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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

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

Haights 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)*

Registrant's Telephone Number, Including Area Code:
(914) 289-9400

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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of Exchange Act. (Check one):

Large Accelerated Filer ☐ Accelerated Filer ☐ Non-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 ☑

The registrant had 20,012,914 shares of Common Stock, par value $0.001 per share, outstanding as of May 14, 2007.

HAIGHTS CROSS COMMUNICATIONS, INC.

Quarterly Report for the
Quarter Ended March 31, 2007

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HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended March 31,	
	2007	2006
	(In thousands)	
		As restated
Revenue	$ 52,933	$ 51,490
Costs and expenses:		
Cost of goods sold	14,426	14,760
Marketing and sales	14,923	14,762
Fulfillment and distribution	4,687	4,408
General and administrative	7,009	7,060
Restructuring charges	19	134
Amortization of pre-publication costs	4,406	4,339
Depreciation expense and amortization of intangibles	1,414	1,353
Total cost and expenses	46,884	46,816
Income from operations	6,049	4,674
Other (income) expense:		
Interest expense	17,279	15,835
Interest income	(868)	(655)
Amortization of deferred financing costs	913	733
Other expense	(7)	6
Total other expenses	17,317	15,919
Loss before provision for income taxes	(11,268)	(11,245)
Provision for income taxes	(1,334)	(1,282)
Loss before discontinued operations	(12,602)	(12,527)
Discontinued operations:		
Loss from operations of discontinued operations	—	—
Loss on disposal of discontinued operations	(41)	(2)
Net loss	(12,643)	(12,529)
Preferred stock dividends and accretion	(871)	(796)
Net loss available to common stockholders	$(13,514)	$(13,325)

See accompanying notes to unaudited consolidated financial statements.

HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	March 31, 2007 Unaudited	December 31, 2006 Audited
	(In thousands, except per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 53,293	$ 69,847
Accounts receivable, net	25,621	22,462
Inventory, net	23,376	23,242
Direct response advertising costs — current portion, net	4,788	3,838
Prepaid royalties	6,070	6,135
Prepaid expenses and other current assets	2,488	2,658
Total current assets	115,636	128,182
Pre-publication costs, net	46,307	45,173
Direct response advertising costs, net	7,941	7,389
Property and equipment, net	11,161	11,279
Goodwill	135,566	135,566
Intangible assets, net	23,574	24,242
Deferred financing costs, net	9,522	10,347
Other assets	494	508
Total assets	$ 350,201	$ 362,686
LIABILITIES, REDEEMABLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable and accrued liabilities	$ 24,885	$ 30,862
Accrued interest	3,977	9,039
Deferred subscription revenue	15,425	14,140
Current portion of long term debt	1,300	1,300
Total current liabilities	45,587	55,341
Long term liabilities:		
Senior secured term loan	124,525	124,850
11 3/4% senior notes	172,028	172,146
12 1/2% senior discount notes	108,052	104,847
Series B senior preferred stock, redeemable, $.001 par value, 6,000,000 shares authorized, 2,000,230 shares issued and outstanding (approximate aggregate liquidation value as of March 31, 2007 of $157,517)	155,776	149,626
Deferred tax liability	16,093	14,905
Deferred gain on Series B cancellation and other long term liabilities	3,632	3,838
Total long term liabilities	580,106	570,212
Commitments*(Note 13)*		
Redeemable preferred stock:		
Series A preferred stock, redeemable, $.001 par value, 30,000 shares authorized, 22,476 shares issued and outstanding (approximate aggregate liquidation value as of March 31, 2007 of $40,104)	39,975	39,196
Series C preferred stock, redeemable, $.001 par value, 3,500 shares authorized, issued and outstanding (approximate aggregate liquidation value as of March 31, 2007 of $4,054)	1,947	1,855
Total redeemable preferred stock	41,922	41,051
Stockholders' deficit:		
Common stock, $.001 par value, 30,000,000 shares authorized, 20,012,914 shares issued and outstanding as of March 31, 2007 and December 31, 2006	20	20
Accumulated other comprehensive income	677	658
Accumulated deficit	(318,111)	(304,596)
Total stockholders' deficit	(317,414)	(303,918)
Total liabilities, redeemable preferred stock and stockholders' deficit	$ 350,201	$ 362,686

See accompanying notes.

HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three Months Ended March 31,	
	2007	2006
	(In thousands)	
		(As restated)
Operating activities from continuing operations		
Net loss from continuing operations	$(12,602)	$(12,527)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:		
Non-cash interest expense	9,177	7,934
Allowance for doubtful accounts and obsolescence	1,804	1,473
Depreciation and amortization of property and equipment, pre-publication costs and intangibles	5,820	5,692
Amortization of deferred financing costs	913	733
Amortization of premium on 11 3/4% senior notes	(118)	(120)
Deferred taxes — non-cash	1,188	1,126
Other non-operating income (loss) — non-cash	—	9
Changes in operating assets and liabilities:		
Accounts receivable	(3,814)	(3,597)
Inventory	(1,283)	(669)
Prepaid expenses, royalty advances and other current assets	234	2,120
Direct response advertising costs	(1,501)	(1,684)
Other assets	14	—
Accounts payable, accrued and other liabilities	(6,002)	(5,530)
Accrued interest	(5,062)	(4,952)
Deferred subscription revenue	1,285	907
Net cash used in operating activities from continuing operations	(9,947)	(9,085)
Investing activities from continuing operations		
Additions to pre-publication costs	(5,526)	(5,605)
Additions to property and equipment	(614)	(1,173)
Additions to intangible assets	(14)	(6)
Acquisitions, net of cash acquired	—	(99)
Proceeds from sale of business	—	500
Proceeds from sale of assets	—	9
Net cash used in investing activities from continuing operations	(6,154)	(6,374)
Financing activities from continuing operations		
Proceeds from exercise of stock options	—	10
Repayment of senior secured term loan	(325)	(325)
Additions to deferred financing costs	(88)	(80)
Net cash used in financing activities from continuing operations	(413)	(395)
Effect of exchange rates on cash	7	13
Cash flows of discontinued operations		
Operating cash flows	(47)	(121)
Investing cash flows	—	—
Net cash used in discontinued operations	(47)	(121)
Net decrease in cash and cash equivalents	(16,554)	(15,962)
Cash and cash equivalents at beginning of period	69,847	69,592
Cash and cash equivalents at end of period	$ 53,293	$ 53,630

See accompanying notes to unaudited consolidated financial statements.

HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)

1. Basis of Presentation

Haights Cross Communications, Inc., a Delaware corporation (together with its subsidiaries, "we," "our," the "Company" or "Haights 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 Haights Cross Operating Company ("Haights Cross"). The unaudited interim financial statements contained herein consist of the accounts of Haights Cross and its subsidiaries on a consolidated basis.

The Company is a developer and publisher of products for the K-12 supplemental education, library and medical education markets. The Company's products include supplemental reading books with a concentration on non-fiction content, state-specific test preparation materials, skills assessment and intervention books, unabridged audiobooks and continuing medical education products. The Company's high quality products are sold primarily to schools, libraries and medical professionals.

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. All material intercompany accounts and transactions have been eliminated upon consolidation and, in connection with the previously disclosed reorganization of our segment financial reporting into four business segments, certain previously reported amounts have been reclassified to be consistent with current financial statement presentation. 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, 2006.

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

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 interest and penalty expense related income tax matters recorded during the quarter ended March 31, 2007.

The Company files income tax returns in the U.S. federal, state, local and foreign jurisdictions. Income tax returns filed for fiscal years 2002 and earlier are no longer subject to examination by U.S. federal, state, local and foreign authorities. No federal, state, local and foreign income tax returns are currently under examination. Certain income tax returns for fiscal years 2003 through 2006 remain open to examination by U.S. federal, state, local and foreign tax authorities. The Company believes that it has made adequate provision for all income tax uncertainties pertaining to these open tax years.

In February 2007, the FASB issued SFAS No. 159, "Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is expected to expand the use of fair value measurement, which is consistent with the FASB's long-term measurement objectives for accounting for financial instruments. SFAS 159 is effective for the Company beginning on January 1, 2008. The Company is currently evaluating the potential effect SFAS 159 will have on the Company's financial position, results of operations, liquidity and related disclosures.

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157"), which establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The statement applies under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007; therefore the Company will begin to apply the standard in its fiscal year commencing January 1, 2008. The Company is in the process of evaluating the impact, if any, SFAS No. 157 will have on the Company's financial position, results of operations, liquidity and related disclosures.

3. Restatement of Financial Statements

In finalizing the audit of the Company's financial statements for the year ended December 31, 2006 management determined that a restatement of the Company's financial statements at and for the years ended December 31, 2004 and 2005 and for all quarterly periods during 2005 and the first through third quarters of 2006 was required. The Company has included the effects of these restatements in this Quarterly Report on Form 10-Q for the year to date period ended March 31, 2007.

The Company accounts for income taxes pursuant to the provisions of SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). In general, under SFAS No. 109, deferred tax assets and liabilities are recorded to reflect the future tax consequences attributable to the effects of differences between the carrying amounts of assets and liabilities for financial reporting and for income tax purposes.

The Company determined that it should increase the valuation allowance on deferred income tax assets from amounts that had previously been provided. Historically, the Company has recorded deferred income tax liabilities and the related deferred income tax expense based on netting deferred tax liabilities resulting from goodwill deductions on certain reporting units against deferred tax assets resulting from goodwill impairments on other reporting unit prior to determining the required valuation allowance. Because of the uncertainty of the realization of the deferred tax assets related to goodwill, the Company has determined that the valuation allowance should be increased for these items. Accordingly, the Company has determined that a restatement of the deferred income tax expense and related deferred income tax liability at and for the years and related quarterly periods ended December 31, 2004, 2005 and for each of the three fiscal quarters in 2006 quarterly periods.

Deferred income tax expense and the related deferred tax liability are non-cash items for the Company and are excluded when the Company is evaluating compliance with the debt covenants applicable to its existing financing arrangements. The restatement had no effect on cash tax expense or actual cash income taxes due. The Company's Net Operating Loss (NOL) carryforward at December 31, 2006 of approximately $111.7 million and the ability to offset future current income tax liabilities against this NOL is also unaffected by this restatement.

4. Stock–Based Compensation

As of March 31, 2007, the Company maintained the 2000 Stock Option and Grant Plan (the "Plan"), which is a stock-based compensation plan that provides for grants of incentive stock options to employees of the Company

(including officers and employee directors), as well as grants of non-qualified stock options to employees and consultants of the Company.

The Plan is administered by the Company's Board of Directors (the "Board"). The Board has the right, in its discretion, to select the individuals eligible to receive awards, determine the terms and conditions of the awards granted, accelerate the vesting schedule of any award and generally administer and interpret the Plan. They also have the right to adjust the exercise price after a reorganization, recapitalization, stock split or similar change in the Company's common stock. Under the Plan, the Company generally grants stock options for a fixed number of shares to employees with an exercise price equal to or greater than the fair value of the shares at the date of grant. The exercise price of these options is determined by the Board using commonly-employed valuation methods for the market in which the Company operates. The Company determined the intrinsic value of the outstanding options to be $0 for the period ended March 31, 2007. No options were granted during either of the three-month periods ended March 31, 2006 and March 31, 2007.

The Company issues time-based stock options which are generally subject to a three-year vesting schedule. Time-based options vest in annual installments of 20%, 30% and 50% on the first, second and third anniversary of the grant date, respectively, while other options are subject to performance-based vesting. All options expire ten years from the date of grant and may be exercised for specific periods after the termination of the optionee's employment or other service relationship with the Company.

Prior to January 1, 2006, the Company accounted for the Plan using the fair value method of accounting for stock options under SFAS No. 123. Under the fair value method, compensation expense for options was measured at the grant date and was based on the value of the award as determined using the minimum value method. The expense then was recognized over the vesting period of the grant. Effective January 1, 2006, the Company adopted the fair-value recognition provisions of SFAS No. 123(R), using the prospective transition method. Accordingly, the Company has not restated prior periods. Compensation expense for all share-based payments granted subsequent to January 1, 2006 are based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

The Company recognized compensation expense as a "general and administrative expense" in its statements of operations on a ratable basis over the vesting period for each option. As of March 31, 2007, there was approximately $25,000 of total unrecognized compensation expense related to non-vested stock options that will be recognized over a weighted-average period of 3 years.

The total cash received from the exercise of stock options was $0 and approximately $10,000 for the three-month periods ended March 31, 2007 and 2006, respectively, and is classified as cash flows from financing activities. Prior to the adoption of SFAS No. 123(R), the Company was required to present all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the statements of cash flows. SFAS No. 123(R) requires the Company to classify cash flows from tax benefits attributable to tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) as financing cash flows. The Company did not have any excess tax benefits for the three-month periods ended March 31, 2007 and 2006.

Changes in outstanding options are as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted- Average Remaining Contractual Life
Outstanding as of December 31, 2006	1,982,953	$ 1.33	7.56 yrs
Forfeited in three-months ended March 31, 2007	41,965		
Granted in three-months ended March 31, 2007	—		
Exercised in three-months ended March 31, 2007	—		
Outstanding as of March 31, 2007	1,940,988	$ 1.34	7.30yrs
Options exercisable and vested at March 31, 2007	1,164,788	$ 1.76	
Options available for grant at March 31, 2007	446,098		
Options unvested at March 31, 2007	776,200		8.93yrs

5. Inventory

Inventory consists of the following:

	March 31, 2007	December 31, 2006
Raw materials	$ 1,289	$ 1,371
Work-in-process	776	1,013
Finished goods	25,370	24,541
	27,435	26,925
Allowance for obsolescence	4,059	3,683
Inventory, net	$ 23,376	$ 23,242

6. Pre-publication Costs

Pre-publication costs consist of the following:

	March 31, 2007	December 31, 2006
Pre-publication costs	$ 97,973	$ 92,851
Less accumulated amortization	51,666	47,678
Pre-publication costs, net	$ 46,307	$ 45,173

Amortization of pre-publication costs for the three-month periods ended March 31, 2007 and 2006 was $4.4 million and $4.3 million, respectively.

7. Goodwill

Goodwill and other intangible assets with indefinite lives are tested for impairment annually, as required by SFAS 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. For purposes of estimating the fair value of the reporting unit the Company used a weighted average of discounted cash flow approach and market valuation approach.

8. 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:

Definite Life Assets	Lives	March 31, 2007	December 31, 2006
Customer list	10 years	$ 23,240	$ 23,240
Non-compete agreements	3-5 years	1,900	1,900
Other	5 years	179	171
		25,319	25,311
Less: accumulated amortization		(6,576)	(5,898)
		18,743	19,413
Trademarks	Indefinite	4,831	4,829
Net intangible assets		$ 23,574	$ 23,242

Amortization expense for each of the three-month periods ended March 31, 2007 and 2006 was $0.7 million. Accumulated amortization amounts by asset type as of March 31, 2007 were $5.6 million for customer list, $0.8 million for non-compete agreements and $0.1 million for other intangible assets. Accumulated amortization by asset class as of December 31, 2006 was $5.0 million for customer lists, $0.7 million for non-compete agreements and $0.2 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:

	Total
Amortization of intangibles:	
Remainder of 2007	$ 2,043
2008	2,720
2009	2,666
2010	2,420
2011	2,324
Thereafter	6,570
	$ 18,743

9. 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 our *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.

The cost of the restructuring activity by type is as follows:

	Warehouse and Order Fulfillment Consolidation			
	Severance and related	Lease terminations costs	Relocation and other	Total Consolidation
Amount expected to be incurred	$ 65	$ 180	$ 162	$ 407
Accrued restructuring liability as of December 31, 2005	—	—	—	—
Restructuring expense	13	—	121	134
Cash paid	(13)	—	(89)	(102)
Accrued restructuring liability as of March 31, 2006	—	—	32	32
Restructuring expense	52	180	41	273
Cash paid	(43)	(24)	(72)	(139)
Accrued restructuring liability as of June 30, 2006	9	156	1	166
Restructuring expense	—	—	—	—
Cash paid	(9)	(24)	(1)	(34)
Accrued restructuring liability as of September 30, 2006	—	132	—	132
Restructuring expense	—	—	—	—
Cash paid	—	(27)	—	(27)
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	$ 0	$ 97	$ 0	$ 97

All restructuring activity for the periods presented was related to *Buckle Down Publishing* and is therefore reported within the Test-prep and Intervention segment.

10. Income Taxes

The provision for income taxes consists of the following:

	Three Months Ended March 31,	
	2007	2006
Current income tax expense:		
Foreign	$ (146)	$ (156)
Deferred income tax expense:		
U.S. Federal	(1,188)	(1,126)
Total provision for income taxes	$(1,334)	$(1,282)

Foreign income tax expense is derived from taxable earnings on sales in the United Kingdom of $0.5 million for both of the three-months ended March 31, 2007 and 2006.

The deferred income tax expense of $1.2 million and $1.1 million for the three-month periods ended March 31, 2007 and 2006, respectively, relates to the book and tax difference for goodwill and other indefinite life assets for these periods.

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 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. A reconciliation of the statutory Federal income tax rate to the effective rate for the three-month periods ended March 31, 2007 and 2006, respectively, is as follows:

	Three Months Ended March 31,	
	2007	2006
Statutory rate	34%	34%
State and local income taxes (net of federal benefit)	6%	6%
Change in valuation allowance	(26)%	(27)%
Non-deductible interest expense	(24)%	(21)%
Other	(2)%	(3)%
Effective tax rate	(12)%	(11)%

11. Financing Arrangements

At March 31, 2007 the Company was not compliant with certain of its various debt agreement covenants. Refer to Note 17 below for a description of subsequent events affecting our Senior Secured Revolving Credit Facility, Senior Secured Term Loans, 11 3/4% Senior Notes and 12 1/2% Senior Discount Notes.

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

On August 20, 2003, Haights 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").

The Facility matures on May 20, 2008 and is secured by a first 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 Facility contains customary restrictive covenants and financial ratio requirements. Borrowings under the Facility bear interest at variable rates based on LIBOR plus an applicable spread. The Facility has been amended periodically to allow for acquisitions and to amend or waive compliance with certain financial ratio requirements. As of March 31, 2007, the Company had not drawn any amounts on the Facility and our available borrowing capacity under the Facility, as limited by our financial covenant ratios, was $20.5 million.

The First Term Loan matures on August 20, 2008, is subordinate to the Facility and is secured by a second 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 contains customary restrictive covenants and debt incurrence tests. The First Term Loan bears interest at a variable rate based on the Eurodollar (subject to a 2% floor), plus an applicable margin based on a graduated rate schedule. As of March 31, 2007, the effective interest rate on all borrowings under the First Term Loan was 9.86%. Beginning on November 15, 2003

and continuing through maturity, the Company is required to make principal payments on the First Term Loan of $250,000 per quarter.

The Senior Notes mature on August 15, 2011, and are subordinate to the Facility and the Term Loans (as defined below). 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 December 10, 2004, Haights 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 with, the original Senior Notes. In connection with the issuance of the additional Senior Notes, Haights 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 matures on August 20, 2008. As of March 31, 2007, the effective interest rate on all borrowings under the Second Term Loan was 8.86%. As of March 31, 2007, the Company had $170.0 million aggregate principal amount of outstanding Senior Notes and $125.8 million aggregate principal amount of indebtedness outstanding under the Term Loans.

The Facility, the Term Loans and the Senior Notes have been fully and unconditionally guaranteed, jointly and severally, by the Company and each of Haights Cross' existing and future restricted subsidiaries. (See Note 16.)

12 1/2% Senior Discount Notes

On February 2, 2004, Haights 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 Haights Cross Communications and rank equally with all of Haights 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 Haights 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 Haights Cross Communications' guarantee of the Facility, the Term Loans and the Senior Notes. The Company can redeem the Senior Discount Notes on or after February 15, 2008 and, prior to February 15, 2007, may redeem up to 35% of the aggregate principal amount at maturity of the Senior Discount Notes with net cash proceeds from certain equity offerings. 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 March 31, 2007 (in thousands):

Instrument:	Issuance Date	Due Date	Face Amount	Premium (Discount) At issuance	Interest Rate as of March 31, 2007	Book Value as of March 31, 2007
Haights Cross:						
Senior secured term loan	08/20/03	08/20/08	$100,000	—	9.86%	$ 96,500
Senior secured term loan	12/10/04	08/20/08	$ 30,000	—	8.86%	29,325
						$ 125,825
11 3/4% Senior notes	08/20/03	08/15/11	$140,000	—	11.75%	$ 140,000
11 3/4% Senior notes	12/10/04	08/15/11	$ 30,000	$ 3,150	11.75%	32,028
						$ 172,028
Haights Cross Communications:						
12 1/2% Senior discount notes	02/02/04	08/15/11	$135,000	$ (61,347)	12.5%	$ 108,052
Series B preferred (See Note 12)	12/10/99	12/10/11	$ 50,006	$ (3,410)	16.0%	155,776
Total debt						$ 561,681

The following table shows the required future repayments under the Company's current financing arrangements as of March 31, 2007 (in thousands):

Remainder of 2007	$ 975
2008	124,850
2009	—
2010	—
2011	462,518
Total	588,343
Less: Unamortized discounts and other	(26,662)
	$561,681

12. 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 has a liquidation value of $1,000 per share, plus any accrued but unpaid dividends. The Preferred A accrues quarterly cumulative dividends at an annual rate of 8%. Beginning on December 31, 2019, any Preferred A holder may require the Company to redeem its outstanding Preferred A shares at a redemption price equal to $1,000 per share, plus any accrued but unpaid dividends. Each holder of a share of Preferred A is entitled to one vote per share. The initial carrying value of the Preferred A was $22.3 million. Unless earlier redeemed or repurchased, the Preferred A will accrete to an aggregate liquidation value of $110.2 million through December 19, 2019, the date holders can require redemption.

On December 10, 1999, the Company issued 2,400,000 shares of nonvoting Series B senior preferred stock (the "Preferred B"), warrants to acquire 3,333,861 shares of common stock at $.01 per share (the "Common Warrants"), and warrants to acquire 3,458 shares of Preferred A at $.01 per share (the "Preferred Warrants"), for aggregate proceeds of $60.0 million. In 2004, the Company canceled 1,194,814 of the Common Warrants, and 1,245 of the Preferred Warrants, in connection with two separate Preferred B retirement transactions.

On January 22, 2004, DLJ Merchant Banking Partners II, L.P. and its affiliates (the "DLJ Parties") sold substantially all of their shares of Preferred B, Preferred Warrants and Common Warrants to third parties. In connection with the sale, (i) the terms of the Preferred B were amended to clarify that unpaid cash dividends would accrue on a quarterly compounded basis, and (ii) an investor's agreement among the Company and the DLJ Parties was amended to eliminate the DLJ Parties' board designation right and related director approval rights, and the DLJ Parties' board designee resigned from the Company's board of directors. In consideration for the amendment to the terms of the Preferred B, the DLJ Parties returned to the Company for cancellation 104,770 shares of Preferred B with an aggregate liquidation value of $5,000,000, warrants to purchase 778 shares of Preferred A with a carrying value of $778,000 and warrants to purchase 743,148 shares of Common Stock. In connection with the return and cancellation of the Preferred B shares, the Company reversed $0.2 million of discount and fees representing the pro rata portion of the unamortized discount and issuance costs of the Preferred B, resulting in a net deferred gain of $5.6 million which is being amortized against interest expense over the remaining term of the Preferred B.

On February 2, 2004, the Company repurchased 295,000 outstanding shares of Preferred B at a price equal to 99% of their aggregate liquidation value, or $14.1 million. In connection with this repurchase, warrants to purchase 467 shares of the Company's Preferred A with a liquidation value of $0.5 million and warrants to purchase 451,666 shares of the Company's Common Stock were returned to the Company for cancellation. In connection with the repurchase of the Preferred B shares, the Company reversed $0.5 million of discount and fees representing the pro rata portion of the Preferred B unamortized discount and issuance costs. The resulting gain of $0.1 million was recorded and included in other income.

The Preferred B has a liquidation value of $25 per share, plus any accrued but unpaid dividends. Prior to January 1, 2005, the Preferred B accrued quarterly cumulative dividends at an annual rate of 16%, which dividends were added to its carrying value. Beginning January 1, 2005, such dividends became payable quarterly in cash. Under the terms of the Preferred B, if the Company fails to pay four consecutive or six quarterly cash dividends for any reason, the holders of the Preferred B are entitled to elect one director to serve on the Company's Board of Directors. The Company has failed to pay any such cash dividends and, effective January 20, 2006, the holders of the Preferred B elected, by written consent, Eugene I. Davis to serve on the Company's Board of Directors. As of March 31, 2007, the Company had accrued $46.8 million for unpaid cash dividends, but has elected not to pay cash

dividends because the Company is restricted from paying such dividends by the terms of the indenture for its Senior Discount Notes.

The Preferred B is mandatorily redeemable on December 10, 2011 at its liquidation value, plus any accrued but unpaid dividends. After December 10, 2004, the Company may redeem the Preferred B at 110% of its liquidation value, plus any accrued but unpaid dividends. The redemption premium in connection with an optional redemption periodically declines each year through 2008 to 100% of liquidation value, plus any accrued but unpaid dividends. The initial carrying value of the Preferred B was $53.9 million, which was net of $0.8 million of issuance costs. The issuance costs will be amortized through December 10, 2011. Unless earlier redeemed or repurchased, the Preferred B will accrete to the mandatory redemption price of $25 per share plus accrued but unpaid dividends (the liquidation value) on the Preferred B through December 10, 2011, the date upon which it is mandatorily redeemable.

Upon a change of control of the Company after December 10, 2002, to the extent the Company has funds legally available, the Company is required to offer to redeem the Preferred B at 108% of its liquidation value plus any accrued but unpaid dividends. The redemption premium in connection with a change of control offer periodically declines each year through 2008 to 100% of liquidation value plus any accrued but unpaid dividends.

As of December 10, 1999, the 3,333,861 Common Warrants and the 3,458 Preferred Warrants were valued at $1.9 million and $3.5 million, respectively. Each warrant is exercisable into shares of common stock or Preferred A, as applicable, at an exercise price of $0.01 per share and has an expiration date of December 10, 2011. The fair value of the Common Warrants was estimated at the grant date using the Black-Scholes option-pricing model. The fair value of the Preferred Warrants was estimated based upon the redemption value of the Preferred A discounted to present value of the Preferred A.

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 has a liquidation value of $1,000 per share, plus any accrued but unpaid dividends. The Preferred C accrues quarterly cumulative dividends at an annual rate of 5%. The Preferred C shall automatically convert into common stock upon the consummation of the Company's initial public offering, with the number of shares of common stock issued on such conversion to be determined as follows: (a) if such initial public offering occurs on or prior to April 15, 2008, the number of shares of common stock to be issued shall be equal to the original face value of the Preferred C of $3.5 million divided by the price per share at which the common stock is offered to the public in such offering, or (b) if such initial public offering occurs after April 15, 2008, the number of shares of common stock to be issued shall be equal to the original face value of the Preferred C of $3.5 million plus all accrued and unpaid dividends thereon, divided by the price per share at which the common stock is offered to the public in such offering. Beginning on April 15, 2012, any Preferred C holder may require the Company to redeem the outstanding shares of Preferred C held by that holder at a redemption price equal to $1,000 per share plus any accrued but unpaid dividends. The holders of shares of Preferred C are not entitled to any voting rights. The Company may, at its option, at any time, redeem shares of Preferred C, in whole or in part, at a price equal to 101% of the per share liquidation value plus any accrued but unpaid dividends. The initial carrying value of the Preferred C was $1.1 million. Unless earlier redeemed or repurchased, the Preferred C will accrete to the aggregate liquidation value of $5.2 million through April 15, 2012, the date holders can require redemption.

The Company has 30,000,000 shares of common stock authorized for issuance. As of March 31, 2007, the Company had 20,012,914 shares issued and outstanding, 2,387,086 shares reserved for the issuance upon the exercise of stock options granted under the Plan and 2,139,047 shares reserved for the issuance upon the exercise of Common Warrants.

Media/ Communications Partners III Limited Partnership and its affiliates beneficially own 71.7% of Haights Cross Communications' common stock and they can therefore direct our policies and can select a majority of Haights Cross Communications' directors. The interest of Media/ Communications Partners III Limited Partnership and its affiliates may conflict with the interest of our other investors.

We are a party to a registration rights agreement with certain of our holders of common stock, pursuant to which we have granted those persons or entities the right to register shares of common stock held by them under the Securities Act of 1933, as amended (the "Securities Act"). The holders of these rights are entitled to demand that we register their shares of common stock under the Securities Act. These holders are also entitled to "piggyback" registration rights in which they may require us to include their shares of common stock in future registration statements that we may file, either for our own account or for the account of other security holders exercising

registration rights. In addition, after our initial public offering, certain of these holders have the right to request that their shares of common stock be registered on a Form S-3 registration statement so long as the anticipated aggregate sales price of such registered shares as of the date of filing of the Form S-3 registration statement is at least $0.5 million. The foregoing registration rights are subject to various conditions and limitations, including the right of underwriters of an offering to limit the number of registrable securities that may be included in an offering. The registration rights terminate as to any particular stockholder on the date on which the holder may sell all of his or its shares pursuant to Rule 144(k) under the Securities Act. We are generally required to bear all of the expenses of these registrations, except underwriting commissions, selling discounts and transfer taxes.

13. Commitments

On February 27, 2007, certain holders of the Preferred B filed an action in the Delaware Chancery Court seeking an order to compel the Company to allow them access to inspect certain of the Company's corporate and business books and records pursuant to a request under Section 220 of the Delaware General Corporation Law and under the Investors Agreement, as amended, between the Company and certain of its stockholders. No monetary relief is sought in this action. The plaintiffs made a number of allegations in the action, including allegations of breach of fiduciary duty and corporate mismanagement, to support their request for access to the Company's books and records. The Company contended that the documents sought by plaintiffs in this action far exceeded those to which they are entitled under Section 220 or the Investors Agreement, believed the action was without merit, and intended to vigorously defend against it.

On June 29, 2007, in connection with a recapitalization agreement the Company entered into with, among others, the holders of the Preferred B, the plaintiffs agreed to dismiss this action upon the closing of such agreement. See Note 17 to these consolidated financial statements below for a description of the recapitalization agreement.

In addition to the foregoing, 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 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.

14. Comprehensive Loss

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

	Three Months Ended March 31,	
	2007	2006
		As restated
	(Unaudited)	
Net loss	$(12,643)	$(12,529)
Foreign currency translation adjustment	19	17
Comprehensive Loss	$(12,624)	$(12,512)

15. 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 four business segments: K-12 Supplemental Education, Test-prep and Intervention, Library and Medical Education.

Our K-12 Supplemental Education segment is comprised of our *Sundance/Newbridge* business. Our Test-Prep and Intervention segment is comprised of our *Triumph Learning, Buckle Down Publishing* and *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 is comprised of our *Oakstone Publishing* business, which includes the *Scott Publishing* and CME*info* businesses since the dates of their respective acquisitions.

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 four reporting segments and corporate for the three-month periods ending March 31, 2007 and 2006 are as follows:

	K-12 Supplemental Education	Test-prep & Intervention	Library	Medical Education	Corporate	Consolidated
Three Months Ended March 31, 2007 (unaudited)						
Revenue	$ 5,386	$ 19,592	$ 20,592	$ 7,363	$ —	$ 52,933
Cost of good sold	1,422	3,872	7,061	2,071	—	14,426
Marketing and sales	3,049	6,141	3,591	2,142	—	14,923
Fulfillment and distribution	807	1,622	1,472	786	—	4,687
General and administrative	954	2,066	1,632	851	1,506	7,009
Restructuring charges	—	19	—	—	—	19
Amortization of pre-publication costs	815	1,969	1,287	335	—	4,406
Depreciation expense and amortization of intangibles	205	703	207	288	11	1,414
Income (loss) from operations	$ (1,866)	$ 3,200	$ 5,342	$ 890	$ (1,517)	$ 6,049
Interest expense	$ 805	$ 4,254	$ 1,336	$ 1,268	$ 9,616	$ 17,279
Capital expenditures — property and equipment	159	191	156	96	12	614
Capital expenditures — pre-publication costs	578	3,268	1,398	282	—	5,526
Goodwill	—	50,488	64,513	19,565	—	135,566
Total assets	20,679	117,891	106,869	40,637	64,125	350,201

	K-12 Supplemental Education	Test-prep & Intervention	Library	Medical Education	Corporate	Consolidated
Three Months Ended March 31, 2006 (unaudited)						
Revenue	$ 7,940	$ 17,810	$ 18,744	$ 6,996	$ —	$ 51,490
Cost of good sold	2,143	3,608	6,749	2,260	—	14,760
Marketing and sales	3,449	5,324	3,752	2,237	—	14,762
Fulfillment and distribution	892	1,264	1,494	758	—	4,408
General and administrative	1,050	2,063	1,538	879	1,530	7,060
Restructuring charges	—	134	—	—	—	134
Amortization of pre-publication costs	1,413	1,458	1,167	301	—	4,339
Depreciation expense and amortization of intangibles	214	695	201	224	19	1,353
Income (loss) from operations	$ (1,221)	$ 3,264	$ 3,843	$ 337	$ (1,549)	$ 4,674
Interest expense	$ 663	$ 3,513	$ 1,417	$ 1,099	$ 9,143	$ 15,835
Capital expenditures — property and equipment	145	128	822	77	1	1,173
Capital expenditures — pre-publication costs	1,625	2,613	1,179	188	—	5,605
Goodwill	24,393	60,906	64,513	19,743	—	169,555
Total assets	53,895	122,430	101,497	39,979	69,110	386,911

16. Condensed Consolidating Financial Statements

On August 20, 2003 and December 10, 2004, Haights Cross issued $140.0 million and $30.0 million, respectively, of its Senior Notes, which have been fully and unconditionally guaranteed, jointly and severally, by the Company and each of Haights Cross' existing and future restricted subsidiaries. Haights Cross and its guarantor subsidiaries are 100% owned, directly or indirectly, by the Company. Subject to certain exceptions, Haights 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 March 31, 2007				
	Parent Guarantor	HCOC	Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenue	$ —	$ —	$ 52,933	$ —	$ 52,933
Costs and expenses	—	1,518	45,366	—	46,884
Income (loss) from operations	—	(1,518)	7,567	—	6,049
Equity in the income (loss) of subsidiaries	(2,202)	(1,720)	—	3,922	—
Loss from discontinued operations	—	41	—	—	41
Other expenses (income)	10,441	(1,077)	9,287	—	18,651
Net (loss) income	$ (12,643)	$ (2,202)	$ (1,720)	$ 3,922	$ (12,643)

	Three Months Ended March 31, 2006				
	Parent Guarantor	HCOC	Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Revenue	$ —	$ —	$ 51,490	$ —	$ 51,490
Costs and expenses	—	1,549	45,267	—	46,816
(Loss) income from operations	—	(1,549)	6,223	—	4,674
Equity in the income (loss) of subsidiaries	(3,390)	(1,971)	—	5,361	—
Loss from discontinued operations	—	2	—	—	2
Other expenses (income)	9,139	(132)	8,194	—	17,201
Net (loss) income	$ (12,529)	$ (3,390)	$ (1,971)	$ 5,361	$ (12,529)

Unaudited Interim Condensed Consolidating Balance Sheets:

	As of March 31, 2007				
	Parent Guarantor	HCOC	Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Assets					
Current assets	$ 3,756	$ 50,771	$ 61,109	$ —	$ 115,636
Investment in subsidiaries	2,010	247,692	—	(249,702)	—
Long term assets	2,012	7,585	224,968	—	234,565
Total assets	$ 7,778	$306,048	$ 286,077	$ (249,702)	$ 350,201
Liabilities, Redeemable Preferred Stock and Stockholders' Deficit					
Current liabilities	$ —	$ 7,485	$ 38,102	$ —	$ 45,587
Long term liabilities	283,270	296,553	283	—	580,106
Redeemable preferred stock	41,922	—	—	—	41,922
Stockholders' deficit:					
Common stock	20	—	—	—	20
Accumulated deficit and other	(317,434)	2,010	247,692	(249,702)	(317,434)
Total stockholders' deficit	(317,414)	2,010	247,692	(249,702)	(317,414)
Total liabilities, redeemable preferred stock and stockholders' deficit	$ 7,778	$306,048	$ 286,077	$ (249,702)	$ 350,201

	As of December 31, 2006				
	Parent Guarantor	HCOC	Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Assets					
Current assets	$ 3,718	$ 64,437	$ 60,027	$ —	$ 128,182
Investment in subsidiaries	4,193	241,564	—	(245,757)	—
Long term assets	2,127	8,295	224,082	—	234,504
Total assets	$ 10,038	$314,296	$ 284,109	$ (245,757)	$ 362,686
Liabilities, Redeemable Preferred Stock and Stockholders' Deficit					
Current liabilities	$ —	$ 13,107	$ 42,234	$ —	$ 55,341
Long term liabilities	272,905	296,996	311	—	570,212
Redeemable preferred stock	41,051	—	—	—	41,051
Stockholders' deficit:					
Common stock	20	—	—	—	20
Accumulated deficit	(303,938)	4,193	241,564	(245,757)	(303,938)
Total stockholders' deficit	(303,918)	4,193	241,564	(245,757)	(303,918)
Total liabilities, redeemable preferred stock and stockholders' deficit	$ 10,038	$314,296	$ 284,109	$ (245,757)	$ 362,686

Unaudited Interim Condensed Consolidating Statements of Cash Flows:

	Three-months Ended March 31, 2007				
	Parent Guarantor	HCOC	Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Cash provided by (used in):					
Operating activities from continuing operations:	$ 38	$ (5,235)	$ (4,750)	$ —	$ (9,947)
Investing activities from continuing operations:					
Additions to pre-publication costs	—	—	(5,526)	—	(5,526)
Additions to property and equipment	—	(12)	(602)	—	(614)
Additions to intangible assets	—	—	(14)	—	(14)
Intercompany activity	—	(7,829)	7,829	—	—
Acquisitions, net of cash acquired	—	—	—	—	—
Proceeds form the sale of business	—	—	—	—	—
Proceeds from sale of assets	—	—	—	—	—
Net cash provided by (used in) investing activities	—	(7,841)	1,687	—	(6,154)
Financing activities:		—			—
Proceeds from exercise of stock options	—	—	—	—	—
Repayment of senior secured term loan	—	(325)	—	—	(325)
Additions to deferred financing costs	—	(88)	—	—	(88)
Net cash provided used in financing activities	—	(413)	—	—	(413)
Effect of exchange rates on cash	—	—	7	—	7
Net cash used in discontinued operations	—	(47)	—	—	(47)
Net change in cash and cash equivalents	38	(13,536)	(3,056)	—	(16,554)
Cash and cash equivalents at beginning of period	3,718	63,989	2,140	—	69,847
Cash and cash equivalents at end of period	$ 3,756	$ 50,453	$ (916)	$ —	$ 53,293

	Three Months Ended March 31, 2006				
	Parent Guarantor	HCOC	Guarantor Subsidiaries	Eliminations	Consolidated
			(in thousands)		
Cash provided by (used in):					
Operating activities from continuing operations:	$ 32	$ (6,810)	$ (2,307)	$ —	$ (9,085)
Investing activities:					
Additions to pre-publication costs	—	—	(5,605)	—	(5,605)
Additions to property and equipment	—	(1)	(1,172)	—	(1,173)
Additions to intangible assets	—	—	(6)	—	(6)
Intercompany activity	(10)	(6,468)	6,478	—	—
Acquisitions, net of cash acquired	—	(99)	—	—	(99)
Proceeds form the sale of Chelsea House				500	500
Proceeds from sale of assets	—	—	9	—	9
Net cash provided by (used in) investing activities	(10)	(6,068)	(296)	—	(6,374)
Financing activities:					
Net proceeds from issuance of stock	10	—	—	—	10
Repayment of senior secured loan	—	(325)	—	—	(325)
Additions to deferred financing costs		(80)	—	—	(80)
Net cash provided by (used in) financing activities	10	(405)	—	—	(395)
Effect of exchange rates on cash	—	—	13	—	13
Net cash used in discontinued operations	—	(121)	—	—	(121)
Net change in cash and cash equivalents	32	(13,404)	(2,590)	—	(15,962)
Cash and cash equivalents at beginning of period	3,571	64,650	1,371	—	69,592
Cash and cash equivalents at end of period	$ 3,603	$ 51,246	$ (1,219)	$ —	$ 53,630

17. Subsequent Event

Delay in Filing Periodic Reports

We are a "voluntary filer" for purposes of the periodic and current reporting requirements of the SEC. We are a voluntary filer because we do not have a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or listed on an exchange or in any automated inter-dealer quotation system of any national securities association, and we are no longer required to file reports under Section 15(d) of the Exchange Act. Rather, we continue to file our reports under the Exchange Act in order to comply with the reporting covenants contained in our outstanding term loan agreements and bond indentures.

On April 2, 2007, we filed a Notification of Late Filing on Form 12b-25 with the SEC relating to our inability to file on a timely basis this Annual Report on Form 10-K as a result of (i) the need to complete work on a restatement of our financial statements to reflect adjustments to our accounting for Preferred Warrants and deferred income taxes, which restatement is discussed and included herein, and (ii) the need to further investigate, and to allow our independent accountants to conduct additional procedures with respect to, matters of disagreement that Mr. Eugene I. Davis, who is a member of our Board of Directors, had expressed concerning the process by which new management employment agreements, entered into beween us and Mr. Peter J. Quandt, our Chief Executive Officer, and Mr. Paul J. Crecca, our Executive Vice President and Chief Financial Officer, on January 31, 2007, had been approved by the Board of Directors. On April 17, 2007, we filed a Current Report on Form 8-K disclosing that we were not yet in a position to file our Annual Report on Form 10-K insofar as the investigation referred to above was still ongoing.

Effect of late filing on our financial reporting covenants. Under our Facility (as defined below), we are required to file our annual financial statements with the agent for such Facility within 90 days following the end of our fiscal year and our quarterly financial statements with the agent for such facility within 45 days following the end of our first three fiscal quarters of each fiscal year. Under the agreements relating to our Senior Secured Term Loans and the indentures relating to our Senior Notes and Senior Discount Notes (each as defined herein), we are required to timely deliver to the agent under the Senior Secured Term Loans and the trustee under the bond indentures, within the time periods specified by the SEC's rules and regulations, the financial information required to be contained in our Annual Report on Form 10-K and other periodic reports, including our Quarterly Reports on Form 10-Q. As a result of the delay in filing our Annual Report on Form 10-K, we defaulted on our annual financial information delivery covenants in the Facility, in the agreements for the Senior Secured Term Loans, and in the indentures for our Senior Notes and Senior Discount Notes. In addition, as a result of the delay in filing this Quarterly Report on Form 10-Q for our quarter ended March 31, 2007, we defaulted on our quarterly financial information delivery covenants in the Facility, in the agreements for the Senior Secured Term Loans, and in the indentures for our Senior Notes and Senior Discount Notes.

Under the respective terms of the Facility, the Senior Secured Term Loan agreements, and the indentures, a default of a financial information delivery covenant can become an "Event of Default," and potentially enable the indebtedness thereunder to become accelerated, following written notice to us from the agents and/or trustee and/or the requisite lenders or holders and the continuation of such default without cure for a stated period (referred to as the "cure period"). The cure period under the Facility with respect to a default of a financial information delivery covenant is 30 days following notice, and the cure period under the Senior Secured Term Loan agreements and the indentures with respect to a default of a financial information delivery covenant is 60 days following notice.

With respect to the Facility, the indentures and the Senior Secured Term Loans:

- We received a default notice from the agent under the Facility on May 14, 2007, which stated that we were in default of the annual financial information delivery covenant for our failure to timely furnish to the agent under the Facility our annual financial information for our fiscal year ended December 31, 2006. We received a second default notice from the agent under the Facility on June 12, 2007, which stated that an Event of Default would not be deemed to occur as a result of failing to timely furnish the annual financial information for our fiscal year ended December 31, 2006 if we furnished such information to the agent by July 12, 2007. On July 12, 2007, we received a third notice from the agent under the Facility extending the cure period to July 26, 2007.

- We received default notices from the trustee under the indentures on May 29, 2007, which stated that an Event of Default would not be deemed to occur as a result of failing to timely file with the SEC our annual financial information for the fiscal year ended December 31, 2006 included in our Annual Report on Form 10-K if we filed this report within 60 days of the date of notice.
- We received a default notice from the agent under the agreements for our Senior Secured Term Loans on June 19, 2007, which stated that an Event of Default would not be deemed to occur as a result of failing to timely file with the SEC our annual financial information for the fiscal year ended December 31, 2006 included in our Annual Report on Form 10-K and our quarterly financial information for our fiscal quarter ended March 31, 2007 (included in this Quarterly Report on Form 10-Q for the quarter ended March 31, 2007) if we filed such reports within 60 days of the date of notice.

Accordingly, by filing our Annual Report on Form 10-K on July 19, 2007 with the SEC and/or delivering it to the applicable agents and/or trustee, we have cured our outstanding defaults relating to the filing and/or furnishing of our annual financial information for our fiscal year ended December 31, 2006. We are currently filing this Quarterly Report on Form 10-Q with SEC which will cure defaults of our covenants relating to the filing and/or furnishing of our quarterly financial information for our fiscal quarter ended March 31, 2007.

As a result of the default under the Senior Secured Term Loan agreements, the interest rate on the outstanding balance under the First Term Loan (as defined below) increased as of April 18, 2007 from 9.86% to 11.36%. Such interest rate will decrease to 9.86% one business day after the filing of our Annual Report on Form 10-K and this Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2007.

Investigation of disagreements with Mr. Davis. In communications with the company and our auditors, Mr. Davis had made allegations to the effect that (i) “fraud” had been committed in connection with the “creation” of the employment agreements with Messrs. Quandt and Crecca, (ii) Messrs. Christopher S. Gaffney and Stephen F. Gormley, who constitute a majority of our non-employee directors and who approved the agreements, had a conflict of interest with respect to the agreements because they were “interested parties” and stood to gain personal benefits by approving such agreements, and (iii) a compensation consultant retained by the company to prepare and advise upon the agreements should have been retained directly by the Board of Directors, and that the ultimate report delivered by the compensation consultant was inadequate to support the agreements. In response, the Board of Directors engaged independent outside counsel to investigate Mr. Davis’ allegations and report back to the Board of Directors.

On June 29, 2007, the independent counsel presented its final findings to the Board of Directors. The material findings were as follows:

- The employment agreements were not misleading and did not have secret terms, and no director that voted upon the agreements was deprived of relevant information that would have affected his vote. Accordingly, Mr. Davis’ claim of “fraud” was not supported.
- Messrs. Gaffney and Gormley were not “interested” in the agreements and their involvement in negotiating the agreements did not constitute a conflict of interest.
- The engagement of the compensation consultant by the company was the “functional equivalent” of engagement by the Board of Directors, insofar as Messrs. Gaffney and Gormley, who constituted two of the three directors (Mr. Davis being the third) who would have made the decision to engage the consultant, knew of, and approved, the engagement.
- The report of the compensation consultant was supported by legitimate bases.

Consistent with the independent counsel’s recommendations, the Compensation Discussion & Analysis included in Item 11 of our Annual Report on Form 10-K contains a description of the process leading up to the

approval of the employment agreements and the role of the compensation consultant in the preparation and approval of such agreements. This description, together with a complete description of the employment agreements (and related noncompetition agreements) is set forth in "Item 11 – Compensation Discussion & Analysis" in our Annual Report on Form 10-K.

Recapitalization

On June 29, 2007, we entered into an agreement with the holders of a majority of the outstanding shares of each of the Preferred B, the Preferred A and our Common Stock (the "Recapitalization Agreement"). Under the terms of the Recapitalization Agreement, upon the execution thereof the parties approved, and we adopted and filed, an amendment to our certificate of incorporation that provides for the holders of the Preferred C, the Preferred B, and the Preferred A to elect to convert the outstanding shares thereof (and the related Preferred Warrants) into Common Stock at an agreed upon rate. Upon the closing of the Recapitalization Agreement, (i) the parties would approve, and we would adopt and file, a second amendment to our certificate of incorporation that would have the effect of eliminating all existing outstanding shares of Common Stock and options and warrants to purchase such Common Stock, and (ii) the holders of the Preferred C, Preferred B, and Preferred A, by the requisite votes of such holders, would elect to convert their securities into Common Stock at the agreed upon rate. In addition, Mr. Peter J. Quandt, our Chairman and Chief Executive Officer, and Mr. Paul J. Crecca, our Executive Vice President and Chief Financial Officer, would execute and deliver a management stock purchase agreement, pursuant to which such officers would acquire shares of restricted Common Stock of the Company.

After giving effect to the transactions contemplated by the Recapitalization Agreement, persons who formerly held the Preferred B would hold, in the aggregate, 82% of the outstanding shares of our Common Stock, and persons who formerly held the Preferred A and Preferred C would hold, in the aggregate, 15% of the outstanding shares of our Common Stock. Messrs. Quandt and Crecca, after giving effect to the management stock purchase agreement, would hold, in the aggregate, 3% of the outstanding shares of our Common Stock, and no options or warrants to purchase shares of capital stock would remain outstanding.

In addition to the foregoing, upon the closing of the Recapitalization Agreement:

- Our stockholders, including Mr. Quandt, would enter into a Shareholders Agreement providing for, among other things, a new six-member Board of Directors to be composed of Mr. Quandt and five persons designated by various former Preferred B and Preferred A holders; and
- We would enter into a release agreement with the applicable Preferred B holders, pursuant to which, among other things, such holders would dismiss the pending legal action described above under "Part II, Item 4 – Legal Proceedings" in this Quarterly Report on Form 10-Q.

The closing of the Recapitalization Agreement is subject to the satisfaction of certain stated conditions, including (i) the waiver by the requisite holders of our Senior Secured Term Loans, Senior Notes and Senior Discount Notes of applicable "change of control" covenants that, absent such waiver, might apply in connection with the conversion of the Preferred C, Preferred B, and Preferred A into Common Stock, and (ii) the execution and delivery of the agreements referred to above.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

"Safe Harbor" Statement under Private Securities Litigation Reform Act of 1995

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"). The forward-looking statements included in this Quarterly Report on Form 10-Q include statements concerning our plans, objectives, goals, strategies, future events, future sales or performance, capital expenditures, financing needs, plans or intentions relating to acquisitions, business trends and other information that is not historical information. When used in this Quarterly Report on Form 10-Q, the words "estimates," "expects," "anticipates," "projects," "plans," "intends," "believes," "forecasts" and variations of such words or similar expressions are intended to identify forward-looking statements. All forward-looking statements, including, without limitation, management's examination of business trends, are based upon our current expectations, beliefs, projections and assumptions. Our expectations, beliefs, projections and assumptions are expressed in good faith and we believe there is a reasonable basis for them. However, there can be no assurance that our financial condition or results of operations will meet the expectations set forth in our forward-looking statements.

The forward-looking statements that we make in this Quarterly Report on Form 10-Q are subject to a variety of risks, uncertainties, and other factors that could cause actual results to differ materially from such forward-looking statements. We refer you to documents filed by us with the Securities and Exchange Commission, specifically our most recent Annual Report on Form 10-K, as may be amended from time to time, which identify important risks that could cause our actual results to differ materially from those contained in our forward-looking statements. Other factors could also materially affect our actual results.

Without limitation of the foregoing, among the important factors or risks that could cause our actual results to differ from those contained in our forward-looking statements are: (i) our substantial leverage and indebtedness, which may adversely affect our ability to operate our business and place us at a competitive disadvantage in our industry; (ii) our history of losses, which we expect to continue; (iii) changes in funding of school systems and libraries by federal, state and local governments, which could reduce our sales and profits, if any, (iv) our inability to compete in the highly competitive industry in which we operate, (v) the seasonal and cyclical nature of sales of our products; (vi) the effect that misuse, misappropriation or other loss of our proprietary rights could have on our results of operations; (vii) our need to defend against intellectual property infringement and other claims, which may cause us to incur significant costs and divert management attention; (viii) the inability of our investors to evaluate the application of our cash and cash equivalents, over which management is given broad discretion; (ix) our dependence on key personnel; (x) a growth in multimedia products that may compete with and reduce our publishing activities; (xi) technological changes that may reduce the sales of our products; (xii) the effect of an increase in paper or postage costs, which could adversely affect our business; (xiii) our inability to successfully complete acquisitions, and that such acquisitions may divert management attention from operating our business; (xiv) the ability of our principal stockholders, who own a large percentage of our common stock, to influence or control the Company; (xv) a change in beneficial ownership of our principal stockholder, over which we have no control, could result in an event of default under the Facility; (xvi) our inability to take certain actions because of restrictions contained in our debt instruments, which may adversely affect our operations; (xvii) our ability to update and expand the content of existing products and develop new products in a cost effective manner and on a timely basis; (xviii) the effect that a material change to or repeal of the federal government's No Child Left Behind Act (the "NCLB Act") would have on our revenue and profitability; (xix) the effect that a substantial reduction in the emphasis placed by federal and state governments on assessment and remediation in K-12 education would have on our operations; (xx) our dependence on a limited number of suppliers and service providers, the interruption of supply or service with which could have a material adverse effect on our operations; (xxi) a disruption in our distribution centers could significantly lower our revenues and profitability; (xxii) our dependence on a central computer system, which if damaged, or if service is interrupted or a failure occurs, could adversely affect our customer relationships and harm our ability to attract new customers; (xxiii) changes in the competitive environment, including those which could adversely affect our cost of sales; (xxiv) changes in the relative profitability of products sold; (xxv) regulatory changes that could affect the purchase of our products; (xxvi) delays and unanticipated expenses in developing new programs and other products or in developing new technology products, and market acceptance and use of online instruction and assessment materials; (xxvii) the potential effect of a continued weak economy on sales of our products; (xxviii) the risk that our well-known authors will depart and write for our competitors; and (xxix) the effect of changes in accounting, regulatory and/or tax policies and practices, including the additional professional and internal costs necessary for compliance with recent and proposed future changes in SEC rules (including the Sarbanes-Oxley Act of 2002), listing standards and accounting rules.

Information included in this Quarterly Report on Form 10-Q is made as of the date hereof. We undertake no obligation, and disclaim any duty, to update our forward-looking statements, including any financial projections we make. We do not endorse any projections regarding future performance that may be made by third parties.

Recent Developments.

Delay in Filing Periodic Reports

We are a "voluntary filer" for purposes of the periodic and current reporting requirements of the SEC. We are a voluntary filer because we do not have a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or listed on an exchange or in any automated inter-dealer quotation system of any national securities association, and we are no longer required to file reports under Section 15(d) of the Exchange Act. Rather, we continue to file our reports under the Exchange Act in order to comply with the reporting covenants contained in our outstanding term loan agreements and bond indentures.

On April 2, 2007, we filed a Notification of Late Filing on Form 12b-25 with the SEC relating to our inability to file on a timely basis our Annual Report on Form 10-K as a result of (i) the need to complete work on a restatement of our financial statements to reflect adjustments to our accounting for Preferred Warrants and deferred income taxes, which restatement is discussed and included herein, and (ii) the need to further investigate, and to allow our independent accountants to conduct additional procedures with respect to, matters of disagreement that Mr. Eugene I. Davis, who is a member of our Board of Directors, had expressed concerning the process by which new management employment agreements, entered into beween us and Mr. Peter J. Quandt, our Chief Executive Officer, and Mr. Paul J. Crecca, our Executive Vice President and Chief Financial Officer, on January 31, 2007, had been approved by the Board of Directors. On April 17, 2007, we filed a Current Report on Form 8-K disclosing that we were not yet in a position to file our Annual Report on Form 10-K insofar as the investigation referred to above was still ongoing.

Effect of late filing on our financial reporting covenants. Under our Facility (as defined below), we are required to file our annual financial statements with the agent for such Facility within 90 days following the end of our fiscal year and our quarterly financial statements with the agent for such facility within 45 days following the end of our first three fiscal quarters of each fiscal year. Under the agreements relating to our Senior Secured Term Loans and the indentures relating to our Senior Notes and Senior Discount Notes (each as defined herein), we are required to timely deliver to the agent under the Senior Secured Term Loans and the trustee under the bond indentures, within the time periods specified by the SEC's rules and regulations, the financial information required to be contained in our Annual Report on Form 10-K and other periodic reports, including our Quarterly Reports on Form 10-Q. As a result of the delay in filing our Annual Report on Form 10-K, we defaulted on our annual financial information delivery covenants in the Facility, in the agreements for the Senior Secured Term Loans, and in the indentures for our Senior Notes and Senior Discount Notes. In addition, as a result of the delay in filing this Quarterly Report on Form 10-Q for our quarter ended March 31, 2007, we defaulted on our quarterly financial information delivery covenants in the Facility, in the agreements for the Senior Secured Term Loans, and in the indentures for our Senior Notes and Senior Discount Notes.

Under the respective terms of the Facility, the Senior Secured Term Loan agreements, and the indentures, a default of a financial information delivery covenant can become an "Event of Default," and potentially enable the indebtedness thereunder to become accelerated, following written notice to us from the agents and/or trustee and/or the requisite lenders or holders and the continuation of such default without cure for a stated period (referred to as the "cure period"). The cure period under the Facility with respect to a default of a financial information delivery covenant is 30 days following notice, and the cure period under the Senior Secured Term Loan agreements and the indentures with respect to a default of a financial information delivery covenant is 60 days following notice.

With respect to the Facility, the indentures and the Senior Secured Term Loans:

- We received a default notice from the agent under the Facility on May 14, 2007, which stated that we were in default of the annual financial information delivery covenant for our failure to timely furnish to the agent under the Facility our annual financial information for our fiscal year ended December 31, 2006. We received a second default notice from the agent under the Facility on June 12, 2007, which stated that an Event of Default would not be deemed to occur as a result of failing to timely furnish the annual financial information for our fiscal year ended December 31, 2006 if we furnished such information to the agent by July 12,

2007. On July 12, 2007, we received a third notice from the agent under the Facility extending the cure period to July 26, 2007.

- We received default notices from the trustee under the indentures on May 29, 2007, which stated that an Event of Default would not be deemed to occur as a result of failing to timely file with the SEC our annual financial information for the fiscal year ended December 31, 2006 included in our Annual Report on Form 10-K if we filed this report within 60 days of the date of notice.
- We received a default notice from the agent under the agreements for our Senior Secured Term Loans on June 19, 2007, which stated that an Event of Default would not be deemed to occur as a result of failing to timely file with the SEC our annual financial information for the fiscal year ended December 31, 2006 included in our Annual Report on Form 10-K and our quarterly financial information for our fiscal quarter ended March 31, 2007 (included in this Quarterly Report on Form 10-Q for the quarter ended March 31, 2007) if we filed such reports within 60 days of the date of notice.

Accordingly, by filing our Annual Report on Form 10-K with the SEC on July 19, 2007 and/or delivering it to the applicable agents and/or trustee, we have cured our outstanding defaults relating to the filing and/or furnishing of our annual financial information for our fiscal year ended December 31, 2006. We are currently filing this Quarterly Report on Form 10-Q with SEC which will cure defaults of our covenants relating to the filing and/or furnishing of our quarterly financial information for our fiscal quarter ended March 31, 2007.

As a result of the default under the Senior Secured Term Loan agreements, the interest rate on the outstanding balance under the First Term Loan (as defined below) increased as of April 18, 2007 from 9.86% to 11.36%. Such interest rate will decrease to 9.86% one business day after the filing of our Annual Report on Form 10-K and this Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2007.

Investigation of disagreements with Mr. Davis. In communications with the company and our auditors, Mr. Davis had made allegations to the effect that (i) "fraud" had been committed in connection with the "creation" of the employment agreements with Messrs. Quandt and Crecca, (ii) Messrs. Christopher S. Gaffney and Stephen F. Gormley, who constitute a majority of our non-employee directors and who approved the agreements, had a conflict of interest with respect to the agreements because they were "interested parties" and stood to gain personal benefits by approving such agreements, and (iii) a compensation consultant retained by the company to prepare and advise upon the agreements should have been retained directly by the Board of Directors, and that the ultimate report delivered by the compensation consultant was inadequate to support the agreements. In response, the Board of Directors engaged independent outside counsel to investigate Mr. Davis' allegations and report back to the Board of Directors.

On June 29, 2007, the independent counsel presented its final findings to the Board of Directors. The material findings were as follows:

- The employment agreements were not misleading and did not have secret terms, and no director that voted upon the agreements was deprived of relevant information that would have affected his vote. Accordingly, Mr. Davis' claim of "fraud" was not supported.
- Messrs. Gaffney and Gormley were not "interested" in the agreements and their involvement in negotiating the agreements did not constitute a conflict of interest.
- The engagement of the compensation consultant by the company was the "functional equivalent" of engagement by the Board of Directors, insofar as Messrs. Gaffney and Gormley, who constituted two of the three directors (Mr. Davis being the third) who would have made the decision to engage the consultant, knew of, and approved, the engagement.
- The report of the compensation consultant was supported by legitimate bases.

Consistent with the independent counsel's recommendations, the Compensation Discussion & Analysis included in Item 11 of our Annual Report on Form 10-K contains a description of the process leading up to the approval of the employment agreements and the role of the compensation consultant in the preparation and approval of such agreements. This description, together with a complete description of the employment agreements (and related noncompetition agreements) is set forth in "Item 11 – Compensation Discussion & Analysis" in our Annual Report on Form 10-K.

Recapitalization

On June 29, 2007, we entered into an agreement with the holders of a majority of the outstanding shares of each of the Preferred B, the Preferred A and our Common Stock (the "Recapitalization Agreement"). Under the terms of the Recapitalization Agreement, upon the execution thereof the parties approved, and we adopted and filed, an amendment to our certificate of incorporation that provides for the holders of the Preferred C, the Preferred B, and the Preferred A to elect to convert the outstanding shares thereof (and the related Preferred Warrants) into Common Stock at an agreed upon rate. Upon the closing of the Recapitalization Agreement, (i) the parties would approve, and we would adopt and file, a second amendment to our certificate of incorporation that would have the effect of eliminating all existing outstanding shares of Common Stock and options and warrants to purchase such Common Stock, and (ii) the holders of the Preferred C, Preferred B, and Preferred A, by the requisite votes of such holders, would elect to convert their securities into Common Stock at the agreed upon rate. In addition, Mr. Peter J. Quandt, our Chairman and Chief Executive Officer, and Mr. Paul J. Crecca, our Executive Vice President and Chief Financial Officer, would execute and deliver a management stock purchase agreement, pursuant to which such officers would acquire shares of restricted Common Stock of the Company.

After giving effect to the transactions contemplated by the Recapitalization Agreement, persons who formerly held the Preferred B would hold, in the aggregate, 82% of the outstanding shares of our Common Stock, and persons who formerly held the Preferred A and Preferred C would hold, in the aggregate, 15% of the outstanding shares of our Common Stock. Messrs. Quandt and Crecca, after giving effect to the management stock purchase agreement, would hold, in the aggregate, 3% of the outstanding shares of our Common Stock, and no options or warrants to purchase shares of capital stock would remain outstanding.

In addition to the foregoing, upon the closing of the Recapitalization Agreement:

- Our stockholders, including Mr. Quandt, would enter into a Shareholders Agreement providing for, among other things, a new six-member Board of Directors to be composed of Mr. Quandt and five persons designated by various former Preferred B and Preferred A holders; and
- We would enter into a release agreement with the applicable Preferred B holders, pursuant to which, among other things, such holders would dismiss the pending legal action described above under "Part II, Item 4 – Legal Proceedings in this Quarterly Report on Form 10-Q."

The closing of the Recapitalization Agreement is subject to the satisfaction of certain stated conditions, including (i) the waiver by the requisite holders of our Senior Secured Term Loans, Senior Notes and Senior Discount Notes of applicable "change of control" covenants that, absent such waiver, might apply in connection with the conversion of the Preferred C, Preferred B, and Preferred A into Common Stock, and (ii) the execution and delivery of the agreements referred to above.

Overview

We are a leading developer and publisher of products for the K-12 supplemental education, library and medical education markets. Our products include supplemental reading books with a concentration on non-fiction content, state-specific test preparation materials, skills assessment and intervention books, unabridged audiobooks and continuing medical education products. Our high quality products are sold primarily to schools, libraries and medical professionals and we believe we have leading positions in the three markets and four segments we serve.

- *K-12 Education:*
  - *K-12 Supplemental Education:* We publish supplemental reading materials for the pre-kindergarten through eighth grade, or PreK-8, market under the well-recognized imprints *Sundance Publishing* and *Newbridge Educational Publishing,* and we also offer non-proprietary supplemental reading and literature products for the K-12 market.

- *Test-prep and Intervention:* We publish state-specific test preparation materials for K-12 competency tests under our well-recognized imprints and brands such as *Triumph Learning, Coach* and *Buckle Down.* We also offer skills assessment products and intervention materials for struggling math and reading students under the widely known *Options Publishing* imprint.

- *Library:* We publish unabridged audiobooks and other products for adults and children under the *Recorded Books* brand, and market these titles, as well as selected non-proprietary audiobooks and other products, primarily to public libraries and schools.
- *Medical Education:* We publish audio-based continuing medical education, or CME, materials for doctors and other health care professionals under the *Oakstone Publishing* imprint and self-study CME courses under our CME*info* imprint. We also publish personal wellness information products for companies seeking to improve employee awareness of health and wellness issues under the *Top Health* and *Personal Best* brands.

Business Segments

Our financial reporting is organized into four business segments: K-12 Supplemental Education, Test-prep and Intervention, Library and Medical Education.

K-12 Supplemental Education. Our K-12 Supplemental Education segment publishes supplemental reading materials for the Pre K-8 market and literary, biographical and topical books published in series for school libraries. It also markets non-proprietary, supplemental reading products and literature for the K-12 market. This segment is comprised of our *Sundance/Newbridge* imprints.

Test-prep and Intervention. Our Test-prep and Intervention segment publishes state-specific test preparation materials for K-12 state-specific competency tests and proprietary instructional materials with the focus on students in kindergarten through 8th grade, who need more help after using textbooks. This segment is comprised of our *Triumph Learning, Buckle Down Publishing* and *Options Publishing* imprints.

Library. Our Library segment publishes unabridged audiobooks and other products for adults and children and markets these titles, as well as non-proprietary audiobooks and other products, to public libraries and schools. This segment is comprised of our *Recorded Books* business.

Medical Education. Our Medical Education segment publishes and markets 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. This segment is comprised of our *Oakstone Publishing* business.

Restatements

In finalizing the audit of our financial statements for the year ended December 31, 2006, management determined that a restatement of our financial statements at and for the years ended December 31, 2004 and 2005 and for all quarterly periods relevant to current reporting requirements through the third quarter of 2006 was required. The restatement reflected adjustments to our accounting for Preferred Warrants and deferred income taxes. We have included the effects of these restatement adjustments in this Quarterly Report on Form 10-Q for the interim period ended March 31, 2006. See a description of the restatement in Note 2, “Summary of Significant Accounting Policies” in our consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q. These restatements had no impact on our EBITDA or compliance with our debt covenants.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Changes in facts, circumstances and market conditions may result in revised estimates.

The critical accounting policies described herein are those that are, in management's opinion, most important to the presentation of our consolidated financial condition and results of operations.

Revenue and Expense Recognition

We recognize revenue from books and other non-subscription sales when the product is shipped to the customer. Product shipment terms are FOB shipping point and collectability is reasonably assured at the time of shipment. Subscription revenue is deferred and recognized as the subscription is fulfilled. Short term rental revenue for audio books is recognized at the time of the rental and audio book lease revenue is deferred and recognized ratably over the term of the lease. Revenue is recognized net of provisions for estimated returns. These estimated return provisions are based upon historical experience and other industry factors including management's expectations. Actual return experience is monitored and any significant change from management's expectations results in an adjustment in the reserve rates utilized to estimate returns.

Cost of goods sold is recognized when the related revenue is recognized and primarily consists of paper, media, printing, binding and duplication and author royalty expenses.

Pre-Publication Costs

We capitalize the costs associated with the development of our new products. These costs primarily include author fees under work-for-hire agreements (excluding royalties), the costs associated with artwork, photography and master tapes, other external creative costs, internal editorial staff costs and pre-press costs that are directly attributable to the products. These costs are tracked at the product title or product series level and are amortized beginning in the month the product is introduced to market. These costs are amortized over the estimated life cycle of the book or product, based upon the sales performance of similarly existing products that are sold in the same business segment, for periods ranging from eighteen months to five years. The amortization rate is determined by the expected annual performance during the life cycle and, accordingly, in many cases an accelerated amortization method is utilized. Costs determined to be unrecoverable are written off. A write-off occurs most often when sales of a product are lower than anticipated or when a later version of the product is released. In addition, life cycles are periodically monitored for changes in length or rate of sales during the life cycle. When changes are significant, the amortization rate and period are adjusted.

Goodwill and Other Intangible Assets

Goodwill represents the excess of net acquisition cost over the estimated fair value of net assets acquired of purchased companies. On January 1, 2002, we adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). Under SFAS No. 142, intangible assets considered to have indefinite lives, such as goodwill, are no longer amortized to expense but are periodically evaluated for impairment at the reporting unit level. Intangible assets with finite lives continue to be amortized to expense over their useful lives.

Under SFAS No. 142, goodwill and other indefinite lived intangible assets are subject to an annual impairment test as well as an interim test if an event occurs or circumstances change between annual tests indicating that the asset might be impaired. The goodwill impairment test is a two-step process. 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 taken for the difference. For purposes of estimating the fair value of the reporting unit, we use a weighted average of discounted cash flow approach and market valuation approach. The Company tests the goodwill of each of its reporting units annually, and more frequently if impairment indicators exist.

Direct Response Advertising Costs

Direct response advertising costs are incurred to solicit sales from potential new customers who can be shown to have responded specifically to an advertising campaign that results in probable future economic benefits. We have two types of direct response advertising costs: direct mail and catalogs. We are able to track the revenue, costs and profitability from these advertising efforts at the campaign level. Both the direct mail and catalog campaign costs are capitalized and the net recoverability is evaluated on a product-by-product basis at the campaign level. The life and amortization rate are determined by historical experience with similar products at the same business. Generally, greater than 80% of direct mail costs are amortized in the first year, with all costs being amortized over lives ranging from 12-18 months. The sole exception to this policy is the direct mail costs relating to the *Oakstone Publishing* subscription business, which are amortized on an accelerated basis over the estimated life of the subscriber for up to five years. For these subscription products, the life is based on the original subscription period plus anticipated subsequent renewal periods. The rate of amortization is based on the expiration and cancellation rate of subscribers for similar subscription products.

Catalog costs are amortized over the estimated life of the catalog, generally between one and eighteen months with greater than 90% of catalog costs being amortized in the first year. The estimated life and amortization rate are based on the sales experience of similar catalogs at the same business segment. Amortization of direct response advertising costs is included in marketing and sales expense in the accompanying consolidated statements of operations. If a direct mail solicitation or catalog is determined to be unprofitable, all remaining capitalized costs are written-off at that time.

Inventory and Related Obsolescence

Inventory consists primarily of books, CDs and audiocassetts, which are valued at the lower of cost or market, as determined by the first-in, first-out method. Obsolescence reserves on slow-moving or excess merchandise are recorded, where applicable, based upon regular reviews of inventories on-hand and estimated future demand. If a book is taken out of print, superseded by a later version or ceases to sell, it is considered obsolete and all related inventory amounts are written-off. If quantities of a book exceed expected future demand based on historical sales of that title, the excess inventory is also written off.

Stock-Based Compensation

We have a stock option plan, pursuant to which stock options for a fixed number of shares of common stock are granted to employees with an exercise price equal to or greater than the fair value of the shares at the date of grant. The exercise prices of options issued under the plan are determined by our board of directors using commonly employed valuation methods. Awards under the plan generally are issued with vesting terms pursuant to which a portion of the award vests over time (typically three years) and the remainder vests (typically in three tranches) based on the achievement of annual performance goals.

Prior to January 1, 2006, we accounted for stock options by following the minimum value method under SFAS No. 123. Under the minimum value method, compensation expense for options is measured at the grant date based on the value of the award, as determined using the minimum value option valuation model, and is recognized over the vesting period of the grant. In December 2004, the FASB issued SFAS No. 123(R), which is a revision of SFAS No. 123. SFAS No. 123(R) supersedes Accounting Principles Board Opinion (APB) 25, "Accounting for Stock Issued to Employees," and amends SFAS 95, "Statement of Cash Flows." Generally, SFAS No. 123(R) requires all stock-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. In April 2005, the SEC delayed the effective adoption to January 1, 2006 for calendar year-end companies. The Company adopted SFAS No. 123 effective January 1, 2002, and will continue to expense the previously granted options using the values determined under the minimum-value method to awards outstanding prior to January 1, 2006, which is the date upon which the Company adopted SFAS 123(R). Effective January 1, 2006 the Company adopted the fair value recognition provisions of SFAS No. 123(R), using the prospective transition method to account for all awards granted, modified or settled after the date of adoption.

Income Taxes

We account for income taxes pursuant to the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). Under SFAS No. 109, deferred tax assets and liabilities are recorded to reflect the future tax consequences attributable to the effects of differences between carrying amounts of existing assets and liabilities for financial reporting and for income tax purposes. A history of generating taxable income is required in order to substantiate the recording of a net tax asset. Because we have not yet generated taxable income, we have placed a 100% valuation allowance on our net tax benefits. We will re-evaluate the deferred tax valuation allowance based on future earnings. Our federal and state operating loss carryforwards at December 31, 2006 were $111.7 million expiring through 2026.

Redeemable Capital Stock

We account for our Series B senior Preferred stock in accordance with Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS No. 150"). Our Series B senior preferred stock (the "Preferred B") is mandatorily redeemable on December 10, 2011, at its original face value, plus any accrued but unpaid dividends. Our Series A preferred stock (the "Preferred A") and Series C convertible preferred stock (the "Preferred C") are redeemable at the option of the holders thereof beginning on December 31, 2019 and April 15, 2012, respectively, and are not mandatorily redeemable. Accordingly, SFAS No. 150 is not applicable to the Preferred A or Preferred C. However, the Preferred A and Preferred C have been classified as mezzanine equity since their redemption is not within the Company's control. According to FSP No. 150-5: "Issuer's Accounting Under FASB Statement No. 150 for Freestanding Warrants and Other Similar Instruments on Shares that are Redeemable," ("FSP No. 150-5"), the Preferred A Warrants (Preferred Warrants) are also classified as a liability and recorded at fair value, because the Preferred Warrants embody obligations on the Company to issue securities that have a redemption right.

Results of Operations

Three Months Ended March 31, 2007 Compared To Three Months Ended March 31, 2006

The following table summarizes the results of operations and the percentage of total revenue represented by each category for the three-months ended March 31, 2007 and 2006:

	Three Months Ended March 31,			
	2007		2006	
	(In Thousands)			
Revenue				
K-12 Supplemental Education	$ 5,386	10.2%	$ 7,940	15.4%
Test Prep and Intervention	19,592	37.0%	17,810	34.6%
Library	20,592	38.9%	18,744	36.4%
Medical Education	7,363	13.9%	6,996	13.6%
Total Revenue	52,933	100.0%	51,490	100.0%
Cost of goods sold	14,426	27.3%	14,760	28.7%
Selling, general and administrative expenses:				
Marketing and sales	14,923	28.2%	14,762	28.6%
Fulfillment and distribution	4,687	8.9%	4,408	8.6%

	Three Months Ended March 31,			
	2007		2006	
	(In Thousands)			
General and administrative expense	7,009	13.2%	7,060	13.7%
Restructuring charges	19	0.0%	134	0.3%
Total selling, general and administrative expenses	26,638	50.3%	26,364	51.2%
Amortization of pre-publication costs	4,406	8.3%	4,339	8.4%
Depreciation expense/amortization of intangibles	1,414	2.7%	1,353	2.6%
Income from operations	6,049	11.4%	4,674	9.1%
Interest expense	17,279	32.6%	15,835	30.8%
Other expenses, net of interest income	38	0.1%	84	0.1%
Loss before taxes	(11,268)	(21.3)%	(11,245)	(21.8)%
Tax provision	(1,334)	(2.5)%	(1,282)	(2.5)%
Loss before discontinued operations	(12,602)	(23.8)%	(12,527)	(24.3)%
Loss from discontinued operations	41	0.1%	(2)	(0.0)%
Net loss	$(12,643)	(23.9)%	$(12,529)	(24.3)%

Revenue

Our total revenue increased $1.4 million, or 2.8%, to $52.9 million for the three-month period ended March 31, 2007 from $51.5 million for the three-month period ended March 31, 2006. The increase is primarily due to the Test-prep and Intervention and Library segments. The Test-prep and Intervention segment benefited from the release of new products and increased demand resulting from the testing requirements created by the NCLB Act. The Library segment benefited from strong download audio performance including the introduction of *Playaway*, a new lightweight pre-loaded audio player that Recorded Books is now offering.. This revenue growth was offset partially by the continued decline from our K-12 Supplemental Education segment.

K-12 Supplemental Education. Revenue for the K-12 Supplemental Education segment decreased $2.6 million, or 32.2%, to $5.4 million for the three-month period ended March 31, 2007, from $7.9 million for the three-month period ended March 31, 2006. Our *Sundance/Newbridge* business, which represents 100% of this segment, competes in the K-12 market for classroom materials. This revenue decline resulted from what we believe is a significantly more competitive market, and in particular in the leveled-reader product category, from which *Sundance/Newbridge* generates a significant percentage of its sales. This market's competitors include other supplemental educational publishers such as Harcourt Achieve and National Geographic, as well as basal textbook publishers, such as McGraw Hill and Houghton Mifflin, which are generally much larger and have greater financial resources than the Company. We believe a significant percentage of all basal textbook programs are purchased for the classroom through state-wide and state organized "adoption" processes, and that these basal publishers have leveraged their brand position in the market to offer leveled-reader products that are very competitive with *Sundance/Newbridge's* most significant product lines. We believe another factor currently affecting *Sundance/Newbridge* sales is the extremely high level of attention being given to the new NCLB mandated tests, resulting in a focus on test-preparation materials to the current exclusion of other supplemental education products. We further believe that this high level of attention to testing and test scores has resulted in a trend wherein an increased number of product purchase decisions are being made at levels above the school facility level, such as the district or state level. We believe this trend strongly favors the supplemental education products offered by the basal textbook publishers, who have established strong brand reputations through the state-wide adoption processes. To address these challenges, we have implemented numerous product positioning and marketing initiatives to differentiate our existing products from the competition, as well as pursuing new product development opportunities which will further differentiate and diversify our product lines.

Test-prep and Intervention. Revenue for the Test-prep and Intervention segment increased $1.8 million, or 10.0%, to $19.6 million for the three-month period ended March 31, 2007, from $17.8 million for the three-month period ended March 31, 2006. While operating in the same K-12 classroom materials market as *Sundance/Newbridge, Triumph Learning* and *Buckle Down,* publish and market test-preparation study materials to a discrete niche of this overall market. A key provision of the NCLB Act required each state to implement, beginning with the 2005-2006 school year, increased standardized testing across many grade levels. The state standardized tests in reading, math, and science and social studies are the subject of *Triumph Learning's* and *Buckle Down's* test-prep study materials. *Triumph Learning* and *Buckle Down* proactively sought to benefit from the demand created by the NCLB Act by publishing new state, subject and grade specific test-prep study materials (for example a State of New York, Grade 5, Math test-preparation workbook) corresponding to these new tests for many but not all states. While *Triumph Learning's* and *Buckle Down's* pre-publication costs increased significantly in the last two years, both businesses have reported exceptional sales growth since the release of new NCLB focused products in late 2005. Revenues for *Triumph Learning* and *Buckle Down* product lines increased $2.2 million, or 17.1%, to $15.3 million for the three-month period ended March 31, 2007 from $13.1 million for the three-month period ended

March 31, 2006. We anticipate that *Triumph Learning* and *Buckle Down* will continue to benefit in 2007 from the demand created by the NCLB Act.

*Options Publishin*g, reflected within the Test-prep and Intervention segment focuses on publishing and marketing high-quality products for underperforming and struggling students primarily in reading and math, referred to generally as intervention products. Revenue from *Options Publishing* decreased $0.5 million, or 9.5%, to $4.3 million for the three-month period ended March 31, 2007 from $4.8 million for the three-month period ended March 31, 2006. We believe the decline in period over period revenue for *Options Publishing* results from the focus of buying decisions on test-preparation products and also the trend of purchase decisions being made at higher school administration levels, as mentioned above in the K-12 Supplemental Education discussion, which favors the larger well known basal publishing brands and products.

Library. The Library segment, which consists of our *Recorded Books* business, publishes unabridged audiobooks and other audio-based products in both CD and audiocassette formats. *Recorded Books* markets to public libraries, schools, retail vendors and directly to consumers, with sales to public libraries generally accounting for more than two-thirds of revenue. Revenue for the Library segment, increased $1.8 million, or 9.9%, to $20.6 million for the three-month period ended March 31, 2007, from $18.7 million for the three-month period ended March 31, 2006. The majority of the segment revenue growth is attributable to the core public library channel, which increased 12.2% and represented approximately 72% of the business for the quarter. The growth was achieved through the strength of solid download audio performance, increased revenue in the United Kingdom and incremental revenue from *Playaway*, the new preloaded digital audio player product offered by *Recorded Books*.

Medical Education. Revenue for the Medical Education segment increased $0.4 million, or 5.2%, to $7.4 million for the three-month period ended March 31, 2007, from $7.0 million for the three-month period ended March 31, 2006. The increase in segment revenue is attributable to the Wellness channel products, which include newsletters and calendars as well as other ancillary products.

Cost of Goods Sold

Cost of goods sold decreased $0.3 million, or 2.3%, to $14.4 million for the three-month period ended March 31, 2007 from $14.8 million for the three-month period ended March 31, 2006. Cost of goods sold as a percentage of revenue decreased to 27.3% from 28.7% period over period, primarily due to favorable changes in product mix and cost reductions.

K-12 Supplemental Education. Cost of goods sold for the K-12 Supplemental Education segment decreased $0.7 million, or 33.7%, to $1.4 million for the three-month period ended March 31, 2007 from $2.1 million for the three-month period ended March 31, 2006 due primarily to the decline in revenue. Cost of goods sold as a percentage of revenue for the K-12 Supplemental Education segment decreased to 26.4% from 27.0% period over period primarily due to decreases in inventory obsolescence provisions.

Test-prep and Intervention. Cost of goods sold for the Test-prep and Intervention segment increased $0.3 million, or 7.3%, to $3.9 million for the three-month period ended March 31, 2007 from $3.6 million for the three-month period ended March 31, 2006 as a result of revenue growth for the segment period over period. Cost of goods sold as a percentage of revenue for the Test-prep and Intervention segment decreased to 19.8% from 20.3% period over period primarily due to a change in product mix reflecting higher priced products.

Library. Cost of goods sold for the Library segment increased $0.3 million, or 4.6% to $7.1 million for the three-month period ended March 31, 2007 from $6.7 million for the three-month period ended March 31, 2006. Cost of goods sold as a percentage of revenue decreased to 34.3% from 36.0% period over period. The improvement in cost of goods sold as a percentage to revenue was a result of the changes in product mix coupled with production cost improvements.

Medical Education. Cost of goods sold for the Medical Education segment decreased $0.2 million, or 8.4% to $2.1 million for the three-month period ended March 31, 2007 from $2.3 million for the three-month period ended March 31, 2006. Cost of goods sold as a percentage of revenue decreased to 28.1% from 32.3% period over period, primarily due to cost savings realized in transitioning from an external vendor to an in-house production of the CME*info* products and reduced marketing expenses.

Selling, General & Administrative Expense

Selling, general and administrative expense is comprised of marketing and sales, fulfillment and distribution, general and administrative, and restructuring charges in the accompanying consolidated statements of operations. Selling, general and administrative expense increased $0.3 million, or 1.0%, to $26.6 million for the three-month period ended March 31, 2007 from $26.4 million for the three-month period ended March 31, 2006. Selling, general and administrative expense as a percentage of revenue decreased to 50.3% from 51.2%, period over period.

K-12 Supplemental Education. Selling, general and administrative expense for the K-12 Supplemental Education segment decreased $0.6 million, or 10.8%, to $4.8 million for the three-month period ended March 31, 2007 from $5.4 million for the three-month period ended March 31, 2006 due to a reduction in revenue based costs including commissions and overhead expenses eliminated with the closing of our New York office. Selling, general and administrative expenses as a percentage of revenue increased to 89.3% from 67.9% period over period resulting primarily from the effect of decreased revenue on fixed expenses such as salaries.

Test-prep and Intervention. Selling, general and administrative expense for the Test-prep and Intervention segment increased $1.1 million, or 12.1%, to $9.8 million for the three-month period ended March 31, 2007 from $8.8 million for the three-month period ended March 31, 2006. The increase was primarily due to volume related commission expenses, increased catalog and direct mail related marketing expenses and increased overhead cost from the Northborough warehouse facility. Selling, general and administrative expenses as a percentage of revenue for the Test-prep and Intervention segment increased to 50.3% from 49.3% period over period due to the increased catalog and direct mail related expenses as well as the increased facility costs from the fulfillment and distribution function.

Library. Selling, general and administrative expense for the Library segment decreased $0.1 million, or 1.3%, to $6.7 million for the three-month period ended March 31, 2007 from $6.8 million for the three-month period ended March 31, 2006 primarily due to reduced sales and marketing expenses period over period. Selling, general and administrative expense as a percentage of revenue decreased to 32.5% from 36.2% period over period, primarily due to the favorable impact of the revenue increase on fixed costs.

Medical Education. Selling, general and administrative expense for the Medical Education segment decreased $0.1 million, or 2.4%, to $3.8 million for the three-month period ended March 31, 2007 from $3.9 million for the three-month period ended March 31, 2006. The decrease is primarily due to reduced "one-shot" marketing expenses within our core medical education product line, the absence of transition expenses related to the acquisition of CME*info* that were incurred in 2006 and additional costs savings achieved through process improvements. Selling, general and administrative expense as a percentage of revenue decreased to 51.3% from 55.4% period over period.

Corporate. Our corporate general and administrative expense were $1.5 million for both of the three-month periods ended March 31, 2007 and March 31, 2006.

Amortization of Pre-Publication Costs

Amortization of pre-publication costs increased $0.1 million to $4.4 million for the three-month period ended March 31, 2007, from $4.3 million for the three-month period ended March 31, 2006. The current level of amortization expense reflects the greater emphasis on investment spending in recent years that will continue through 2007.

Depreciation Expense and Amortization of Intangibles

Depreciation expense and amortization of intangibles was $1.4 million for each of the three-month periods ended March 31, 2007 and 2006.

Interest Expense

Interest expense increased $1.4 million, or 9.1%, to $17.3 million for the three-month period ended March 31, 2007 from $15.8 million for the three-month period ended March 31, 2006. This increase was due to the compounding effect of interest on our Senior Discount Notes and Preferred B and the increase in rates on our Term Loans. Our total outstanding debt increased from $528.4 million as of March 31, 2006 to $561.7 million as of March 31, 2007. The increase is a result of accretion on the Preferred B and amortization of the discount on our Senior Discount Notes, offset slightly by principal payments on our Term Loans.

Cash interest expense increased $0.2 million to $8.1 million for the three-month period ended March 31, 2007 from $7.9 million for the three-month period ended March 31, 2006. The average interest rate increased to 9.64% for the three-month period ended March 31, 2007 from 8.81% for the three-month period ended March 31, 2006. Our cash interest bearing outstanding debt was $297.9 million as of March 31, 2007 compared to $299.6 million as of March 31, 2006.

Interest expense consists of the following:

	Three Months Ended March 31,	
	2007	2006
	(In thousands)	
Interest expense:		
Senior secured term loans	$ 3,042	$ 2,845
11¾% senior notes	4,994	4,994
12½% senior discount notes — non-cash	3,205	2,839
Series B senior preferred stock — non-cash	5,972	5,095
Other	88	85
Total interest expense	17,301	15,858
Less: capitalized interest	(22)	(23)
Net Interest expense	$17,279	$15,835

As of March 31, 2007 the Company had $125.8 million in aggregate principal amount outstanding under the Term Loans, with such amount bearing interest at rates between 8.86% and 9.86%. The average interest rate on the Term Loans was 9.64% for the three-month period ended March 31, 2007.

Discontinued Operations

There were no significant items reported in discontinued operations for either of the three-month periods ended March 31, 2007 and 2006.

Provision for Income Taxes

We have restated our financial statements for presentation of deferred tax expense, the related deferred tax assets and liabilities and the valuation allowance for the three-month period ended March 31, 2006. (See "Restatement of Financial Statements" in Note 2 in our consolidated the accompanying financial statements included elsewhere in this Quarterly Report on Form 10-Q.)

The provision for income taxes was $1.3 million for both of the three month periods ended March 31, 2007 and 2006. Deferred income tax expense was $1.2 and $1.1 million for the three month periods ended March 31, 2007 and 2006, respectively, reflecting the difference in book and tax basis for goodwill and other indefinite-lived assets. A current income tax expense of $0.1 and $0.2 million was recorded for the three month periods ended March 31, 2007 and 2006, respectively. The current income tax expense relates to our United Kingdom subsidiary, *WF Howes,* which had taxable earnings in the United Kingdom of $0.5 million for both of the three month periods ended March 31, 2007 and 2006.

Net Loss

Net losses for the three-month periods ended March 31, 2007 and 2006 were $12.6 million and $12.5 million, respectively. Operating income increased $1.4 million to $6.0 million for the three month period ended March 31, 2007 from $4.7 million for the three month period ended March 31, 2006 primarily due to the revenue increase and a more favorable product mix. Other expenses increased $1.4 million period over period, primarily due to the increase in interest expense. The provision for income taxes increased $0.1 million period over period.

Liquidity and Capital Resources

At March 31, 2007 the Company was not compliant with certain covenants of its various debt agreements. Refer to the section above in this Management's Discussion and Analysis under the heading "Recent Developments" for a description of recent developments that may affect our liquidity and capital resources discussed below.

We have relied primarily on our available cash balance to fund our working capital, capital expenditure, business acquisition and debt service requirements. As of March 31, 2007 we have an available cash balance of $53.3 million. During the three-month period ended March 31, 2007 we funded $5.5 million in pre-publication costs for new product development, $0.6 million of capital expenditures for property and equipment, and $13.5 million of cash interest and principal payments on our senior secured Terms Loans. In addition to our available cash balance, our $30.0 million Facility was undrawn at March 31, 2007.

The available borrowing capacity under our Facility was $20.5 million. Borrowings under the Facility bear interest at variable rates based on LIBOR plus an applicable spread. The revolving credit facility expires on May 20, 2008. We may incur additional debt to finance future acquisitions.

As of March 31, 2007, we had accrued $46.8 million for unpaid cash dividends on the Preferred B. We are restricted from making cash dividend payments on the Preferred B by restrictive payment provisions of our 12 1/2% Senior Discount Notes agreement.

We are highly leveraged and have significant debt service obligations. Our primary sources of liquidity are our available cash balance, cash flow from operations and available borrowings under the Facility. We expect that ongoing requirements for debt service, working capital, capital expenditures and permitted business acquisitions will be funded from these sources.

Our ability to make scheduled payments of principal of, or to pay interest on, or to refinance, our indebtedness, or to fund planned capital expenditures will depend on our ability to generate cash in the future, which is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

While we cannot assure that our business will generate sufficient cash flow from operations, that any revenue growth or operating improvements will be realized or that future borrowings will be available under the Facility in an amount sufficient to enable us to service our indebtedness or to fund our other liquidity needs, based on our current level of operations, we believe that cash flow from operations and available cash, together with available borrowings under the Facility, will be adequate to meet our future liquidity needs until the maturity of our Senior Secured Term Loans in August 2008. With respect to our Term Loans, while we cannot guarantee that capital market conditions will exist which allow for the refinancing of the balance outstanding, with the secured position of this debt in the Company's assets, its relatively high seniority in our capital structure, the attractiveness of the floating interest rate feature, and liquidity in the capital markets for this form of investment for lenders, we expect to be able to complete a refinancing of our Term Loans at or prior to their maturity. In addition, from time to time as needs arise, we may seek to raise additional capital through the issuance, in registered offerings or in private placements, of debt or equity securities on terms to be determined at the time of such issuances, to finance possible future acquisitions, the maturity of the Term Loans or other general corporate purposes.

Cash Flows

Net cash used by operating activities increased to $9.9 million for the three-month period ended March 31, 2007 from $9.1 million for the three-month period ended March 31, 2006, due to greater working capital needs.

Cash used in investing activities decreased to $6.2 million for the three months ended March 31, 2007 from $6.4 million for the three months ended March 31, 2006. Cash used in investing activities consists primarily of expenditures on pre-publication costs and property, plant and equipment.

Cash used in financing activities was $0.4 million for both of the three month periods ended March 31, 2007 and 2006. Cash used in financing activities consists primarily of principal payments on our Senior Secured Term Loans.

Capital Expenditures

Capital expenditures — pre-publication costs relate to the costs incurred in the development of new products. For the three months ended March 31, 2007, we had $5.5 million of pre-publication expenditures compared to $5.6 million during the three months ended March 31, 2006. We plan expenditures of $24.6 million for pre-publication costs in 2007. This level of spending is intended to support our successful core products and allow for the development of new products.

Capital expenditures — property and equipment relate to the purchase of tangible fixed assets such as computers, software and leasehold improvements. For the three months ended March 31, 2007 we had $0.6 million of property, building and equipment expenditures compared to $1.2 million for the three months ended March 31, 2006. We plan expenditures of $3.1 million for property and equipment in 2007. This level of spending allows for our planned implementation of an ERP system at our *Recorded Books* business, the rollout of a customer relationship management (“CRM”) system for several businesses, and general additions to furniture, fixtures and equipment.

Contractual Obligations and Commitments

There have been no material changes in our contractual obligations or commitments since December 31, 2006.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet financing arrangements.

Seasonality and Quarterly Results of Operations

Our business is subject to moderate seasonal fluctuations. Our revenue and income from operations have historically been higher during the second and third calendar quarters. In addition, our quarterly results of operations have fluctuated in the past and can be expected to continue to fluctuate in the future, as a result of many factors, including, without limitation, 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 unaudited quarterly information includes all normal recurring adjustments that management considers necessary for a fair presentation of the information shown. Because of the seasonality of our business and other factors, results for any interim period are not necessarily indicative of the results that may be achieved for the full fiscal year.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

In the normal course of business, our financial position and results of operations are routinely subject to a variety of risks. These risks include market risk associated with interest rate movements on borrowings and investments that we make on variable interest rates. Currently, our $30.0 million Facility, which is undrawn, and our Term Loans bear interest at variable rates based on LIBOR plus an applicable spread.

We regularly assess these market risks and have established policies and business practices to protect against the adverse effect of these and other potential exposures. We utilize cash from operations and short-term borrowings to fund our working capital and investment needs. Cash balances are normally invested in high-grade securities with terms shorter than three-month periods. Because of the short-term nature of these investments, changes in interest rates would not materially affect the fair value of these financial instruments.

As of March 31, 2007, a hypothetical 10% change in interest costs of our variable rate debt would change interest expense on an annual basis by $1.2 million. As of March 31, 2007, a hypothetical 10% change in the interest rate applicable to our investments would change interest income on an annual basis by $0.1 million. These amounts are determined by calculating the effect of a hypothetical interest rate change on our variable rate debt and our investments, and without regard to the effects of other possible occurrences, such as actions to mitigate these risks or changes in our financial structure.

Our $30.0 million Facility is available to finance our working capital requirements, subject to certain restrictive covenants that can reduce the available aggregate borrowings under the Facility. As of March 31, 2007, the available borrowing capacity under the Facility, which was undrawn, was $20.5 million, and the applicable interest rate is based on LIBOR plus an applicable spread. Also as of March 31, 2007, we had $125.8 million in aggregate principal amount outstanding under the Term Loans. The applicable interest rates on the Term Loans, which are based on LIBOR plus an applicable spread, were 9.86% for the First Term Loan and 8.86% for the Second Term Loan.

We have minimal exposure to foreign currency rate fluctuations on our foreign sales, as currently we have minimal transaction gain or loss recognized in our statement of operations due to currency fluctuations, mainly fluctuations in UK pounds. As a result, we do not hedge the exposure to these changes. As of March 31, 2007, a hypothetical 10% change in the foreign currency exchange rates applicable to such transactions would not have a material impact on our results of operations.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As required by Rule 15d-15 under the Exchange Act, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of and design and operation of our disclosure controls and procedures, as defined by Exchange Act Rules 13a-15(a) and 15d-15(e), as of the end of the period covered by this report. Due to the identification of a material weakness in internal control over financial reporting during the audit for the year ended December 31, 2006 related to technical deficiencies in expertise with respect to (i) our accounting for income taxes, (ii) our application of FSP No. 150-5 to our Preferred Warrants and (iii) our calculation of the amount of goodwill impairment at Options Publishing, we concluded that our disclosure controls and procedures were not effective, at the reasonable assurance level, in ensuring that information required to be disclosed by us in reports filed with the SEC is recorded, processed, summarized and reported on in a timely basis.

In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurances of achieving the desired control objectives, and management necessarily is required to apply its judgment in designing and evaluating the controls and procedures. We regularly review and document our disclosure controls and procedures, and our internal controls over financial reporting, and may from time to time make appropriate changes aimed at enhancing their effectiveness and ensure that our systems evolve with our business.

As a result of the deficiencies that are described above, each of which was discovered during the audit of the financial statements for our fiscal year ended December 31, 2006, management determined that a material weakness in internal control over financial reporting related to our technical expertise in these areas exists. This determination prompted our management to conclude that, as of December 31, 2006 and continuing at March 31, 2007 there was more than a remote likelihood that a material misstatement of our annual or interim financial statements would not be prevented or detected on a timely basis by our employees in the normal course of performing their assigned functions. This material weakness exists because our management does not currently have adequate technical expertise with respect to these technical areas to effectively oversee and review our accounting in this area. This lack of adequate technical expertise resulted in a misstatement in our accounting for income taxes during the years and related quarterly periods ended December 31, 2004 and 2005 and for the first three quarters of 2006, a misstatement in the classification of the Preferred Warrants in the third quarter of 2005 and a calculation error in the goodwill impairment for *Options Publishing* as of October 1, 2006, which was identified during the course of our 2006 audit. As a result of these items, we provided in our Annual Report on Form 10-K for our fiscal year ended December 31, 2006 a restatement of our financial statements as of and for the years and related quarterly periods ended December 31, 2004, 2005 and for each of the three fiscal quarters in 2006.

(b) Changes in Internal Controls over Financial Reporting

There was no change in our internal control over financial reporting during the quarter ended March 31,

2007 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Regarding the material weaknesses described above, we intend to implement enhanced control procedures over accounting for income taxes, accounting for the Preferred Warrants and goodwill impairment valuations which include:

- Improving our documentation and training related to policies and procedures for the controls related to our significant accounts and processes;
- Educating and training our management and staff to improve technical expertise with respect to these technical areas;
- Engaging expert resources to assist with tax and goodwill valuation accounting; and
- Re-allocating and/or relocating duties of finance personnel to enhance review and monitoring procedures.

While we believe that the remedial actions described above will result in the correction of the material weakness in our internal control over financial reporting, the exact timing of when the conditions will be corrected is dependent upon future events, which may or may not occur.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

On February 27, 2007, certain holders of our Preferred B filed an action in the Delaware Chancery Court seeking an order to compel us to allow them access to inspect our corporate and business books and records pursuant to a request under Section 220 of the Delaware General Corporation Law and under the Investors Agreement, as amended, between us and certain of our stockholders. No monetary relief is sought in this action. The plaintiffs made a number of allegations in the action, including allegations of breach of fiduciary duty and corporate mismanagement, to support their request for access to our books and records. We contended that the documents sought by plaintiffs in this action far exceeded those to which they are entitled under Section 220 or the Investors Agreement, believed the action was without merit, and intended to vigorously defend against it.

On June 29, 2007, in connection with a recapitalization agreement we entered into with, among others, the holders of the Preferred B, the plaintiffs agreed to dismiss this action upon the closing of such agreement. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Recent Developments” for a description of the recapitalization agreement.

In addition to the foregoing, from time to time, we are involved in litigation that we consider to be ordinary routine litigation incidental to our business. We are not presently involved in any legal proceedings that we expect, individually or in the aggregate, to have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 6. Exhibits

EXHIBIT INDEX

Exhibit Number	Description	Page or Method of Filing
3.1	Second Amended and Restated Certificate of Incorporation of Haights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.1 of the Company's Annual Report on Form 10-K filed April 19, 2004.
3.1(a)	Certificate of Designations, Preferences and Rights of Series C Preferred Stock of Haights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.1(a) of the Company's Registration Statement on Form S-4 (Reg. No. 333-122750) filed February 11, 2005.
3.2	Bylaws of Haights 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.
10.1	Employment Agreement, dated as of January 31, 2007, by and between Haights Cross Communications, Inc. and Peter J. Quandt	Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed February 2, 2007 and Current Report on Form 8-K/A filed February 23, 2007
10.2	Noncompetition Agreement, dated as of January 31, 2007, by and between Haights Cross Communications, Inc. and Peter J. Quandt	Incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed February 2, 2007 and Current Report on Form 8-K/A filed February 23, 2007
10.3	Employment Agreement, dated as of January 31, 2007, by and between Haights Cross Communications, Inc. and Paul J. Crecca	Incorporated by reference to Exhibit 10.3 of the Company's Current Report on Form 8-K filed February 2, 2007 and Current Report on Form 8-K/A filed February 23, 2007
10.4	Noncompetition Agreement, dated as of January 31, 2007, by and between Haights Cross Communications, Inc. and Paul J. Crecca	Incorporated by reference to Exhibit 10.4 of the Company's Current Report on Form 8-K filed February 2, 2007 and Current Report on Form 8-K/A filed February 23, 2007
10.5	Amendment No. 7 and Waiver No. 4 to Revolving Credit Agreement, dated as of March 28, 2007, by and among Haights Cross Operating Company, the Several Lenders from time to time parties thereto, Bear Stearns Corporate Lending Inc., as Syndication Agent and The Bank of New York, as Administrative Agent	Incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed April 3, 2007
31.1	Rule 13a-14(a)/15d-14(a) Certification of Peter J. Quandt	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Paul J. Crecca	Filed herewith
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* **The Company is not an "issuer," as the term is defined by Section 2(a)(7) of the Sarbanes-Oxley Act of 2002 (the "Act"), because it does not have a class of securities registered under Section 12 of the Securities Act and it is not required to file reports under Section 15(d) of the Exchange Act. Accordingly, the Company is not required to file the certifications that are otherwise required by 18 U.S.C. Section 1350, which were adopted as Section 906 of the Act.**

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HAIGHTS CROSS COMMUNICATIONS, INC.

By:

Dated: July 19, 2007	/s/ Peter J. Quandt Peter J. Quandt Chairman, Chief Executive Officer and President (Principal Executive Officer)
Dated: July 19, 2007	/s/ Paul J. Crecca Paul J. Crecca Executive Vice President and Chief Financial Officer (Principal Financial Officer)
Dated: July 19, 2007	/s/ Mark Kurtz Mark Kurtz Vice President of Finance and Accounting and Chief Accounting Officer (Principal Accounting Officer)

Exhibit 31.1

CERTIFICATION

I, Peter J. Quandt, certify that:

1. I have reviewed this report on Form 10-Q of Haights Cross Communications, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 19, 2007

By: /s/ Peter J. Quandt
Name: Peter J. Quandt
Title: Chairman, Chief Executive Officer and President

Exhibit 31.2

CERTIFICATION

I, Paul J. Crecca, certify that:

1. I have reviewed this report on Form 10-Q of Haights Cross Communications, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 19, 2007

By: /s/ Paul J. Crecca
Name: Paul J. Crecca
Title: Executive Vice President and Chief Financial Officer