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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, 2008

Or

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

For the transition period from      to

Commission File Number: 333-109381

**Hights Cross Communications, Inc.**

*(Exact Name of Registrant as Specified in Its Charter)*

**Delaware**

*(State or Other Jurisdiction of  
Incorporation)*

**13-4087398**

*(I.R.S. Employer  
Identification Number)*

**10 New King Street  
White Plains, NY**

*(Address of Principal Executive Offices)*

**10604**

*(Zip Code)*

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The registrant had 9,958,112 shares of Common Stock, par value \$0.0003 per share, outstanding as of May 15, 2008.

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**HAIGHTS CROSS COMMUNICATIONS, INC.**

**Quarterly Report for the  
Quarter Ended March 31, 2008**

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

	<b>Three Months Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
	(In thousands)	
Revenue	\$ 51,830	\$ 52,933
Costs and expenses:		
Cost of goods sold	14,290	14,426
Marketing and sales	14,519	14,923
Fulfillment and distribution	4,962	4,687
General and administrative	8,025	7,009
Restructuring charges	862	19
Amortization of pre-publication costs	4,918	4,406
Depreciation expense and amortization of intangibles	1,536	1,414
Total costs and expenses	49,112	46,884
Income from operations	2,718	6,049
Other (income) expenses:		
Interest expense	11,307	17,279
Interest income	(695)	(868)
Amortization deferred financing costs	759	913
Other expense (income)	(6)	(7)
Total other expenses	11,365	17,317
Loss before income taxes and discontinued operations	(8,647)	(11,268)
Provision for income taxes	(1,205)	(1,334)
Loss before discontinued operations	(9,852)	(12,602)
Discontinued operations:		
Loss on disposal of discontinued operations	(40)	(41)
Net loss	(9,892)	(12,643)
Preferred stock dividends and accretion	—	(871)
Net loss available to common stockholders	\$ (9,892)	\$ (13,514)

See accompanying notes to unaudited consolidated financial statements.

**HAIGHTS CROSS COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

	<u>March 31,</u> <u>2008 (Unaudited)</u>	<u>December 31,</u> <u>2007 (Audited)</u>
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 48,039	\$ 61,784
Accounts receivable, net	27,085	26,504
Inventory, net	20,216	19,573
Direct response advertising costs — current portion, net	4,257	3,965
Prepaid royalties	6,170	6,342
Prepaid expenses and other current assets	2,434	2,994
<b>Total current assets</b>	<b>108,201</b>	<b>121,162</b>
Pre-publication costs, net	40,980	40,620
Direct response advertising costs, net	8,899	8,232
Property and equipment, net	10,312	10,638
Goodwill	135,566	135,566
Intangible assets, net	20,913	21,565
Deferred financing costs, net	5,740	6,499
Other assets	438	490
<b>Total assets</b>	<b><u>\$ 331,049</u></b>	<b><u>\$ 344,772</u></b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	\$ 30,692	\$ 33,607
Accrued interest	3,731	8,948
Deferred subscription revenue	15,480	15,275
Current portion of long term debt	124,525	124,850
<b>Total current liabilities</b>	<b>174,428</b>	<b>182,680</b>
<b>Long term liabilities:</b>		
11 <sup>3</sup> / <sub>4</sub> % senior notes	171,552	171,670
12 <sup>1</sup> / <sub>2</sub> % senior discount notes	122,009	118,362
Deferred tax liability	19,460	18,474
Other long term liabilities	200	415
<b>Total long term liabilities</b>	<b>313,221</b>	<b>308,921</b>
<b>Commitments (Note 13)</b>		
<b>Stockholders' deficit:</b>		
Common stock, \$.0003 par value, 30,000,000 shares authorized, 9,958,112 shares issued and outstanding at March 31, 2008 and 9,966,229 shares issued and outstanding at December 31, 2007	3	3
Accumulated other comprehensive income	748	755
Accumulated deficit	(157,351)	(147,587)
<b>Total stockholders' deficit</b>	<b>(156,600)</b>	<b>(146,829)</b>
<b>Total liabilities and stockholders' deficit</b>	<b><u>\$ 331,049</u></b>	<b><u>\$ 344,772</u></b>

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
<b>Operating activities from Continuing Operations</b>		
Net loss from continuing operations	\$ (9,852)	\$(12,602)
Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities:		
Non-cash interest expense	3,646	9,177
Allowance for doubtful accounts	1,061	655
Allowance for obsolescence	565	1,149
Depreciation and amortization of property and equipment, pre-publication costs and intangibles	6,454	5,820
Amortization of deferred financing costs	759	913
Amortization of premium on 11 <sup>3</sup> / <sub>4</sub> % senior notes	(117)	(118)
Deferred taxes— non-cash	986	1,188
Other non-operating income — non-cash	129	—
Changes in operating assets and liabilities:		
Accounts receivable	(1,642)	(3,814)
Inventory	(1,208)	(1,283)
Prepaid expenses, royalty advances and other current assets	732	234
Direct response advertising costs	(959)	(1,501)
Other assets	50	14
Accounts payable, accrued and other liabilities	(3,122)	(6,002)
Accrued interest	(5,217)	(5,062)
Deferred subscription revenue	205	1,285
Net cash used in operating activities from continuing operations	<u>(7,530)</u>	<u>(9,947)</u>
<b>Investing activities from Continuing Operations</b>		
Additions to pre-publication costs	(5,281)	(5,526)
Additions to property and equipment	(523)	(614)
Additions to intangible assets	(36)	(14)
Net cash used in investing activities from continuing operations	<u>(5,840)</u>	<u>(6,154)</u>
<b>Financing activities from Continuing Operations</b>		
Repayment of senior secured term loan	(325)	(325)
Additions to deferred financing costs	—	(88)
Net cash used in financing activities from continuing operations	<u>(325)</u>	<u>(413)</u>
Effect of exchange rates on cash	(5)	7
<b>Cash flows of discontinued operations</b>		
Operating cash flows	(45)	(47)
Net cash used in discontinued operations	<u>(45)</u>	<u>(47)</u>
Net decrease in cash and cash equivalents	(13,745)	(16,554)
Cash and cash equivalents at beginning of year	61,784	69,847
Cash and cash equivalents at end of year	<u>\$ 48,039</u>	<u>\$ 53,293</u>

See accompanying notes to unaudited consolidated financial statements.

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

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

**1. Basis of Presentation**

Hights Cross Communications, Inc., a Delaware corporation (together with its subsidiaries, “we,” “our,” the “Company” or “Hights Cross Communications”), whose predecessor was formed in January 1997, is a holding company that conducts all of its operations through its direct and indirect subsidiaries, including, without limitation, its wholly-owned subsidiary Hights Cross Operating Company (“Hights Cross”). Between November 2007 and January 2008, we initiated a sale process for all of our operating businesses, and that process continues. Our *Sundance/Newbridge* business was originally offered for sale in November 2007 and subsequently on March 17, 2008 the Board of Directors further authorized the orderly wind-down of this business. We have not considered any of our operating businesses as discontinued operations as of March 31, 2008, as we have not committed to a specific plan to sell the operating businesses where it is unlikely that changes to the sale process will occur.

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 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. These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements included with our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

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

***Going Concern***

The accounting principles generally accepted in the United States of America contemplate our continuation as a going concern. The Term Loans are due on August 15, 2008, and therefore have been reclassified from long-term to current based on their maturity date. As of March 31, 2008, we had a working capital deficiency of \$66.2 million. Although we cannot predict the effects of our sale announcements on our businesses, based on our current level of operations, we believe that cash flow from operations and available cash will be adequate to meet our future liquidity needs until the obligation to repay our Term Loans on August 15, 2008. We expect that cash on hand and generated from operations will be insufficient to fund the repayment of the Term Loans when due. We have initiated a sales process for our businesses and/or our entire company and therefore have not sought to extend our Term Loans at this time. If we are unable to receive sufficient net proceeds from this sales process by the due date of our Term Loans, or we are otherwise unable to extend or refinance a substantial portion of our obligations under our Term Loans, our existing capital resources will not enable us to meet our obligations under the Term Loans or continue operations beyond August 2008. Moreover, non-payment of our Term Loans when due would trigger a cross-default under our indentures governing the Senior Notes and Senior Discount

Notes, which could require us to make an immediate payment under such indentures and obligations at a time when we would not have the funds to do so. We cannot assure that we will be able to enter into a sale transaction that allows us to repay our Term Loans or to refinance our Term Loans when due. Accordingly, as a result of the foregoing uncertainties, substantial doubt exists about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments to the amount or classification of assets and liabilities to reflect this uncertainty.

## **2. Recent Accounting Pronouncements**

On January 1, 2008, the Company adopted certain provisions of Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (“SFAS 157”), which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and expands on required disclosures about fair value measurement. The provisions of SFAS 157 adopted on January 1, 2008 relate to financial assets and liabilities as well as other assets and liabilities carried at fair value on a recurring basis and did not have a material impact on the Company’s consolidated financial statements. The provisions of SFAS 157 related to other nonfinancial assets and liabilities will be effective for the Company on January 1, 2009, and will be applied prospectively. The Company is currently evaluating the impact that these additional SFAS 157 provisions will have on the Company’s consolidated financial statements.

In February 2007, the FASB issued Statement 159, *The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of SFAS 115* (“SFAS 159”), which permits but does not require us to measure financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. As we have not elected to fair value any of our financial instruments under the provisions of SFAS 159, the adoption of this statement does not have any impact to our consolidated financial statements.

## **3. Recapitalization Transaction**

On August 10, 2007, we consummated a recapitalization agreement (the “Recapitalization Agreement”). Under the terms of the Recapitalization Agreement, holders of our previously outstanding Preferred B converted their shares of Preferred B into approximately 82% of our outstanding shares of common stock, holders of our previously outstanding Preferred A, Preferred C and Preferred Warrants converted their shares and warrants into shares of common stock and common stock warrants representing approximately 15% of our outstanding shares of common stock, and certain members of management acquired new shares of common stock under the terms of management stock purchase agreements representing approximately 3% of our outstanding common stock. In connection with the foregoing, all previously outstanding shares of common stock were effectively eliminated through the reclassification into one share of common stock in a reverse split and all outstanding Common Warrants and options to purchase common stock were similarly effectively eliminated by the reverse split of the common stock. As a result of the closing of the transactions contemplated by the Recapitalization Agreement, the Company has only outstanding common stock and common stock warrants, and no shares of Preferred A, Preferred B or Preferred C, or stock options, remain outstanding.

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

## **4. Stock Based Compensation**

Total stock-based compensation expense is recognized as a “general and administrative expense” in the consolidated statements of operations on a ratable basis over the vesting period for each option. The Company did not issue any form of Stock Options for the three months ended March 31, 2008 and 2007. For the three months ended March 31, 2007, compensation expense recorded relating to the grant of stock options was *de minimus*. However as described below Restricted Shares were issued to the directors and related compensation expense was recorded.

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

Additionally, pursuant to Management Stock Purchase Agreements dated August 10, 2007, Paul Crecca and Peter Quandt purchased, for \$0.001 per share, 75,000 and 225,000 shares of restricted stock, respectively. Mr. Quandt’s 225,000 shares of common stock were deemed to be fully vested at the time of his resignation. Mr. Crecca’s restricted shares are subject to a three year vesting

period. Each non-employee member of the Board of Directors received a restricted stock award of 8,117 shares of our common stock with the Chairman receiving 12,175 shares. The restricted stock granted pursuant to all of these awards was to vest in February 2008. During the year ended December 31, 2007 for \$0.001 per share director Eugene I. Davis purchased 12,175 shares of restricted stock, and directors John A. McKenna, Jr., Curry E. Ford and T.J. Vigliotta have purchased 8,117 shares of restricted stock each. In January 2008, prior to the vesting of his restricted stock, Mr. Vigliotta elected to forfeit all of his restricted stock. In January 2008, prior to the vesting of his restricted stock, Mr. Curry elected to forfeit all of his restricted stock in exchange for an issuance by the Company to Glenview Capital Management, LLC, of an equivalent amount under the same terms and conditions. Subsequently, we issued to Glenview Capital Management, LLC, which has designated Mr. Ford to serve as our director, a restricted stock award of 8,117 shares. All outstanding restricted stock awards fully vested on February 10, 2008 for issuances to Mr. Davis and Glenview Capital Management, LLC and February 21, 2008 for the issuance to Mr. McKenna. Total stock-based compensation expense is recognized as a “general and administrative expense” in the consolidated statements of operations on a ratable basis over the vesting period. The compensation expense recorded for these restricted shares was \$0.1 million for the three months ended March 31, 2008.

## 5. Inventory

Inventory consists of the following:

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
Raw materials	\$ 1,665	\$ 1,354
Work-in-process	929	599
Finished goods	24,880	24,593
	<u>27,474</u>	<u>26,546</u>
Less allowance for obsolescence	7,258	6,973
Inventory, net	<u>\$ 20,216</u>	<u>\$ 19,573</u>

## 6. Pre-publication Costs

Pre-publication costs consist of the following:

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
Pre-publication costs	\$111,696	\$ 106,421
Less accumulated amortization	70,716	65,801
Pre-publication costs, net	<u>\$ 40,980</u>	<u>\$ 40,620</u>

## 7. Goodwill

Goodwill and other intangible assets with indefinite lives are tested for impairment annually, and more frequently if impairment indicators exist, 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.

## 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, 2008	December 31, 2007
Customer list	10 years	\$ 23,240	\$ 23,240
Non-compete agreements	3-5 years	1,900	1,900
Other	5 years	179	167
		<u>25,319</u>	<u>25,307</u>
Less: accumulated amortization		<u>(9,286)</u>	<u>(8,597)</u>
		16,033	16,710
Trademarks	Indefinite	<u>4,880</u>	<u>4,855</u>
Net intangible assets		<u>\$ 20,913</u>	<u>\$ 21,565</u>

Amortization expense for the three months ended March 31, 2008 and 2007 was \$0.7 million and \$0.7 million, respectively. Accumulated amortization amounts by asset type as of March 31, 2008 were \$8.0 million for customer list, \$1.1 million for non-compete agreements and \$0.2 million for other intangible assets. Accumulated amortization by asset class as of December 31, 2007 was \$7.4 million for customer lists, \$1.1 million for non-compete agreements and \$0.1 million for other intangible assets.

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

	<u>Total</u>
Amortization of intangibles:	
Remainder of 2008	2,050
2009	2,673
2010	2,427
2011	2,328
2012	2,325
Thereafter	<u>4,230</u>
	<u>\$ 16,033</u>

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

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

On September 28, 2007, the Board of Directors also authorized a restructuring of *Sundance/Newbridge* whereas the Company would reduce its workforce by approximately 30 employees and would refocus its distributed product line over the subsequent

months. The plan was to have all remaining operations retrenched or modified to maximize asset value and generate positive cash flow. The purpose of this effort was to save operational costs and to respond to the issues in the marketplace while improving the business' financial performance.

On November 5, 2007, the Board of Directors authorized a plan to sell the *Sundance/Newbridge* business and on March 17, 2008, the Board of Directors further authorized the orderly wind-down of the business. As a result, the *Sundance/Newbridge* restructuring was expanded to include the severance of the remaining *Sundance/Newbridge* employees and the full absorption of the shared service function by *Triumph Learning*. The Company expects to complete the restructuring process by the end of the second quarter of 2008 and expects to incur a total restructuring charge of approximately \$2.8 million in connection with this effort.

Restructuring activity related to the *Options Publishing* merger with *Buckle Down Publishing* relates to *Options Publishing* and is therefore reported within the Test-prep and Intervention segment. Restructuring activity related to *Sundance/Newbridge* will be reported within our K-12 Supplemental Education segment.

The cost of the restructuring activity by type of cost for the years ended December 31, 2007 and quarter ended March 31, 2008 is as follows:

	Severance and Related	Lease Terminations Costs	Relocation and Other	Total Consolidation
<b>Buckle Down — Warehouse and Order Fulfillment Consolidation</b>				
Amount expected to be incurred	\$ 65	\$ 180	\$ 162	\$ 407
Accrued restructuring liability as of December 31, 2006	—	105	—	105
Restructuring expense	—	75	—	75
Cash paid	—	(109)	—	(109)
Accrued restructuring liability as of December 31, 2007	—	71	—	71
Restructuring expense	—	19	—	19
Cash paid	—	(28)	—	(28)
Accrued restructuring liability as of March 31, 2008	\$ —	\$ 62	\$ —	\$ 62
<b>Options Publishing — Consolidation with Buckle Down</b>				
Amount expected to be incurred	\$ 1,000	\$ —	\$ 87	\$ 1,087
Accrued restructuring liability as of December 31, 2006	—	—	—	—
Restructuring expense	845	—	61	906
Cash paid	(219)	—	(61)	(280)
Accrued restructuring liability as of December 31, 2007	626	—	—	626
Restructuring expense	155	—	26	181
Cash paid	(696)	—	(26)	(722)
Accrued restructuring liability as of March 31, 2008	\$ 85	\$ —	\$ —	\$ 85
<b>Abandonment of Sundance/Newbridge business</b>				
Amount expected to be incurred	\$ 2,730	\$ —	\$ 51	\$ 2,781
Accrued restructuring liability as of December 31, 2006	—	—	—	—
Restructuring expense	1,409	—	51	1,460
Cash paid	(141)	—	(51)	(192)
Accrued restructuring liability as of December 31, 2007	1,268	—	—	1,268
Restructuring expense	662	—	—	662
Cash paid	(271)	—	—	(271)
Accrued restructuring liability as of March 31, 2008	\$ 1,659	\$ —	\$ —	\$ 1,659

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

## 10. Income Taxes

Effective January 1, 2007, the Company adopted FASB Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. As a result of the implementation of FIN 48, the Company did not recognize any adjustments in the liability for unrecognized tax benefits. The Company does not have any

accrued interest or penalties associated with unrecognized tax benefits. The Company's continuing policy is to recognize interest and penalties related to income tax matters as tax expense. There were no significant interest and penalty expense related income tax matters recorded during the three months ended March 31, 2008.

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. Certain income tax returns for fiscal years 2003 through 2006 remain open to examination by U.S. federal, state, local and foreign tax authorities. Currently the fiscal year 2005 federal tax return is under examination as it relates to the *Chelsea House* sale transaction. The Company believes that no provisions are required for all income tax uncertainties pertaining to these open tax years.

The provision for income taxes consists of the following:

	Three Months Ended March 31	
	2008	2007
Current income tax expense:		
Foreign	\$ (219)	\$ (146)
Deferred income tax expense:		
U.S. Federal	(986)	(1,188)
Total benefit (provision) for income taxes	<u>\$ (1,205)</u>	<u>\$ (1,334)</u>

Foreign income tax expense is derived from taxable earnings on sales in the United Kingdom of \$0.7 million and \$0.5 million in the three-month periods ended March 31, 2008 and 2007, respectively.

In calculating the provision for income taxes on an interim basis, the Company uses an estimate of the annual effective tax rate based upon facts and circumstances known to the Company. The Company's effective rate is based on expected pretax income or loss, statutory tax rates, changes in the deferred tax asset valuation allowance and permanent differences between financial statement and tax return income applicable to the Company in the various jurisdictions in which the Company operates. The Company has not recorded a deferred income tax benefit related to the pre-tax loss for the three months ended March 31, 2008 as management has determined that such income tax benefit is not more likely than not to be realized in 2008. The deferred income tax expense reflects the increase in deferred tax liabilities as a result of the amortization for income tax purposes of goodwill and indefinite lived assets not reflected in book income.

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

## 11. Financing Arrangements

### *Senior Secured Revolving Credit Facility, Term Loans, 11<sup>3</sup>/<sub>4</sub>% Senior Notes*

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

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

The First Term Loan matures on August 15, 2008, and is secured by a lien on all of the Company's property and assets (tangible and intangible), including all capital stock of existing and future subsidiaries (except future excluded subsidiaries). The First Term Loan 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, 2008, the effective interest rate on all borrowings under the First Term Loan was 7.57%. 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. (See Note 1 "Basis of Presentation — Going Concern").

The Senior Notes mature on August 15, 2011, and are effectively subordinated to the Term Loans (as defined below) to the extent of the collateral securing the Term Loans. The Senior Notes contain customary restrictive covenants and debt incurrence tests. The

Senior Notes bear interest at a fixed rate of 11<sup>3</sup>/<sub>4</sub>% with payments due semi-annually on February 15 and on August 15. Interest payments commenced on February 15, 2004. (See Note 1 “Basis of Presentation — Going Concern”).

On December 10, 2004, Hights Cross issued an additional \$30.0 million aggregate principal amount of its Senior Notes under its existing indenture. These Senior Notes are *pari passu* with, of the same series as and vote on any matter submitted to bondholders, the original Senior Notes. In connection with the issuance of the additional Senior Notes, Hights Cross entered into a new \$30.0 million Senior Secured Term Loan (the “Second Term Loan” and, together with the First Term Loan, the “Term Loans”). Amounts borrowed under the Second Term Loan rank equally with the amounts borrowed under the First Term Loan. The Second Term Loan also matures on August 15, 2008. As of March 31, 2008, the effective interest rate on all borrowings under the Second Term Loan was 6.5%. As of March 31, 2008, the Company had \$170.0 million aggregate principal amount of outstanding Senior Notes and \$124.5 million aggregate principal amount of indebtedness outstanding under the Term Loans. The balance of the Term Loans is classified as short-term liability. (See Note 1 “Basis of Presentation — Going Concern”).

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

#### 12<sup>1</sup>/<sub>2</sub>% Senior Discount Notes

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

The following table is a summary of the Company’s current outstanding debt as of March 31, 2008 (in thousands):

Instrument	Issuance Date	Due Date	Face Amount	Premium (Discount) At Issuance	Interest Rate As of March 31, 2008	Book Value As of March 31, 2008
<b>Hights Cross:</b>						
First Term Loan	08/20/03	08/15/08	\$100,000	—	7.57%	\$ 95,500
Second Term Loan	12/10/04	08/15/08	\$ 30,000	—	6.57%	29,025
						<u>124,525</u>
11 <sup>3</sup> / <sub>4</sub> % Senior notes	08/20/03	08/15/11	\$140,000	—	11.75%	140,000
11 <sup>3</sup> / <sub>4</sub> % Senior notes	12/10/04	08/15/11	\$ 30,000	\$ 3,150	11.75%	31,552
						<u>171,552</u>
<b>Hights Cross Communications:</b>						
12 <sup>1</sup> / <sub>2</sub> % Senior discount notes	02/02/04	08/15/11	\$135,000	\$(61,347)	12.5%	122,009
<b>Total debt</b>						<u><u>\$ 418,086</u></u>

The following table shows the required future repayments under the Company's current financing arrangements as of March 31, 2008 (in thousands):

Remainder of 2008	\$124,525
2009	—
2010	—
2011	305,000
2012	—
Total	<u>429,525</u>
Less: Unamortized discounts and other	<u>(11,439)</u>
	<u>\$418,086</u>

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

On December 10, 1999, the Company issued 2,400,000 shares of nonvoting Series B senior preferred stock (the "Preferred B"). The Preferred B had a liquidation value of \$25 per share, plus any accrued but unpaid dividends accrued quarterly cumulative dividends at an annual rate of 16%, and was mandatorily redeemable by the Company on December 10, 2011 at a redemption price equal to its liquidation value, plus any accrued but unpaid dividends. Upon the closing of the Recapitalization Agreement, all outstanding shares of Preferred B were converted to common stock at an agreed upon rate, and no shares of Preferred B remain outstanding.

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

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

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

## 13. Commitments

From time to time, the Company is involved in litigation that it considers to be ordinary routine litigation incidental to our business. The Company is not presently involved in any 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:

	<u>Three Months Ended March 31,</u> <u>2008</u>	<u>2007</u> <u>As restated</u> <u>(Unaudited)</u>
Net loss	\$ (9,892)	\$ (12,643)
Foreign currency translation adjustment	(7)	19
Comprehensive Loss	<u>\$ (9,899)</u>	<u>\$ (12,624)</u>

## 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/ 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 *CMEinfo* businesses.

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, 2008 and 2007 are as follows:

	<u>K-12 Supplemental Education</u>	<u>Test-prep &amp; Intervention</u>	<u>Library</u>	<u>Medical Education</u>	<u>Corporate</u>	<u>Consolidated</u>
<b>Three Months Ended March 31, 2008 (unaudited)</b>						
Revenue	\$ 3,551	\$ 20,034	\$ 21,257	\$ 6,988	\$ —	\$ 51,830
Cost of goods sold	1,087	3,709	7,420	2,074	—	14,290
Marketing and sales	1,475	6,751	3,645	2,648	—	14,519
Fulfillment and distribution	658	1,928	1,517	859	—	4,962
General and administrative	515	2,131	1,889	961	2,529	8,025
Restructuring charges	663	199	—	—	—	862
Amortization of pre-publication costs	816	2,322	1,409	371	—	4,918
Depreciation expense and amortization of intangibles	141	890	195	296	14	1,536
Income (loss) from operations	<u>\$ (1,804)</u>	<u>\$ 2,104</u>	<u>\$ 5,182</u>	<u>\$ (221)</u>	<u>\$ (2,543)</u>	<u>\$ 2,718</u>
Interest expense	\$ 929	\$ 3,951	\$ 896	\$ 1,274	\$ 4,257	\$ 11,307
Capital expenditures — property and equipment	3	119	137	262	2	523
Capital expenditures — pre-publication costs	18	3,389	1,544	330	—	5,281
Goodwill	—	50,488	64,513	20,565	—	135,566
Total assets	6,267	118,623	109,174	42,185	54,800	331,049

	<u>K-12 Supplemental Education</u>	<u>Test-prep &amp; Intervention</u>	<u>Library</u>	<u>Medical Education</u>	<u>Corporate</u>	<u>Consolidated</u>
<b>Three Months Ended March 31, 2007 (unaudited)</b>						
Revenue	\$ 5,386	\$ 19,592	\$ 20,592	\$7,363	\$ —	\$ 52,933
Cost of goods 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	<u>\$ (1,866)</u>	<u>\$ 3,200</u>	<u>\$ 5,342</u>	<u>\$ 890</u>	<u>\$ (1,517)</u>	<u>\$ 6,049</u>
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	20,565	—	135,566
Total assets	20,679	117,891	106,869	40,637	64,125	350,201

## 16. Condensed Consolidating Financial Statements

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

Unaudited Interim Condensed Consolidating Statements of Operations:

	<b>Three Months Ended March 31, 2008</b>				
	<b>Parent Guarantor</b>	<b>HCOC</b>	<b>Guarantor Subsidiaries</b> <i>(in thousands)</i>	<b>Eliminations</b>	<b>Consolidated</b>
Revenue	\$ —	\$ —	\$ 51,830	\$ —	\$ 51,830
Costs and expenses	119	2,424	46,569	—	49,112
(Loss) income from operations	(119)	(2,424)	5,261	—	2,718
Equity in the income (loss) of subsidiaries	(5,053)	(3,176)	—	8,229	—
Loss from discontinued operations	—	40	—	—	40
Other expenses (income)	4,720	(587)	8,437	—	12,570
Net (loss) income	<u>\$ (9,892)</u>	<u>\$ (5,053)</u>	<u>\$ (3,176)</u>	<u>\$ 8,229</u>	<u>\$ (9,892)</u>

	<b>Three Months Ended March 31, 2007</b>				
	<b>Parent Guarantor</b>	<b>HCOC</b>	<b>Guarantor Subsidiaries</b> <i>(in thousands)</i>	<b>Eliminations</b>	<b>Consolidated</b>
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	<u>\$ (12,643)</u>	<u>\$ (2,202)</u>	<u>\$ (1,720)</u>	<u>\$ 3,922</u>	<u>\$ (12,643)</u>

Unaudited Interim Condensed Consolidating Balance Sheets:

	As of March 31, 2008				
	<u>Parent Guarantor</u>	<u>HCOC</u>	<u>Guarantor Subsidiaries</u> <i>(in thousands)</i>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Assets</b>					
Current assets	\$ 3,901	\$ 43,947	\$ 60,353	\$ —	\$ 108,201
Investment in subsidiaries	(20,380)	234,037	—	(213,657)	—
Long term assets	1,347	5,605	215,896	—	222,848
<b>Total assets</b>	<b>\$ (15,132)</b>	<b>\$283,589</b>	<b>\$ 276,249</b>	<b>\$ (213,657)</b>	<b>\$ 331,049</b>
<b>Liabilities and Stockholders' Deficit</b>					
Current liabilities	\$ —	\$132,386	\$ 42,042	\$ —	\$ 174,428
Long term liabilities	141,468	171,583	170	—	313,221
<b>Stockholders' deficit:</b>					
Common stock	3	—	—	—	3
Accumulated deficit and other	(156,603)	(20,380)	234,037	(213,657)	(156,603)
Total stockholders' deficit	(156,600)	(20,380)	234,037	(213,657)	(156,600)
<b>Total liabilities and stockholders' deficit</b>	<b>\$ (15,132)</b>	<b>\$283,589</b>	<b>\$ 276,249</b>	<b>\$ (213,657)</b>	<b>\$ 331,049</b>

	As of December 31, 2007				
	<u>Parent Guarantor</u>	<u>HCOC</u>	<u>Guarantor Subsidiaries</u> <i>(in thousands)</i>	<u>Eliminations</u>	<u>Consolidated</u>
<b>Assets</b>					
Current assets	\$ 3,872	\$ 56,759	\$ 60,531	\$ —	\$ 121,162
Investment in subsidiaries	(15,313)	231,094	—	(215,781)	—
Long term assets	1,448	6,276	215,886	—	223,610
<b>Total assets</b>	<b>\$ (9,993)</b>	<b>\$294,129</b>	<b>\$ 276,417</b>	<b>\$ (215,781)</b>	<b>\$ 344,772</b>
<b>Liabilities and Stockholders' Deficit</b>					
Current liabilities	\$ —	\$137,554	\$ 45,126	\$ —	\$ 182,680
Long term liabilities	136,836	171,888	197	—	308,921
<b>Stockholders' deficit:</b>					
Common stock	3	—	—	—	3
Accumulated deficit	(146,832)	(15,313)	231,094	(215,781)	(146,832)
Total stockholders' deficit	(146,829)	(15,313)	231,094	(215,781)	(146,829)
<b>Total liabilities and stockholders' deficit</b>	<b>\$ (9,993)</b>	<b>\$294,129</b>	<b>\$ 276,417</b>	<b>\$ (215,781)</b>	<b>\$ 344,772</b>

Unaudited Interim Condensed Consolidating Statements of Cash Flows:

	Three Months Ended March 31, 2008				
	<u>Parent Guarantor</u>	<u>HCOC</u>	<u>Guarantor Subsidiaries</u> <i>(in thousands)</i>	<u>Eliminations</u>	<u>Consolidated</u>
Cash provided by (used in):					
Operating activities from continuing operations:	\$ (107)	\$ (5,861)	\$ (1,562)	\$ —	\$ (7,530)
Investing activities:					
Additions to pre-publication costs	—	—	(5,281)	—	(5,281)
Additions to property and equipment	—	(2)	(521)	—	(523)
Additions to intangible assets	—	—	(36)	—	(36)
Intercompany activity	136	(6,262)	6,126	—	—
Net cash provided by (used in) investing activities	136	(6,264)	288	—	(5,840)
Financing activities:					
Repayment of senior secured loan	—	(325)	—	—	(325)
Net cash used in financing activities	—	(325)	—	—	(325)
Effect of exchange rates on cash	—	—	(5)	—	(5)
Net cash used in discontinued operations	—	(45)	—	—	(45)
Net change in cash and cash equivalents	29	(12,495)	(1,279)	—	(13,745)
Cash and cash equivalents at beginning of period	3,872	56,237	1,675	—	61,784
Cash and cash equivalents at end of period	<u>\$ 3,901</u>	<u>\$ 43,742</u>	<u>\$ 396</u>	<u>\$ —</u>	<u>\$ 48,039</u>
			As of March 31, 2007		
	<u>Parent Guarantor</u>	<u>HCOC</u>	<u>Guarantor Subsidiaries</u> <i>(in thousands)</i>	<u>Eliminations</u>	<u>Consolidated</u>
Cash provided by (used in):					
Operating activities from continuing operations:	\$ 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	—	—
Net cash provided by (used in) investing activities	—	(7,841)	1,687	—	(6,154)
Financing activities:					
Repayment of senior secured term loan	—	(325)	—	—	(325)
Additions to deferred financing costs	—	(88)	—	—	(88)
Net cash 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	<u>\$ 3,756</u>	<u>\$ 50,453</u>	<u>\$ (916)</u>	<u>\$ —</u>	<u>\$ 53,293</u>

## 17. Related Party Transaction

Pursuant to Management Stock Purchase Agreements dated August 10, 2007, Messrs. Crecca and Quandt purchased for \$0.001 a share, 75,000 and 225,000 shares of restricted stock, respectively. Mr. Quandt's 225,000 shares of common stock were deemed to be fully vested at the time of his resignation. Mr. Crecca's restricted shares are subject to a three year vesting period. Each non-employee member of the Board of Directors received a restricted stock award of 8,117 shares of our common stock with the Chairman receiving 12,175 shares. The restricted stock granted pursuant to all of these awards was to vest in February 2008. During the year ended December 31, 2007, for \$0.001 per share director Eugene I. Davis purchased 12,175 shares of restricted stock, and directors John A. McKenna, Jr., Curry E. Ford and T.J. Vigliotta have purchased 8,117 shares of restricted stock each. In January 2008, prior to the vesting of his restricted stock, Mr. Vigliotta elected to forfeit all of his restricted stock. In January 2008, prior to the vesting of his restricted stock, Mr. Curry elected to forfeit all of his restricted stock in exchange for an issuance by the Company to Glenview Capital Management, LLC, of an equivalent amount under the same terms and conditions. Subsequently, we issued to Glenview Capital Management, LLC, which has designated Mr. Ford to serve as our director, a restricted stock award of 8,117 shares. All outstanding restricted stock awards fully vested on February 10, 2008 for issuances to Mr. Davis and Glenview Capital Management, LLC and February 21, 2008 for the issuance to Mr. McKenna. Total stock-based compensation expense is recognized as a "general and administrative expense" in the consolidated statements of operations on a ratable basis over the vesting period. The compensation expense recorded for these restricted shares was \$0.1 million for the quarter ended March 31, 2008.

Monarch Alternative Capital LP ("Monarch Capital"), Deephaven Distressed Opportunities Trading Ltd. and New York Life Investment Management LLC each may be deemed to beneficially own more than 5% of our outstanding stock. Each of these entities or their affiliates also own positions in one or more of our Term Loans, Senior Notes or Senior Discount Notes. Mr. Vigliotta, a director, is a Principal at Monarch Capital and has served as a member of our Board of Directors since August 2007. Monarch Capital acquired its debt positions prior to Mr. Vigliotta's appointment to our Board.

## 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”). Such statements include, without limitation any statements regarding the anticipated sales process or the anticipated results of that process. 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. Among other things, there can be no assurance that any of the operating units will be sold on a timely basis or on favorable terms, if at all. 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 Item 1A of this Quarterly Report on Form 10-Q, 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 sales strategy entails significant risks including but not limited to the diversion of management’s attention from our business and risk of loss of affected employees and/or customers resulting from the announcement of our plans, and sales may not be completed on a timely basis or on satisfactory terms, if at all; (iii) our inability to take certain actions because of restrictions contained in our debt instruments, which may adversely affect our operations; (iv) our sales process may lead to a change in control of our beneficial ownership or a sale of substantially all of our assets, which will constitute an event of default under our debt documents if certain conditions are not met; (v) our history of losses, which we expect to continue; (vi) changes in funding of school systems and libraries by federal, state and local governments, which could reduce our sales and profits, if any, (vii) our inability to compete in the highly competitive industry in which we operate, (viii) the effect that misuse, misappropriation or other loss of our proprietary rights could have on our results of operations; (ix) our need to defend against intellectual property infringement and other claims, which may cause us to incur significant costs and divert management attention; (x) the inability of our investors to evaluate the application of our cash and cash equivalents, over which management is given broad discretion; (xi) our dependence on key personnel; (xii) a growth in multimedia products that may compete with and reduce our publishing activities; (xiii) technological changes that may reduce the sales of our products; (xiv) the effect of an increase in paper or postage costs, which could adversely affect our business; (xv) the ability of our principal stockholders, who own a large percentage of our common stock, to influence or control the Company; (xvi) 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; (xvii) the effect that a material change to or repeal of the federal government’s NCLB Act would have on our revenue and profitability; (xviii) 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; (xix) 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; (xx) a disruption in our distribution centers could significantly lower our revenues and profitability; (xxi) 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; (xxii) 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; (xxiii) our ability to utilize our net operating loss carryforwards; (xiv) the seasonal and cyclical nature of sales of our products; (xxv) changes in the competitive environment, including those which could adversely affect our cost of sales; (xxvi) changes in the relative profitability of products sold; (xxvii) regulatory changes that could affect the purchase of our products; (xxviii) 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; (xxix) the potential effect of a continued weak economy on sales of our products; and (xxx) the risk that our well-known authors will depart and write for our competitors.

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**

### ***Sales Transaction***

On January 28, 2008, the Company announced that it had completed a comprehensive strategic review and finalized plans to offer for sale all of its business assets. Included in the sale are the Company's three remaining operating units *Triumph Learning*, *Recorded Books* and *Oakstone Publishing*. A sale process for *Sundance/Newbridge* business began in November 2007, and subsequently on March 17, 2008 the Board of Directors resolved to initiate a phased wind-down of the operations of *Sundance/Newbridge*. We have not considered any of our operating businesses as discontinued operations as of March 31, 2008, as we have not committed to a specific plan to sell the operating businesses where it is unlikely that changes to the sale process will occur.

### ***Restructuring***

On September 28, 2007, the Board of Directors authorized a restructuring of *Options Publishing* and *Triumph Learning*, whereby the management of *Options Publishing* was merged into *Triumph Learning* and the warehouse functions of *Options Publishing* were consolidated into the shared services division; the accounting functions were taken over by the *Triumph Learning* general accounting group located in New York City; customer services, warehousing and fulfillment were incorporated into the shared services facility in Northborough, MA; and the manufacturing and product purchasing functions were consolidated into a new shared manufacturing group that is being formed in our Iowa City location. The purpose of this restructuring is to save operational costs and to improve the product development process. Furthermore, certain functions of *Triumph Learning* were to be moved to other locations to improve processes, leverage shared resources and take advantage of lower cost facilities. The accounts receivable and cash applications functions were relocated to Northborough, MA; and the manufacturing functions located in NY were moved into the previously discussed shared manufacturing function in Iowa City. Additionally, as of January 1, 2008, the *Triumph Learning* accounting group took over certain accounting functions from *Sundance/Newbridge* related to the shared services facility in Northborough, MA. The Company completed the restructuring process during the first quarter of 2008 and incurred a total restructuring charge of approximately \$1.2 million in connection with this effort.

On September 28, 2007, the Board of Directors also authorized a restructuring of *Sundance/Newbridge* whereas the Company would reduce its workforce by approximately 30 employees and would refocus its distributed product line over the subsequent months. The plan was to have all remaining operations retrenched or modified to maximize asset value and generate positive cash flow. The purpose of this effort was to save operational costs and to respond to the issues in the marketplace while improving business' financial performance.

On November 5, 2007, the Board of Directors authorized a plan to sell the *Sundance/Newbridge* business and subsequently on March 17, 2008 the Board of Directors authorized the orderly wind-down of the business. As a result, the *Sundance/Newbridge* restructuring was expanded to include the severance of the remaining *Sundance/Newbridge* employees and the full absorption of the shared service function by the *Triumph Learning* business. The Company expects to complete the restructuring process by the end of the second quarter of 2008 and expects to incur a total restructuring charge of approximately \$2.8 million in connection with this effort. Approximately \$1.7 million was accrued as of March 31, 2008.

### ***Recapitalization***

On August 10, 2007, we consummated the recapitalization pursuant to the Recapitalization Agreement. Under the terms of the Recapitalization Agreement, holders of our previously outstanding Preferred B converted their shares of Preferred B into approximately 82% of our outstanding shares of common stock, holders of our previously outstanding Preferred A, Preferred C and Preferred Warrants converted their shares and warrants into shares of common stock and common stock warrants representing approximately 15% of our outstanding shares of common stock, and certain members of management acquired new shares of common stock under the terms of management stock purchase agreements representing approximately 3% of our outstanding common stock. In connection with the foregoing, all previously outstanding shares of common stock were effectively eliminated through the reclassification into one share of common stock in a reverse split and all outstanding Common Warrants and options to purchase common stock were similarly effectively eliminated by the reverse split of the common stock. As a result of the closing of the transactions contemplated by the Recapitalization Agreement, the Company has only outstanding common stock and common stock warrants and no shares of Preferred A, Preferred B or Preferred C, or stock options, remain outstanding.

The closing of the Recapitalization Agreement was subject to the satisfaction of certain stated conditions, including the waiver by

the requisite holders of our Term Loans, Senior Notes and Senior Discount Notes of applicable “change of control” covenants that, absent such waiver, might have applied in connection with the conversion of the Preferred C, Preferred B, and Preferred A into common stock. All required waivers were obtained.

### Going Concern Considerations

We have prepared the accompanying financial statements in conformity with accounting principles generally accepted in the United States of America. These principles contemplate our continuation as a going concern. The Term Loans mature on August 15, 2008, and therefore have been reclassified from long-term to current based on their maturity date. As of March 31, 2008, we had a working capital deficiency of \$66.2 million. Although we cannot predict the effects of our sale announcements on our businesses, based on our current level of operations, we believe that cash flow from operations and available cash will be adequate to meet our future liquidity needs until the obligation to repay our Term Loans on August 15, 2008. We expect that cash on hand and generated from operations will be insufficient to fund the repayment of the Term Loans when due. We have initiated a sales process for our businesses and/or our entire company and therefore have not sought to extend our Term Loans at this time. If we are unable to receive sufficient net proceeds from this sales process by the due date of our Term Loans, or we are otherwise unable to extend or refinance a substantial portion of our obligations under our Term Loans, our existing capital resources will not enable us to meet our obligations under our Term Loans or continue operations beyond August 2008. Moreover, non-payment of our Term Loans when due would trigger a cross-default under our indentures governing the Senior Notes and Senior Discount Notes, which could require us to make an immediate payment under such indentures and obligations at a time when we would not have the funds to do so. A sale of all or substantially all of our assets through our proposed sales process or otherwise would constitute a change of control under our Senior Secured Term Loans and the indentures governing the Senior Notes and Senior Discount Notes and would result in an event of default thereunder if the Company does not satisfy certain conditions. We cannot assure that we will be able to enter into a sale transaction that allows us to repay our Term Loans or to refinance our Term Loans when due. Accordingly, as a result of the foregoing uncertainties, substantial doubt exists about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments to the amount or classification of assets and liabilities to reflect this uncertainty. For further discussion, see “Liquidity and Capital Resources” below.

### 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 *Sundance Publishing* and *Newbridge Educational Publishing*, imprints 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 *CMEinfo* 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, Coach, 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.

## **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. 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 audiocassettes, 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.

### ***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.

### ***Redeemable Capital Stock***

We previously accounted for our outstanding Preferred B, which was mandatorily redeemable, 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 Preferred A and Preferred C, on the other hand, which were redeemable at the option of the holders thereof and were not mandatorily redeemable, were not subject to SFAS No. 150 and were instead classified as mezzanine equity. The Preferred Warrants were also required to be classified as a liability and recorded at fair value, because under 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 Warrants were deemed to embody obligations of the Company to issue securities that had a redemption right.

Upon the closing of the Recapitalization Agreement, all outstanding shares of Preferred A, Preferred B and Preferred C were converted to common stock at agreed upon rates, and the Preferred Warrants were converted into warrants to acquire common stock at an agreed upon rate. As a result, we no longer have outstanding any redeemable capital stock, or any securities convertible into or exercisable or exchangeable for redeemable capital stock.

## Results of Operations

### Three Months Ended March 31, 2008 Compared To Three Months Ended March 31, 2007

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, 2008 and 2007:

	Three Months Ended March 31,			
	2008	(In Thousands)		2007
Revenue				
K-12 Supplemental Education	\$ 3,551	6.9%	\$ 5,386	10.2%
Test Prep and Intervention	20,034	38.7%	19,592	37.0%
Library	21,257	41.0%	20,592	38.9%
Medical Education	6,988	13.4%	7,363	13.9%
Total Revenue	51,830	100.0%	52,933	100.0%
Cost of goods sold	14,290	27.6%	14,426	27.3%
Selling, general and administrative expenses:				
Marketing and sales	14,519	28.0%	14,923	28.2%
Fulfillment and distribution	4,962	9.5%	4,687	8.9%
General and administrative expense	8,025	15.5%	7,009	13.2%
Restructuring charges	862	1.7%	19	0.0%
Total selling, general and administrative expenses	28,368	54.7%	26,638	50.3%
Amortization of pre-publication costs	4,918	9.5%	4,406	8.3%
Depreciation expense/amortization of intangibles	1,536	3.0%	1,414	2.7%
Income from operations	2,718	5.2%	6,049	11.4%
Interest expense	11,307	21.8%	17,279	32.6%
Other expenses, net of interest income	58	0.1%	38	0.1%
Loss before taxes	(8,647)	(16.7)%	(11,268)	(21.3)%
Tax provision	(1,205)	2.3%	(1,334)	(2.5)%
Loss before discontinued operations	(9,852)	(19.0)%	(12,602)	(23.8)%
Loss from discontinued operations	(40)	(0.1)%	(41)	(0.1)%
Net loss	<u>\$ (9,892)</u>	<u>(19.1)%</u>	<u>\$ (12,643)</u>	<u>(23.9)%</u>

## Revenue

Our total revenue declined \$1.1 million, or 2.1%, to \$51.8 million for the three-month period ended March 31, 2008 from \$52.9 million for the three-month period ended March 31, 2007. The decline is primarily due to the continued decline from our K-12 Supplemental Education segment. The decline was offset partially by increases in our Test-prep and Intervention and Library segments.

**K-12 Supplemental Education.** Revenue for the K-12 Supplemental Education segment declined \$1.8 million, or 34.1%, to \$3.6 million for the three-month period ended March 31, 2008, from \$5.4 million for the three-month period ended March 31, 2007. 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 that has led to recurring declines in revenues. In addition, we also believe that our business has been negatively affected by a trend towards product purchase decisions

being made at levels above the school facility level, such as the district or state level, which favors the larger well known basal publishing brands and products. Based on these continued declines in revenues, management has initiated an orderly wind-down of this business.

**Test-prep and Intervention.** Revenue for the Test-prep and Intervention segment increased \$0.4 million, or 2.3%, to \$20.0 million for the three-month period ended March 31, 2008, from \$19.6 million for the three-month period ended March 31, 2007. This increase is attributable to the continued success of our Coach product line. 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* test-prep study materials. *Triumph Learning* 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. We anticipate that *Triumph Learning* will continue to benefit in 2008 from the demand created by the NCLB Act.

**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 \$0.7 million, or 3.2%, to \$21.3 million for the three-month period ended March 31, 2008, from \$20.6 million for the three-month period ended March 31, 2007. The majority of the segment revenue growth is attributable to the core public library channel, which increased 8.7% and represented greater than 70% of the business for the quarter. The growth was achieved through the strength of solid performance by *My Library Download Video* and incremental revenue from *Playaway*, the new preloaded digital audio player product offered by *Recorded Books*.

**Medical Education.** Revenue for the Medical Education segment declined \$0.4 million, or 5.1%, to \$7.0 million for the three-month period ended March 31, 2008, from \$7.4 million for the three-month period ended March 31, 2007. The overall decline in segment revenue is attributable to Medical channel products, while our Wellness channel revenues, which include newsletters and calendars as well as other ancillary products, increased.

### Cost of Goods Sold

Cost of goods sold decreased \$0.1 million, or 0.9%, to \$14.3 million for the three-month period ended March 31, 2008 from \$14.4 million for the three-month period ended March 31, 2007. Cost of goods sold as a percentage of revenue increased to 27.6% from 27.3% period over period.

**K-12 Supplemental Education.** Cost of goods sold for the K-12 Supplemental Education segment decreased \$0.3 million, or 23.6%, to \$1.1 million for the three-month period ended March 31, 2008 from \$1.4 million for the three-month period ended March 31, 2007 due primarily to the decline in revenue. Cost of goods sold as a percentage of revenue for the K-12 Supplemental Education segment increased to 30.6% from 26.4% period over period primarily due to increases in inventory obsolescence provisions.

**Test-prep and Intervention.** Cost of goods sold for the Test-prep and Intervention segment decreased \$0.2 million, or 4.2%, to \$3.7 million for the three-month period ended March 31, 2008 from \$3.9 million for the three-month period ended March 31, 2007. Cost of goods sold as a percentage of revenue for the Test-prep and Intervention segment decreased to 18.5% from 19.8% 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 \$0.4 million, or 5.1% to \$7.4 million for the three-month period ended March 31, 2008 from \$7.0 million for the three-month period ended March 31, 2007. Cost of goods sold as a percentage of revenue increased to 34.9% from 34.3% period over period primarily due to an increase in inventory obsolescence provisions.

**Medical Education.** Cost of goods sold for the Medical Education segment was \$2.1 million in each of the three-month periods ended March 31, 2008 and 2007. Cost of goods sold as a percentage of revenue increased to 29.7% from 28.1% period over period.

### 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 \$1.7 million, or 6.5%, to \$28.4 million for the three-month period ended March 31, 2008 from \$26.6 million for the three-month period ended March 31, 2007, primarily due to increased professional fees associated with the offer of our

businesses for sale and increased restructuring and restructuring related charges. Selling, general and administrative expense as a percentage of revenue increased to 54.7% from 50.3%, period over period.

**K-12 Supplemental Education.** Selling, general and administrative expense for the K-12 Supplemental Education segment decreased \$1.5 million, or 31.2%, to \$3.3 million for the three-month period ended March 31, 2008 from \$4.8 million for the three-month period ended March 31, 2007 due to a reduction in revenue based costs including commissions and product costs and decreases in overhead expenses that were eliminated with the closing of our New York office and the wind down of this business. Selling, general and administrative expenses as a percentage of revenue increased to 93.2% from 89.3% 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 \$1.2 million, or 11.8%, to \$11.0 million for the three-month period ended March 31, 2008 from \$9.8 million for the three-month period ended March 31, 2007. The increase was primarily due to increased catalog and direct mail related marketing expenses and increased overhead cost from the Northborough warehouse facility and restructuring and related costs from the Options Publishing reorganization. Selling, general and administrative expenses as a percentage of revenue for the Test-prep and Intervention segment increased to 55.0% from 50.3% 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 increased \$0.4 million, or 5.3%, to \$7.1 million for the three-month period ended March 31, 2008 from \$6.7 million for the three-month period ended March 31, 2007 primarily due to severance and increased legal expenses. Selling, general and administrative expense as a percentage of revenue increased to 33.2% from 32.5% period over period, primarily due to an increase in general and administrative expenses related to severance and legal expenses.

**Medical Education.** Selling, general and administrative expense for the Medical Education segment increased \$0.7 million, or 18.2%, to \$4.5 million for the three-month period ended March 31, 2008 from \$3.8 million for the three-month period ended March 31, 2007. The increase is primarily due to increased marketing expenses related to our CME*info* product line. Selling, general and administrative expense as a percentage of revenue increased to 63.9% from 51.3% period over period, primarily due to marketing related costs.

**Corporate.** Our corporate general and administrative expenses increased \$1.0 million to \$2.5 million for the three months ended March 31, 2008 from \$1.5 million for the three months ended March 31, 2007. The increase is associated with increased professional fees associated with the offer of our businesses for sale.

#### **Amortization of Pre-Publication Costs**

Amortization of pre-publication costs increased \$0.5 million to \$4.9 million for the three-month period ended March 31, 2008, from \$4.4 million for the three-month period ended March 31, 2007, primarily due to increased investments in new product spending within the Test-prep and Intervention segment.

## Depreciation Expense and Amortization of Intangibles

Depreciation expense and amortization was \$1.5 million and \$1.4 million for the three-month periods ended March 31, 2008 and 2007, respectively.

## Interest Expense

Interest expense decreased \$6.0 million, or 34.6%, to \$11.3 million for the three-month period ended March 31, 2008 from \$17.3 million for the three-month period ended March 31, 2007. This decrease was due to the conversion of our Preferred B, which was converted into common stock on August 10, 2007 in connection with the Recapitalization Agreement. Our total outstanding debt decreased from \$561.7 million as of March 31, 2007 to \$418.1 million as of March 31, 2008.

Cash interest expense decreased \$0.4 million to \$7.7 million for the three-month period ended March 31, 2008 from \$8.1 million for the three-month period ended March 31, 2007. The average interest rate decreased to 8.25% for the three-month period ended March 31, 2008 from 9.64% for the three-month period ended March 31, 2007. Our cash interest bearing outstanding debt was \$296.1 million as of March 31, 2008 compared to \$297.9 million as of March 31, 2007.

Interest expense consists of the following:

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Interest expense:		
Senior secured term loans	\$ 2,692	\$ 3,042
11 3/4% senior notes	4,994	4,994
12 1/2% senior discount notes — non-cash	3,646	3,205
Series B senior preferred stock — non-cash	—	5,972
Other	5	88
Total interest expense	11,337	17,301
Less: capitalized interest	(30)	(22)
Net Interest expense	<u>\$ 11,307</u>	<u>\$ 17,279</u>

As of March 31, 2008, the Company had \$124.5 million in aggregate principal amount outstanding under the Term Loans, with such amount bearing interest at rates between 6.57% and 7.57%. The average interest rate on the Term Loans was 8.25% for the three-month period ended March 31, 2008.

## Provision for Income Taxes

The Company has not recorded a deferred income tax benefit related to the pre-tax loss for the three months ended March 31, 2008 as management has determined that such income tax benefit is not more likely than not to be realized in 2008. The deferred income tax expense reflects the increase in deferred tax liabilities as a result of the amortization for income tax purposes of goodwill and indefinite lived assets not reflected in book income.

## Net Loss

Net losses for the three-month periods ended March 31, 2008 and 2007 were \$9.9 million and \$12.6 million, respectively. Operating income decreased \$3.9 million to \$2.7 million for the three month period ended March 31, 2008 from \$6.0 million for the three month period ended March 31, 2007 primarily due to the increase in general and administrative expenses associated with professional fees for the offer of our businesses for sale and restructuring related expenses. Other expenses decreased \$6.0 million period over period, primarily due to the decrease in interest expense. The provision for income taxes decreased \$0.1 million period over period.

## Liquidity and Capital Resources

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, 2008 we have an available cash balance of \$48.0 million. During the three-month period ended March 31, 2008 we funded \$5.3 million in pre-publication costs for new product development, \$0.5 million of capital expenditures for property and equipment, and \$13.2 million of cash interest and principal payments on our senior secured Term Loans.

We have prepared the accompanying financial statements in conformity with accounting principles generally accepted in the United States of America. These principles contemplate our continuation as a going concern. The Term Loans mature on August 15, 2008, and therefore have been reclassified from long-term to current based on their maturity date. As of March 31, 2008, we had a working capital deficiency of \$66.2 million. Although we cannot predict the effects of our sale announcements on our businesses, based on our current level of operations, we believe that cash flow from operations and available cash will be adequate to meet our future liquidity needs until the obligation to repay our Term Loans on August 15, 2008. We expect that cash on hand and generated from operations will be insufficient to fund the repayment of the Term Loans when due. We have initiated a sales process for our businesses and/or our entire company and therefore have not sought to extend our Term Loans at this time. If we are unable to receive sufficient net proceeds from this sales process by the due date of our Term Loans, or we are otherwise unable to extend or refinance a substantial portion of our obligations under our Term Loans, our existing capital resources will not enable us to meet our obligations under our Term Loans or continue operations beyond August 2008. Moreover, non-payment of our Term Loans when due would trigger a cross-default under our indentures governing the Senior Notes and Senior Discount Notes, which could require us to make an immediate payment under such indentures and obligations at a time when we would not have the funds to do so. We cannot assure that we will be able to enter into a sale transaction that allows us to repay our Term Loans or to refinance our Term Loans when due. Accordingly, as a result of the foregoing uncertainties, substantial doubt exists about our ability to continue as a going concern. Our consolidated financial statements do not include any adjustments to the amount or classification of assets and liabilities to reflect this uncertainty.

As of March 31, 2008, we had total indebtedness outstanding of \$418.1 million, including our Term Loans in the aggregate principal amount of \$124.5 million, Senior Notes in the aggregate principal amount of \$170.0 million and Senior Discount Notes in the aggregate accreted amount of \$122.0 million. See Note 11 to our Consolidated Financial Statements. The Term Loans are secured obligations of our subsidiary, Hights Cross, are guaranteed by our other subsidiaries and Hights Cross Communications, and secured by substantially all of our property and assets. The Senior Notes are general unsecured obligations of our subsidiary, Hights Cross, and are also guaranteed by our other subsidiaries and Hights Cross Communications. The Senior Notes are effectively subordinated to the Term Loans to the extent of the collateral securing the Term Loans. The Senior Discount Notes are general unsecured obligations of Hights Cross Communications, ranking equally with all of Hights Cross Communications' senior debt. However, the Senior Discount Notes are structurally subordinated to all existing and future liabilities of our subsidiaries, including the Term Loans and the Senior Notes, and are effectively subordinated to the Term Loans to the extent of the value of the collateral securing the Term Loans. Our loan agreements for our Term Loans and our indentures for our Senior Notes and Senior Discount Notes generally allow us to sell our assets provided that at least 75% of the total consideration we receive is in the form of cash (as defined), such consideration is at least equal to the fair market value of the assets or equity interests sold as determined in good faith by our board of directors, and certain other conditions relating to the application of the net proceeds are met. Certain other conditions would also apply if the sale were to constitute a change of control, including as a result of the sale of substantially all of our assets. See our Annual Report on Form 10-K, "Item 1A. Risk Factors — Risks Relating to our Business — A change of control in us could result in an event of default under our debt agreements."

Upon realizing sufficient net proceeds from the sales process of our businesses, we would generally anticipate that such proceeds would be applied to redeem our debt in the order of seniority in our capital structure described above, with the Term Loans effectively ranking first, the Senior Notes effectively ranking second and the Senior Discount Notes, as a result of their structural subordination, effectively ranking third. However, depending upon the timing, structure and net proceeds, if any, received from our sales process, the timing and payment of our debt could vary from that anticipated above. Our Term Loans are redeemable at their principal amount, plus any accrued and unpaid interest, through their maturity date of August 15, 2008. Our Senior Notes may be redeemed by us beginning on August 15, 2008 at a price of 105.875% of principal, plus any accrued and unpaid interest. As of March 31, 2008, our Senior Discount Notes may be redeemed by us at a price of 106.25% of accreted value plus accrued interest. The premiums payable for the voluntary redemption of the Senior Notes and Senior Discount Notes are reduced over time to zero.

## Cash Flows

Net cash used by operating activities decreased to \$7.5 million for the three month period ended March 31, 2008 from \$9.9 million for the three-month period ended March 31, 2007, primarily due to lower net loss resulting from a decrease in interest expense.

Cash used in investing activities decreased to \$5.8 million for the three months ended March 31, 2008 from \$6.2 million for the three months ended March 31, 2007. Cash used in investing activities consists primarily of expenditures on pre-publication costs and property, plant and equipment.

Cash used in financing activities decreased to \$0.3 million for the three months ended March 31, 2008 from \$0.4 million for the three months ended March 31, 2007. 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, 2008, we had \$5.3 million of pre-publication expenditures compared to \$5.5 million during the three months ended March 31, 2007. We plan expenditures of \$23.6 million for pre-publication costs in 2008. 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, 2008, we had \$0.5 million of property, building and equipment expenditures compared to \$0.6 million for the three months ended March 31, 2007. We plan expenditures of \$3.9 million for property and equipment in 2008. 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, 2007.

### **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.

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, 2008, a hypothetical 10% change in interest costs of our variable rate debt would change interest expense on an annual basis by \$0.8 million. As of March 31, 2008, 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.

As of March 31, 2008, we had \$124.5 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 7.57% for the First Term Loan and 6.57% 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, 2008, 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 4T. Controls and Procedures**

#### **(a) Disclosure Controls and Procedures**

Pursuant to 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 Rule 15d-15(e), as of March 31, 2008. Based on that evaluation, our disclosure controls and procedures were ineffective, as of the end of the period covered by this report, due to the material weakness in our internal control over financial reporting described below.

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 assurance 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.

#### **(b) Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as defined by Exchange Act Rule 15d-15(f). Pursuant to Rule 15d-15 under the Exchange Act, our management carried out an evaluation with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our internal control over financial reporting as of the end of the period covered by this report. Management used the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control — Integrated Framework (COSO)* in conducting its evaluation. Because of its inherent limitations, internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become

inadequate because of changes in conditions or that the degree of compliance with established policies or procedures may deteriorate.

A material weakness is a control deficiency, or a combination of control deficiencies, that results in a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected. As a result of an adjustment to income taxes and the classification of our Preferred Warrants and the calculation of the impairment of goodwill at the *Options Publishing* reporting unit discovered during the audit of the financial statements for our fiscal year ended December 31, 2006 which resulted from a lack of technical expertise, management determined that a material weakness in internal control over financial reporting related to our financial close process existed and continues unremediated as of March 31, 2008. This determination along with limited accounting personnel at *Sundance/Newbridge* prompted our management to conclude that, as of March 31, 2008, there was a reasonable possibility 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.

Our management concluded that due to the material weakness described above, we did not maintain effective internal control over financial reporting as of March 31, 2008.

**(c) Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting that occurred during our most recently completed fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Regarding the material weakness described above, we have identified the following changes necessary to improve our internal control over financial reporting:

- 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 would 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**

From time to time, we are involved in legal proceedings that we consider to be in the normal course of 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 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, 2007, 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 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In January 2008, we issued to Glenview Capital Management, LLC, which has designated Curry Ford to serve as our director, a restricted stock award of 8,117 shares. This issuance was issued and sold in a private placement transaction made in reliance upon the exemption from securities registration afforded by Section 4(2) and/or any other applicable exemption under the Securities Act.

**Item 4. Submission of Matters to a Vote of Security Holders.**

See “Submission of Matters to a Vote of Security Holders” in Item 4 of the Company’s Form 10-K for the year ended December 31, 2007.

**Item 6. Exhibits**

**EXHIBIT INDEX**

<u>Exhibit Number</u>	<u>Description</u>	<u>Page or Method of Filing</u>
3.1	Second Amended and Restated Certificate of Incorporation of Hights 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 Amendment dated August 10, 2007 to Second Amended and Restated Certificate of Incorporation of Hights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.1 of the Company’s Current Report on Form 8-K filed August 16, 2007.
3.1(b)	Certificate of Amendment dated June 28, 2007 to Second Amended and Restated Certificate of Incorporation of Hights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.1(a) of the Company’s Quarterly Report on Form 10-Q filed November 14, 2007.
3.1(c)	Certificate of Amendment dated January 29, 2008 to Second Amended and Restated Certificate of Incorporation of Hights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.1 of the Company’s Current Report on Form 8-K filed January 31, 2008.
3.1(d)	Certificate of Elimination of Shares of Hights Cross Communications, Inc. Designated as Series C Preferred Stock dated January 30, 2008.	Incorporated by reference to Exhibit 3.2 of the Company’s Current Report on Form 8-K filed January 31, 2008.
3.2	Bylaws of Hights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.2 of the Company’s Registration Statement on Form S-4 (Reg. No. 333-109381) filed October 2, 2003.
3.2(a)	Amendment to Bylaws of Hights Cross Communications, Inc.	Incorporated by reference to Exhibit 3.2 of the Company’s Current Report on Form 8-K filed August 16, 2007.
3.2(b)	Amendment to Bylaws of Hights Cross Communications, inc.	Incorporated by referenced to Exhibit 3.1 of the Company’s Current Report on Form 8-K filed September 27, 2007
31.1	Rule 13a-14(a)/15d-14(a) Certification of Paul J. Crecca	Filed herewith
31.2	Rule 13a-14(a)/15d-14(a) Certification of Mark Kurtz	Filed herewith
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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.**



**CERTIFICATION**

I, Paul J. Crecca, certify that:

1. I have reviewed this report on Form 10-Q of Hights 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) 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
  - (d) 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: May 15, 2008

By: /s/ Paul J. Crecca

Name: Paul J. Crecca

Title: President and Chief Executive Officer

**CERTIFICATION**

I, Mark Kurtz, certify that:

1. I have reviewed this report on Form 10-Q of Hights 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) 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
  - (d) 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: May 15, 2008

By: /s/ Mark Kurtz

Name: Mark Kurtz

Title: Senior Vice President and Chief Financial Officer