consolidated excess cash flow (as defined) to prepay any amounts outstanding under the New Term Loan. In addition, subject to certain exceptions and reinvestment basket, we are required to use any net proceeds from the sale or disposition of our assets, net casualty, condemnation proceeds or other extraordinary proceeds and net proceeds from the issuance or incurrence of debt or equity to prepay the New Term Loan. In general, prepayment premiums are not applicable to partial prepayments in accordance with the above. However, prepayment premiums are applicable to (a) partial prepayments on account of debt or equity issuances above agreed on baskets, (b) voluntary prepayments, and (c) upon payments of the New Term Loan (See Note 14) in full on account of any mandatory or voluntary prepayments. When applicable, the following prepayment premiums apply: prepayments on or prior to August 15, 2009 are subject to a premium of 102% of the principal, prepayments after August 15, 2009, but on or before August 15, 2010 are subject to a premium of 101% of the principal. Thereafter, the Company may make prepayments without paying a premium.

All amounts outstanding under the New Term Loan will bear interest, at the Company's option:

- (i) at the three month LIBOR rate (with a floor of 3.00%) plus 8.25% per annum, payable quarterly; or
- (ii) at the prime rate (with a floor of 5.25%) plus 7.0% per annum, payable monthly.

The Credit Agreement contains affirmative and negative covenants customarily applicable to senior secured credit facilities, including covenants restricting the ability of the Company, subject to negotiated exceptions, to incur additional indebtedness and additional liens on their assets, engage in mergers or acquisitions or dispose of assets in excess of scheduled amounts, enter into sale-leaseback transactions, make capital expenditures in excess of scheduled amounts, pay dividends or make other distributions, voluntarily prepay other indebtedness, enter into transactions with affiliated persons, make investments, and change the nature of their businesses.

The credit facilities require Hights Cross and the other loan parties to maintain a maximum secured leverage ratio, a minimum fixed charge coverage ratio, and a minimum net EBITDA (as defined). The maximum secured leverage ratio is 3.33:1 beginning with the quarter ending September 30, 2008, and then ranges from 3.36:1 to 2.94:1 through the fiscal quarter ending March 31, 2011. The minimum fixed charge coverage ratio is 0.83:1 beginning with the Company's fiscal quarter ending September 30, 2008 and then ranges between 0.80:1.00 and 0.67:1 through the fiscal quarter ending March 31, 2011. The minimum net EBITDA is \$29.8 million beginning with the Company's fiscal quarter ending September 30, 2008, and then ranges over time between \$29.2 million to \$33.4 million through the fiscal quarter ending March 31, 2011. The secured leverage ratio is defined as the ratio of Hights Cross' senior secured debt (net of up to \$10 million of balance sheet cash) to the Company's consolidated net EBITDA for the four-fiscal quarter period ending on the measurement date. The fixed charge coverage ratio is defined as the ratio of the Company's consolidated net EBITDA for the four-fiscal quarter period ending on the measurement date to the Company's consolidated interest expense, plus total

taxes and total capital expenditures (subject to certain limited exceptions) for the same period. These terms, and the calculation thereof, are defined in further detail in the Credit Agreement. As of September 30, 2008 the Company was in compliance with all terms and financial covenants of the Credit Agreement.

As of September 30, 2008, the effective interest rate on all borrowings under the New Term Loan was 11.25%.

Backstop Commitment

Effective July 29, 2008, Hights Cross entered into a commitment letter with Monarch Capital on behalf of certain of its affiliated investment funds and Glenview on behalf of certain of its affiliated investment funds. Pursuant to the Commitment Letter, Monarch Capital's and Glenview's affiliated investment funds made commitments to provide \$75 million of senior secured term loans to Hights Cross to refinance its then existing senior secured term loan indebtedness that matured on August 15, 2008. See Note 19 to our consolidated financial statements. These commitments expired upon the execution of the Credit Agreement and consummation of the loan transaction described above.

12 1/2% Senior Discount Notes

On February 2, 2004, Hights Cross Communications issued \$135.0 million aggregate principal amount at maturity of its 12 1/2% Senior Discount Notes due 2011 (the "Senior Discount Notes"), for which it received net proceeds of \$73.7 million. The Senior Discount Notes mature on August 15, 2011, with each Senior Discount Note having an accreted value of \$1,000 at maturity. The Senior Discount Notes will not begin to accrue cash interest until February 1, 2009, after which the Company will be required to make cash interest payments every six months in arrears on February 1 and August 1, commencing August 1, 2009. The Senior Discount Notes are general unsecured obligations of Hights Cross Communications and rank equally with all of Hights Cross Communications' existing and future unsecured senior indebtedness and are senior to all of its future subordinated indebtedness. The Senior Discount Notes are effectively subordinated to all of Hights Cross Communications' existing and future secured indebtedness, to the extent of the collateral securing such indebtedness. The Senior Discount Notes rank *pari passu* in right of payment to Hights Cross Communications' guarantee of the Term Loans and the Senior Notes. The Company can redeem the Senior Discount Notes on or after February 15, 2008. The Senior Discount Notes contain customary restrictive covenants and debt incurrence tests.

The following table is a summary of the Company's current outstanding debt as of September 30, 2008 (in thousands):

Instrument	Issuance Date	Due Date	Face Amount	Premium (Discount) At Issuance	Interest Rate As of September 30, 2008	Book Value As of September 30, 2008
Hights Cross:						
New Term Loan	08/15/08	05/15/11	\$108,200	—	11.25%	\$ 108,200
113/4% Senior notes	08/20/03	08/15/11	\$108,800	—	11.75%	108,800
113/4% Senior notes	12/10/04	08/15/11	\$ 30,000	\$ 3,150	11.75%	31,318
						<u>140,118</u>
Hights Cross Communications:						
121/2% Senior discount notes	02/02/04	08/15/11	\$135,000	\$(61,347)	12.5%	129,649
Total debt						<u>\$ 377,967</u>

The following table shows the required future repayments under the Company's current financing arrangements as of September 30, 2008 (in thousands):

2011	382,000
Less: Unamortized discounts and other	(4,033)
Total	<u>\$377,967</u>

13. Equity and Redeemable Preferred Stock

On December 10, 1999, the Company issued 22,476 shares of voting Series A preferred stock (the "Preferred A"). The Preferred A had a liquidation value of \$1,000 per share, plus any accrued but unpaid dividends, accrued quarterly cumulative dividends at an annual rate of 8%, and was redeemable at the option of the holders thereof beginning on December 31, 2019 at a redemption price equal to \$1,000 per share, plus any accrued but unpaid dividends. Upon the closing of the Recapitalization Agreement, all outstanding shares of Preferred A were converted to common stock at an agreed upon rate, and no shares of Preferred A remain outstanding.

On December 10, 1999, the Company issued 2,400,000 shares of nonvoting Series B senior preferred stock (the "Preferred

B”). The Preferred B had a liquidation value of \$25 per share, plus any accrued but unpaid dividends accrued quarterly cumulative dividends at an annual rate of 16%, and was mandatorily redeemable by the Company on December 10, 2011 at a redemption price equal to its liquidation value, plus any accrued but unpaid dividends. Upon the closing of the Recapitalization Agreement, all outstanding shares of Preferred B were converted to common stock at an agreed upon rate, and no shares of Preferred B remain outstanding.

In connection with the issuance of the Preferred B on December 10, 1999, the Company also issued warrants to acquire common stock (the "Common Warrants"), and warrants to acquire Preferred A (the "Preferred Warrants"). Upon the closing of the Recapitalization Agreement, all outstanding Common Warrants were canceled and all outstanding Preferred Warrants were converted into warrants to acquire common stock at an agreed upon rate.

On April 15, 2004, in connection with the acquisition of *Buckle Down Publishing*, the Company issued 3,500 shares of Series C preferred stock (the "Preferred C"). The Preferred C had a liquidation value of \$1,000 per share, plus any accrued but unpaid dividends, accrued quarterly cumulative dividends at an annual rate of 5%, was automatically convertible into common stock upon the consummation of the Company's initial public offering, was redeemable at the option of the holder thereof beginning on April 15, 2012 at a redemption price equal to \$1,000 per share plus any accrued but unpaid dividends, and was redeemable at the option of the Company at a redemption price equal to 101% of the per share liquidation value plus any accrued but unpaid dividends. Upon the closing of the Recapitalization Agreement, all outstanding shares of Preferred C were converted to common stock at an agreed upon rate, and no shares of Preferred C remain outstanding.

See Note 3 above for a description of the Recapitalization Agreement referred to above.

14. Commitments

From time to time, the Company is involved in litigation that it considers to be ordinary routine litigation incidental to our business. The Company is not presently involved in any such legal proceedings that it expects, individually or in the aggregate, to have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity.

Application of Net Proceeds from Oakstone Publishing Sale. On June 30, 2008, the Company sold its *Oakstone Publishing* business for gross proceeds of \$47.5 million, consisting of consideration received from the buyer of \$42.8 million and \$4.8 million placed in an escrow account to satisfy working capital adjustments and indemnification obligations, if any. The cash consideration from the sale was received on July 1, 2008. Under the indentures for the Senior Notes and the Senior Discount Notes, within 365 days after the receipt of the net proceeds from an asset sale, such as the *Oakstone Publishing* sale, the Company may apply such net proceeds, at its option to (i) repay obligations under any credit facilities (as defined), (ii) to acquire all or substantially all of the assets of, or any capital stock or, another permitted business (as defined), (iii) to make capital expenditures, or to acquire any other assets that are not classified as current assets under generally accepted accounting principles and that are used or useful in a permitted business. Any net proceeds that are not applied or invested within 365 days as provided above will constitute excess proceeds. If the aggregate excess proceeds were to exceed \$10 million, the indentures for our Senior Notes and Senior Discount Notes would require the Company to offer to apply such proceeds to the repayment of the Company's term loans and/or such notes. The Credit Agreement for its New Term Loan (see Note 12) further requires Hights Cross to apply such excess proceeds to the repayment of the New Term Loan no later than the date that is 30 days prior to the date on which Hights Cross would have to apply such proceeds as dictated by the indentures for the Senior Notes and Senior Discount Notes. On August 15, 2008 the Company applied a portion of the net proceeds from the *Oakstone Publishing* sale to the repayment of its senior secured term debt and anticipates that it will apply additional amounts for other permitted uses, such as capital expenditures or additional repayments of the New Term Loans, such that excess proceeds, if any, at the end of the 365 day period will be less than \$10 million.

15. Comprehensive Loss

The following table sets forth the calculation of comprehensive loss for the periods indicated:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
	(Unaudited)		(Unaudited)	
Net income (loss)	\$ (591)	\$ 107,013	\$ 5,854	\$ 79,964
Foreign currency translation adjustment	(437)	79	(440)	184
Comprehensive Loss	<u>\$ (1,028)</u>	<u>\$ 107,092</u>	<u>\$ 5,414</u>	<u>\$ 80,148</u>

16. Segment Reporting

The Company's operating segments are regularly reviewed by the chief operating decision maker for purposes of allocating resources and assessing performance.

The Company's financial reporting is organized into two business segments: Test-prep and Intervention and Library.

Our Test-Prep and Intervention segment is comprised of our *Triumph Learning and Buckle Down Publishing/ Options Publishing* businesses, which have been aggregated due to the similarity of their economic and business characteristics. Our Library segment is comprised of our *Recorded Books* business. Our Medical Education segment was comprised of our *Oakstone Publishing* business which was sold on June 30, 2008 and our K-12 Supplemental Education segment was comprised of our *Sundance Newbridge* business, which was sold on August 27, 2008. As a result of these dispositions, the results of *Oakstone Publishing* and *Sundance Newbridge* have been reclassified as discontinued operations for all periods presented in the consolidated financial statements and Medical Education and K-12 Supplemental Education segments are not included in the information below. (See Note 7 "Dispositions")

The information presented below includes certain expense allocations between the corporate office and the operating business segments. The information is presented after all intercompany and intersegment eliminations and is therefore not necessarily indicative of the results that would be achieved had the business segments been stand-alone businesses. Corporate general and administrative expenses consist of general corporate administration expenses not allocated to the operating business segments.

The results of operations and other data for the two reporting segments and corporate for the three and nine-month periods ending September 30, 2008 and 2007 are as follows:

	<u>Test-prep & Intervention</u>	<u>Library</u>	<u>Corporate</u>	<u>Consolidated</u>
Three Months Ended September 30, 2008 (unaudited)				
Revenue	\$ 25,603	\$ 23,474	\$ —	\$ 49,077
Cost of goods sold	4,712	8,263	—	12,975
Marketing and sales	6,501	3,415	—	9,916
Fulfillment and distribution	1,685	1,515	—	3,200
General and administrative	1,939	2,052	3,320	7,311
Restructuring charges	19	—	—	19
Amortization of pre-publication costs	2,704	1,477	—	4,181
Depreciation expense and amortization of intangibles	838	176	10	1,024
Income (loss) from operations	<u>\$ 7,205</u>	<u>\$ 6,576</u>	<u>\$ (3,330)</u>	<u>\$ 10,451</u>
Interest expense	\$ 4,409	\$ 754	\$ 6,049	\$ 11,212
Capital expenditures — property and equipment	123	149	15	287
Capital expenditures — pre-publication costs	2,848	1,844	—	4,692
Goodwill	50,488	64,513	—	115,001
Total assets	122,026	111,794	50,005	283,825
	<u>Test-prep & Intervention</u>	<u>Library</u>	<u>Corporate</u>	<u>Consolidated</u>
Three Months Ended September 30, 2007 (unaudited)				
Revenue	\$ 26,234	\$ 21,349	\$ —	\$ 47,583
Cost of good sold	5,375	7,570	—	12,945
Marketing and sales	6,333	3,633	—	9,966
Fulfillment and distribution	1,653	1,459	—	3,112
General and administrative	2,171	2,023	6,652	10,846
Restructuring charges	19	—	—	19
Amortization of pre-publication costs	2,255	1,416	—	3,671
Depreciation expense and amortization of intangibles	719	205	15	939
Income (loss) from operations	<u>\$ 7,709</u>	<u>\$ 5,043</u>	<u>\$ (6,667)</u>	<u>\$ 6,085</u>
Interest expense	\$ 4,387	\$ 1,161	\$ 8,972	\$ 14,520
Capital expenditures — property and equipment	201	128	6	335
Capital expenditures — pre-publication costs	3,101	1,637	—	4,738
Goodwill	50,488	64,513	—	115,001
Total assets	124,028	107,479	118,370	349,877

	<u>Test-prep & Intervention</u>	<u>Library</u>	<u>Corporate</u>	<u>Consolidated</u>
Nine Months Ended September 30, 2008 (unaudited)				
Revenue	\$ 66,768	\$ 68,319	\$ —	\$ 135,087
Cost of good sold	12,608	24,033	—	36,641
Marketing and sales	20,091	10,819	—	30,910
Fulfillment and distribution	5,392	4,546	—	9,938
General and administrative	6,102	5,803	8,190	20,095
Restructuring charges	303	—	—	303
Amortization of pre-publication costs	7,695	4,370	—	12,065
Depreciation expense and amortization of intangibles	2,592	548	37	3,177
Income (loss) from operations	<u>\$ 11,985</u>	<u>\$ 18,200</u>	<u>\$ (8,227)</u>	<u>\$ 21,958</u>
Interest expense	\$ 12,456	\$ 2,481	\$ 18,416	\$ 33,353
Capital expenditures — property and equipment	376	445	18	839
Capital expenditures — pre-publication costs	10,553	4,994	—	15,547
Goodwill	50,488	64,513	—	115,001
Total assets	122,026	111,794	50,005	283,825
	<u>Test-prep & Intervention</u>	<u>Library</u>	<u>Corporate</u>	<u>Consolidated</u>
Nine Months Ended September 30, 2007 (unaudited)				
Revenue	\$ 64,316	\$ 64,300	\$ —	\$ 128,616
Cost of good sold	12,647	22,968	—	35,615
Marketing and sales	17,536	11,103	—	28,639
Fulfillment and distribution	4,654	4,433	—	9,087
General and administrative	6,252	5,570	10,414	22,236
Restructuring charges	57	—	—	57
Amortization of pre-publication costs	6,217	3,998	—	10,215
Depreciation expense and amortization of intangibles	2,133	600	40	2,773
Income (loss) from operations	<u>\$ 14,820</u>	<u>\$ 15,628</u>	<u>\$ (10,454)</u>	<u>\$ 19,994</u>
Interest expense	\$ 12,996	\$ 3,788	\$ 33,377	\$ 50,161
Capital expenditures — property and equipment	543	519	67	1,129
Capital expenditures — pre-publication costs	10,049	4,474	—	14,523
Goodwill	50,488	64,513	—	115,001
Total assets	124,028	107,479	118,370	349,877

17. Condensed Consolidating Financial Statements

On August 20, 2003 and December 10, 2004, Hights Cross issued \$140.0 million and \$30.0 million, respectively, of its Senior Notes, and on August 15, 2008 the Company issued \$108.2 million of New Term Loans. Both the Senior Notes and the New Term Loans have been fully and unconditionally guaranteed, jointly and severally, by the Company and each of Hights Cross' existing and future restricted subsidiaries. Hights Cross and its guarantor subsidiaries are 100% owned, directly or indirectly, by the Company. Subject to certain exceptions, Hights Cross is restricted in its ability to make funds available to the Company. The following unaudited interim condensed consolidating financial information of the Company is being provided pursuant to Rule 3-10(d) of Regulation S-X.

Unaudited Interim Condensed Consolidating Statements of Operations:

	Three Months Ended September 30, 2008				Consolidated
	Parent Guarantor	HCOC	Guarantor Subsidiaries (in thousands)	Eliminations	
Revenue	\$ —	\$ —	\$ 49,077	\$ —	\$ 49,077
Costs and expenses	127	3,202	35,297	—	38,626
Income (loss) from operations	(127)	(3,202)	13,780	—	10,451
Equity in the income (loss) of subsidiaries	3,582	8,287	—	(11,869)	—
(Income) loss from discontinued operations	—	657	(1,847)	—	(1,190)
Other expenses (income)	4,046	846	7,340	—	12,232
Net (loss) income	<u>\$ (591)</u>	<u>\$ 3,582</u>	<u>\$ 8,287</u>	<u>\$ (11,869)</u>	<u>\$ (591)</u>

	Three Months Ended September 30, 2007				Consolidated
	Parent Guarantor	HCOC	Guarantor Subsidiaries (in thousands)	Eliminations	
Revenue	\$ —	\$ —	\$ 47,583	\$ —	\$ 47,583
Costs and expenses	45	6,620	34,833	—	41,498
(Loss) income from operations	(45)	(6,620)	12,750	—	6,085
Equity in the income (loss) of subsidiaries	(1,520)	3,988	—	(2,468)	—
(Income) loss from discontinued operations	—	9	(938)	—	(929)
Other expenses (income)	(108,578)	(1,121)	9,700	—	(99,999)
Net (loss) income	<u>\$ 107,013</u>	<u>\$ (1,520)</u>	<u>\$ 3,988</u>	<u>\$ (2,468)</u>	<u>\$ 107,013</u>

	Nine Months Ended September 30, 2008				Consolidated
	Parent Guarantor	HCOC	Guarantor Subsidiaries (in thousands)	Eliminations	
Revenue	\$ —	\$ —	\$ 135,087	\$ —	\$ 135,087
Costs and expenses	381	7,846	104,902	—	113,129
Income (loss) from operations	(381)	(7,846)	30,185	—	21,958
Equity in the income (loss) of subsidiaries	14,651	7,408	—	(22,059)	—
(Income) loss from discontinued operations	—	(14,212)	(1,721)	—	(15,933)
Other expenses (income)	8,416	(877)	24,498	—	32,037
Net (loss) income	<u>\$ 5,854</u>	<u>\$ 14,651</u>	<u>\$ 7,408</u>	<u>\$ (22,059)</u>	<u>\$ 5,854</u>

	Nine Months Ended September 30, 2007				Consolidated
	Parent Guarantor	HCOC	Guarantor Subsidiaries (in thousands)	Eliminations	
Revenue	\$ —	\$ —	\$ 128,616	\$ —	\$ 128,616
Costs and expenses	45	10,408	98,169	—	108,622
Income (loss) from operations	(45)	(10,408)	30,447	—	19,994
Equity in the income (loss) of subsidiaries	(6,884)	370	—	6,514	—
(Income) loss from discontinued operations	—	397	1,555	—	1,952
Other expenses (income)	(86,893)	(3,551)	28,522	—	(61,922)
Net (loss) income	<u>\$ 79,964</u>	<u>\$ (6,884)</u>	<u>\$ 370</u>	<u>\$ 6,514</u>	<u>\$ 79,964</u>

Unaudited Interim Condensed Consolidating Balance Sheets:

	As of September 30, 2008				<u>Consolidated</u>
	<u>Parent Guarantor</u>	<u>HCOC</u>	<u>Guarantor Subsidiaries</u> <i>(in thousands)</i>	<u>Eliminations</u>	
Assets					
Current assets	\$ 3,934	\$ 38,753	\$ 56,679	\$ —	\$ 99,366
Investment in subsidiaries	87	209,294	—	(209,381)	—
Long term assets	1,149	5,708	177,602	—	184,459
Total assets	<u>\$ 5,170</u>	<u>\$253,755</u>	<u>\$ 234,281</u>	<u>\$ (209,381)</u>	<u>\$ 283,825</u>
Liabilities and Stockholders' Deficit					
Current liabilities	\$ 202	\$ 5,350	\$ 24,864	\$ —	\$ 30,416
Long term liabilities	146,255	248,318	123	—	394,696
Stockholders' deficit:					
Common stock	3	—	—	—	3
Accumulated deficit and other	(141,290)	87	209,294	(209,381)	(141,290)
Total stockholders' deficit	<u>(141,287)</u>	<u>87</u>	<u>209,294</u>	<u>(209,381)</u>	<u>(141,287)</u>
Total liabilities and stockholders' deficit	<u>\$ 5,170</u>	<u>\$253,755</u>	<u>\$ 234,281</u>	<u>\$ (209,381)</u>	<u>\$ 283,825</u>
	As of December 31, 2007				
	<u>Parent Guarantor</u>	<u>HCOC</u>	<u>Guarantor Subsidiaries</u> <i>(in thousands)</i>	<u>Eliminations</u>	<u>Consolidated</u>
Assets					
Current assets	\$ 3,872	\$ 56,759	\$ 101,025	\$ —	\$ 161,656
Investment in subsidiaries	(15,314)	231,094	—	(215,780)	—
Long term assets	1,449	6,275	175,392	—	183,116
Total assets	<u>\$ (9,993)</u>	<u>\$294,128</u>	<u>\$ 276,417</u>	<u>\$ (215,780)</u>	<u>\$ 344,772</u>
Liabilities and Stockholders' Deficit					
Current liabilities	\$ —	\$137,554	\$ 45,126	\$ —	\$ 182,680
Long term liabilities	136,836	171,888	197	—	308,921
Stockholders' deficit:					
Common stock	3	—	—	—	3
Accumulated deficit	(146,832)	(15,314)	231,094	(215,780)	(146,832)
Total stockholders' deficit	<u>(146,829)</u>	<u>(15,314)</u>	<u>231,094</u>	<u>(215,780)</u>	<u>(146,829)</u>
Total liabilities and stockholders' deficit	<u>\$ (9,993)</u>	<u>\$294,128</u>	<u>\$ 276,417</u>	<u>\$ (215,780)</u>	<u>\$ 344,772</u>

Unaudited Interim Condensed Consolidating Statements of Cash Flows:

	Nine Months Ended September 30, 2008				<u>Consolidated</u>
	<u>Parent Guarantor</u>	<u>HCOC</u>	<u>Guarantor Subsidiaries</u> <i>(in thousands)</i>	<u>Eliminations</u>	
Cash provided by (used in):					
Operating activities from continuing operations:	\$ (963)	\$ (10,876)	\$ 10,242	\$ —	\$ (1,597)
Investing activities from continuing operations:					
Additions to pre—publication costs	—		(15,547)	—	(15,547)
Additions to property and equipment	—	(19)	(820)	—	(839)
Additions to intangible assets	—	—	(24)	—	(24)
Proceeds from sale of business	—	48,716	—	—	48,716
Proceeds from sale of assets	—	1,181	2	—	1,183
Intercompany activity	1,026	(3,673)	2,647	—	—
Net cash provided by (used in) investing activities	1,026	46,205	(13,742)	—	33,489
Financing activities:					—
Proceeds from issuance of New Term Loans	—	108,200	—	—	108,200
Repayment of Senior Notes	—	(31,200)	—	—	(31,200)
Repayment of Senior Secured Term Loan	—	(124,850)	—	—	(124,850)
Additions to deferred financing costs	—	(2,951)	—	—	(2,951)
Net cash provided used in financing activities	—	(50,801)	—	—	(50,801)
Effect of exchange rates on cash	—	—	(296)	—	(296)
Net cash used in discontinued operations	—	(7,148)	5,403	—	(1,745)
Net change in cash and cash equivalents	63	(22,620)	1,607	—	(20,950)
Cash and cash equivalents at beginning of period	3,872	56,237	1,675	—	61,784
Cash and cash equivalents at end of period	<u>\$ 3,935</u>	<u>\$ 33,617</u>	<u>\$ 3,282</u>	<u>\$ —</u>	<u>\$ 40,834</u>

	Nine Months Ended September 30, 2007				
	<u>Parent Guarantor</u>	<u>HCOC</u>	<u>Guarantor Subsidiaries</u> <i>(in thousands)</i>	<u>Eliminations</u>	<u>Consolidated</u>
Cash provided by (used in):					
Operating activities from continuing operations:	\$ 72	\$ (7,320)	\$ 8,959	\$ —	\$ 1,711
Investing activities from continuing operations:					
Additions to pre-publication costs	—	—	(14,523)	—	(14,523)
Additions to property and equipment	—	(67)	(1,062)	—	(1,129)
Additions to intangible assets	—	—	(24)	—	(24)
Intercompany activity	1,977	(8,393)	6,416	—	—
Proceeds from sale of assets	—	—	6	—	6
Net cash provided by (used in) investing activities	1,977	(8,460)	(9,187)	—	(15,670)
Financing activities:					
Transaction cost – troubled debt restructuring and Recapitalization	(1,932)	—	—	—	(1,932)
Proceeds from exercise of stock options	—	—	—	—	—
Repayment of senior secured term loan	—	(975)	—	—	(975)
Additions to deferred financing costs	—	(88)	—	—	(88)
Net cash provided used in financing activities	(1,932)	(1,063)	—	—	(2,995)
Effect of exchange rates on cash	—	—	132	—	132
Net cash used in discontinued operations	—	(106)	(4,584)	—	(4,690)
Net change in cash and cash equivalents	117	(16,949)	(4,680)	—	(21,512)
Cash and cash equivalents at beginning of period	3,718	63,989	2,140	—	69,847
Cash and cash equivalents at end of period	<u>\$ 3,835</u>	<u>\$ 47,040</u>	<u>\$ (2,540)</u>	<u>\$ —</u>	<u>\$ 48,335</u>

18. Subsequent Events

Effective October 8, 2008, the Company amended and restated its Second Amended and Restated Certificate of Incorporation of the Company, as amended (the “Existing Charter”) by filing the Third Amended and Restated Certificate of Incorporation of the Company (the “Third Amended and Restated Charter”). Certain provisions of the Existing Charter were amended or restated to provide for the following:

- Addition of Section C “Reclassification” to Article IV, which ratifies and confirms the Company’s reclassification of its common stock and preferred stock that occurred on August 10, 2008 (the “Recapitalization”) by further reclassifying all shares of each and every class and series of capital stock of the Company outstanding immediately prior to the filing of the Third Amended and Restated Charter into shares of new Common Stock as reflected on the Company’s stock ledger, which ledger reflects the ownership of the Company based upon the effectiveness of the Recapitalization; and
- Addition of a new Article VIII, which makes explicit the Company’s ability to provide certain indemnification rights and advancement of expenses to its directors, officers and agents in excess of the indemnification and advancement otherwise permitted by Section 145 of the General Corporation Law.

19. Related Party Transaction

Pursuant to Management Stock Purchase Agreements dated August 10, 2007, Messrs. Crecca and Quandt purchased for \$0.001 a share, 75,000 and 225,000 shares of restricted stock, respectively. Mr. Quandt’s 225,000 shares of common stock were deemed to be fully vested at the time of his resignation. Mr. Crecca’s restricted shares are subject to a three year vesting period. Each non-employee member of the Board of Directors received a restricted stock award of 8,117 shares of our common stock with the Chairman receiving 12,175 shares. The restricted stock granted pursuant to all of these awards was to vest in February 2008. During the year ended December 31, 2007, for \$0.001 per share director Eugene I. Davis purchased 12,175 shares of restricted stock, and directors John A. McKenna, Jr., Curry E. Ford and T.J. Vigliotta have purchased 8,117 shares of restricted stock each. In January 2008, prior to the vesting of his restricted stock, Mr. Vigliotta elected to forfeit all of his restricted stock. In January 2008, prior to the vesting of his restricted stock, Mr. Ford elected to forfeit all of his restricted stock in exchange for an issuance by the Company to Glenview Capital Management, LLC, of an equivalent

amount under the same terms and conditions. Subsequently, we issued to Glenview Capital Management, LLC, which has designated Mr. Ford to serve as our director, a restricted stock award of 8,117 shares. All outstanding restricted stock awards fully vested on February 10, 2008 for issuances to Mr. Davis and Glenview Capital Management, LLC and February 21, 2008 for the issuance to Mr. McKenna. Total stock-based compensation expense is recognized as a “general and

administrative expense” in the consolidated statements of operations on a ratable basis over the vesting period. Total stock-based compensation expense is recognized as a “general and administrative expense” in the consolidated statements of operations on a ratable basis over the vesting period. The compensation expense recorded for these restricted shares was \$0 and \$0.1 million for the three and nine months ended September 30, 2008, respectively.

Monarch Alternative Capital LP (“Monarch Capital”), Deephaven Distressed Opportunities Trading Ltd. and New York Life Investment Management LLC each may be deemed to beneficially own more than 5% of our outstanding stock. Each of these entities or their affiliates also own positions in one or more of our Term Loans, Senior Notes or Senior Discount Notes. Mr. Vigliotta, a director, is a Principal at Monarch Capital and has served as a member of our Board of Directors since August 2007. Monarch Capital acquired its debt positions prior to Mr. Vigliotta’s appointment to our Board. Effective July 29, 2008, Hights Cross entered into a commitment letter (the “Commitment Letter”) with Monarch Capital on behalf of certain of its affiliated investment funds and Glenview Capital Management, LLC on behalf of certain of its affiliated investment funds (“Glenview” and together with Monarch Capital, the “Proposed Lenders”). Pursuant to the Commitment Letter, the Proposed Lenders made commitments to provide \$75 million of senior secured term loans (the “Facility”) to Hights Cross to refinance its then existing senior secured term loan indebtedness that matured on August 15, 2008 (the “Refinancing”).

This commitment was obtained as a backstop to ensure the Company had the ability to effect the Refinancing. Accordingly, Hights Cross was free to obtain financing in lieu of the Facility (the “Alternative Term Loan Facility”) and suffer no financial penalty. Upon Hights Cross’ election to proceed with an Alternative Term Loan Facility described above under “New Term Loans”, the commitments of Monarch and Glenview terminated.

Pursuant to the Commitment Letter, Monarch and Glenview each made a commitment to provide 50% of the amount of the Facility. In consideration for this commitment, Hights Cross agreed (i) to pay or reimburse Monarch and Glenview for certain reasonable and documented out-of-pocket costs and expenses and (ii) to pay a non-refundable commitment fee of \$750,000 to each of Monarch and Glenview.

Certain of Monarch’s affiliates or investment funds for which it acts as investment advisor currently beneficially own more than 21% of the common stock of the Company. T.J. Vigliotta, a Principal at Monarch, has served as a member of our Board of Directors since August 2007.

Certain of Glenview’s affiliates or investment funds for which it acts as investment advisor currently beneficially own more than 14% of the common stock of the Company. Curry E. Ford, a Managing Director of Glenview, has served as a member of our Board of Directors since August 2007.

Neither of Messrs. Vigliotta or Ford participated in the Company’s decision to accept the Commitment Letter.

PART II — OTHER INFORMATION**Item 6. Exhibits**

Exhibit Number	Description	Page or Method of Filing
2.1	Asset Purchase Agreement by and among The Rowman & Littlefield Publishing Group, Inc., Sundance/Newbridge, LLC, Hights Cross Operating Company and Sundance/Newbridge Educational Publishing, LLC, dated as of August 27, 2008.	Incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed September 4, 2008.
3.1	Third Amended and Restated Certificate of Incorporation dated October 8, 2008, of Hights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed October 10, 2008.
3.2	Bylaws of Hights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.2 of the Company's Registration Statement on Form S-4 (Reg. No. 333-109381) filed October 2, 2003.
3.2(a)	Amendment to Bylaws dated August 10, 2007, of Hights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.2 of the Company's Current Report on Form 8-K filed August 16, 2007.
3.2(b)	Amendment to Bylaws dated September 21, 2007, of Hights Cross Communications, Inc.	Incorporated by referenced to Exhibit 3.1 of the Company's Current Report on Form 8-K filed September 27, 2007
10.26	Amendment No. 2 dated October 8, 2008 to Shareholders Agreement dated August 10, 2007, as amended on January 29, 2008.	Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed October 10, 2008.
10.27	Separation and Release Agreement by and between Kevin McAliley and Hights Cross Communications, Inc., dated November 10, 2008.	Incorporated by reference to Exhibit 10.27 of the Company's Quarterly Report on Form 10-Q filed November 14, 2008
31.1	Rule 13a-14(a)/15d-14(a) Certification of Paul J. Crecca	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Mark Kurtz	Filed herewith
32.1	Certification of Paul J. Crecca pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.2	Certification of Mark Kurtz pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith

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