

CAMBIUM LEARNING GROUP, INC.

Form 10-Q

May 16, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

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

**For the quarterly period ended March 31, 2011  
OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission File Number: 001-34575**

**Cambium Learning Group, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**27-0587428**

(I.R.S. Employer Identification No.)

**17855 North Dallas Parkway, Suite 400, Dallas,  
Texas**

(Address of Principal Executive Offices)

**75287**

(Zip Code)

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

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

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

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

Large accelerated filer  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 number of shares of the registrant's common stock, \$0.001 par value per share, outstanding as of April 30, 2011 was 43,912,531.

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Cambium Learning Group, Inc. and Subsidiaries  
Condensed Consolidated Statements of Operations  
(In thousands, except per share data)  
(Unaudited)

|                                                               | <b>Three Months Ended</b> |                           |
|---------------------------------------------------------------|---------------------------|---------------------------|
|                                                               | <b>March 31,<br/>2011</b> | <b>March 31,<br/>2010</b> |
| Net revenues                                                  | \$ 30,695                 | \$ 28,222                 |
| Cost of revenues:                                             |                           |                           |
| Cost of revenues                                              | 10,967                    | 11,312                    |
| Amortization expense                                          | 6,618                     | 6,742                     |
| Total cost of revenues                                        | 17,585                    | 18,054                    |
| Research and development expense                              | 2,379                     | 3,010                     |
| Sales and marketing expense                                   | 10,903                    | 11,057                    |
| General and administrative expense                            | 5,812                     | 7,938                     |
| Shipping and handling costs                                   | 334                       | 544                       |
| Depreciation and amortization expense                         | 1,736                     | 2,577                     |
| Embezzlement and related expense (recoveries)                 | (2,436)                   | 19                        |
| Total costs and expenses                                      | 36,313                    | 43,199                    |
| Loss before interest, other income (expense) and income taxes | (5,618)                   | (14,977)                  |
| Net interest expense                                          | (4,405)                   | (4,368)                   |
| Other income (expense), net                                   | 363                       | (10)                      |
| Loss before income taxes                                      | (9,660)                   | (19,355)                  |
| Income tax expense                                            | (97)                      | (85)                      |
| Net loss                                                      | \$ (9,757)                | \$ (19,440)               |
| Net loss per common share:                                    |                           |                           |
| Basic net loss per common share                               | \$ (0.22)                 | \$ (0.44)                 |
| Diluted net loss per common share                             | \$ (0.22)                 | \$ (0.44)                 |
| Average number of common shares and equivalents outstanding:  |                           |                           |
| Basic                                                         | 44,353                    | 44,318                    |
| Diluted                                                       | 44,353                    | 44,318                    |

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

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Cambium Learning Group, Inc. and Subsidiaries  
Condensed Consolidated Balance Sheets  
(In thousands, except per share data)

|                                                     | <b>March 31,<br/>2011<br/>(unaudited)</b> | <b>December 31,<br/>2010</b> |
|-----------------------------------------------------|-------------------------------------------|------------------------------|
| <b>ASSETS</b>                                       |                                           |                              |
| Current assets:                                     |                                           |                              |
| Cash and cash equivalents                           | \$ 19,494                                 | \$ 11,831                    |
| Accounts receivable, net                            | 14,122                                    | 31,627                       |
| Inventory                                           | 26,465                                    | 22,015                       |
| Deferred tax assets                                 | 3,703                                     | 3,703                        |
| Restricted assets, current                          | 2,523                                     | 3,064                        |
| Assets held for sale                                | 2,649                                     |                              |
| Other current assets                                | 4,804                                     | 3,937                        |
| <br>                                                |                                           |                              |
| Total current assets                                | 73,760                                    | 76,177                       |
| <br>                                                |                                           |                              |
| Property, equipment and software at cost            | 35,056                                    | 32,944                       |
| Accumulated depreciation and amortization           | (8,834)                                   | (7,838)                      |
| Property, equipment and software, net               | 26,222                                    | 25,106                       |
| <br>                                                |                                           |                              |
| Goodwill                                            | 151,915                                   | 151,915                      |
| Acquired curriculum and technology intangibles, net | 30,554                                    | 33,063                       |
| Acquired publishing rights, net                     | 35,745                                    | 38,707                       |
| Other intangible assets, net                        | 21,058                                    | 22,132                       |
| Pre-publication costs, net                          | 8,263                                     | 7,834                        |
| Restricted assets, less current portion             | 12,005                                    | 12,641                       |
| Other assets                                        | 22,454                                    | 15,487                       |
| <br>                                                |                                           |                              |
| Total assets                                        | \$ 381,976                                | \$ 383,062                   |

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

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Cambium Learning Group, Inc. and Subsidiaries  
Condensed Consolidated Balance Sheets  
(In thousands, except per share data)

|                                                                                                                                                     | <b>March 31,<br/>2011<br/>(unaudited)</b> | <b>December 31,<br/>2010</b> |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------|------------------------------|
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                                                                                                          |                                           |                              |
| Current liabilities:                                                                                                                                |                                           |                              |
| Current portion of long-term debt                                                                                                                   | \$                                        | \$ 1,280                     |
| Current portion of capital lease obligations                                                                                                        | 400                                       | 378                          |
| Accounts payable                                                                                                                                    | 4,723                                     | 6,465                        |
| Contingent value rights, current                                                                                                                    | 1,931                                     | 1,623                        |
| Accrued expenses                                                                                                                                    | 18,161                                    | 22,888                       |
| Deferred revenue, current                                                                                                                           | 27,723                                    | 34,140                       |
| <br>                                                                                                                                                |                                           |                              |
| Total current liabilities                                                                                                                           | 52,938                                    | 66,774                       |
| <br>                                                                                                                                                |                                           |                              |
| Long-term liabilities:                                                                                                                              |                                           |                              |
| Long-term debt, less current portion                                                                                                                | 174,043                                   | 150,850                      |
| Capital lease obligations, less current portion                                                                                                     | 12,202                                    | 12,317                       |
| Deferred revenue, less current portion                                                                                                              | 3,056                                     | 3,416                        |
| Contingent value rights, less current portion                                                                                                       | 5,746                                     | 5,746                        |
| Other liabilities                                                                                                                                   | 19,433                                    | 19,947                       |
| <br>                                                                                                                                                |                                           |                              |
| Total long-term liabilities                                                                                                                         | 214,480                                   | 192,276                      |
| <br>                                                                                                                                                |                                           |                              |
| Commitments and contingencies (See Note 14)                                                                                                         |                                           |                              |
| <br>                                                                                                                                                |                                           |                              |
| Stockholders equity:                                                                                                                                |                                           |                              |
| Preferred stock (\$.001 par value, 15,000 shares authorized, zero shares issued and outstanding at March 31, 2011 and December 31, 2010)            |                                           |                              |
| Common stock (\$.001 par value, 150,000 shares authorized, 43,913 and 43,869 shares issued and outstanding at March 31, 2011 and December 31, 2010) | 44                                        | 44                           |
| Capital surplus                                                                                                                                     | 260,190                                   | 259,887                      |
| Accumulated deficit                                                                                                                                 | (144,975)                                 | (135,218)                    |
| Other comprehensive income (loss):                                                                                                                  |                                           |                              |
| Pension and postretirement plans                                                                                                                    | (702)                                     | (702)                        |
| Net unrealized gain on securities                                                                                                                   | 1                                         | 1                            |
| <br>                                                                                                                                                |                                           |                              |
| Accumulated other comprehensive income (loss)                                                                                                       | (701)                                     | (701)                        |

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|                                            |            |            |
|--------------------------------------------|------------|------------|
| Total stockholders' equity                 | 114,558    | 124,012    |
| Total liabilities and stockholders' equity | \$ 381,976 | \$ 383,062 |

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



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Cambium Learning Group, Inc. and Subsidiaries  
Condensed Consolidated Statements of Cash Flows  
(In thousands)  
(Unaudited)

|                                                                             | <b>Three Months Ended</b> |                  |
|-----------------------------------------------------------------------------|---------------------------|------------------|
|                                                                             | <b>March 31,</b>          | <b>March 31,</b> |
|                                                                             | <b>2011</b>               | <b>2010</b>      |
|                                                                             | <b>(unaudited)</b>        |                  |
| Operating activities:                                                       |                           |                  |
| Net loss                                                                    | \$ (9,757)                | \$ (19,440)      |
| Adjustments to reconcile net loss to net cash used in operating activities: |                           |                  |
| Depreciation and amortization expense                                       | 8,354                     | 9,319            |
| Gain from recovery of property held for sale                                | (2,649)                   |                  |
| Non-cash interest expense                                                   | 203                       | 530              |
| Gain on derivative instruments                                              |                           | (494)            |
| Change in fair value of contingent value rights obligation                  | 308                       |                  |
| Loss on disposal of assets                                                  |                           | 38               |
| Stock-based compensation and expense                                        | 290                       | 234              |
| Changes in operating assets and liabilities:                                |                           |                  |
| Accounts receivable, net                                                    | 17,505                    | 6,273            |
| Inventory                                                                   | (4,450)                   | (1,383)          |
| Other current assets                                                        | (867)                     | 1,969            |
| Other assets                                                                | 189                       | (258)            |
| Restricted assets                                                           | 1,177                     | (917)            |
| Accounts payable                                                            | (1,742)                   | 2,500            |
| Accrued expenses                                                            | (4,727)                   | (2,452)          |
| Deferred revenue                                                            | (6,777)                   | (2,339)          |
| Other long-term liabilities                                                 | (501)                     | (562)            |
| Net cash used in operating activities                                       | (3,444)                   | (6,982)          |
| Investing activities:                                                       |                           |                  |
| Expenditures for property, equipment, software and pre-publication costs    | (3,354)                   | (2,101)          |
| Net cash used in investing activities                                       | (3,354)                   | (2,101)          |
| Financing activities:                                                       |                           |                  |
| Proceeds from debt                                                          | 174,024                   |                  |
| Repayment of debt                                                           | (152,130)                 | (320)            |
| Deferred financing costs                                                    | (7,340)                   |                  |
| Principal payments under capital lease obligations                          | (93)                      | (115)            |
| Borrowings under revolving credit agreement                                 | 10,000                    | 5,000            |

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|                                                  |           |          |
|--------------------------------------------------|-----------|----------|
| Payment of revolving credit facility             | (10,000)  |          |
| Return of pre-merger member contributions        |           | (30)     |
| Net cash provided by financing activities        | 14,461    | 4,535    |
| Increase (decrease) in cash and cash equivalents | 7,663     | (4,548)  |
| Cash and cash equivalents, beginning of period   | 11,831    | 13,345   |
| Cash and cash equivalents, end of period         | \$ 19,494 | \$ 8,797 |

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

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**Cambium Learning Group, Inc. and Subsidiaries**  
**Notes to the Condensed Consolidated Financial Statements**  
**(Unaudited)**

**Note 1 Basis of Presentation**

Cambium Learning Group, Inc. Cambium Learning Group, Inc. (the Company) was incorporated under the laws of the State of Delaware in June 2009. On December 8, 2009, the Company completed the mergers of Voyager Learning Company ( VLCY ) and VSS-Cambium Holdings II Corp. ( Cambium ) into two of its wholly-owned subsidiaries, resulting in VLCY and Cambium becoming wholly-owned subsidiaries. Following the completion of the mergers, all of the outstanding capital stock of VLCY's operating subsidiaries, Voyager Expanded Learning, Inc. and LAZEL, Inc., was transferred to Cambium Learning, Inc., Cambium's operating subsidiary ( Cambium Learning ). The transaction was accounted for as an acquisition of VLCY by Cambium, as that term is used under U.S. GAAP, for accounting and financial reporting purposes under the applicable accounting guidance for business combinations. In making this determination, management considered that (a) the newly developed entity did not have any significant pre-combination activity and, therefore, did not qualify to be the accounting acquirer and (b) the former sole stockholder of Cambium is the majority holder of the combined entity, while the prior owners of VLCY became minority holders in the combined entity. As a result, the historical financial statements of Cambium have become the historical financial statements of the Company.

Presentation. The Condensed Consolidated Financial Statements include the accounts of the Company and are unaudited. The condensed balance sheet as of December 31, 2010 has been derived from audited financial statements. All intercompany transactions are eliminated.

As permitted under the Securities and Exchange Commission ( SEC ) requirements for interim reporting, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted. The Company believes that these financial statements include all necessary and recurring adjustments for the fair presentation of the interim period results. These financial statements should be read in conjunction with the Consolidated Financial Statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010. Due to seasonality, the results of operations for the three months ended March 31, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011.

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

Nature of Operations. The Company operates in three business segments: Voyager, a comprehensive intervention business; Sopris, a supplemental solutions education business; and Cambium Learning Technologies, a technology-based education product business.

**Note 2 Accounts Receivable**

Accounts receivable are stated net of allowances for doubtful accounts and estimated sales returns. The allowance for doubtful accounts and estimated sales returns totaled \$0.8 million at March 31, 2011, compared to \$0.6 million at December 31, 2010. The allowance for doubtful accounts is based on a review of the outstanding balances and historical collection experience. The reserve for sales returns is based on historical rates of return as well as other factors that in the Company's judgment could reasonably be expected to cause sales returns to differ from historical experience.

**Table of Contents****Note 3 Stock-Based Compensation and Expense**

The total amount of pre-tax expense for stock-based compensation recognized in the three months ended March 31, 2011 and 2010 was \$0.3 million and \$0.2 million, respectively. The stock-based compensation expense recorded was allocated as follows:

| <i>(in thousands)</i>              | <b>Three Months Ended March<br/>31,</b> |             |
|------------------------------------|-----------------------------------------|-------------|
|                                    | <b>2011</b>                             | <b>2010</b> |
| Cost of revenues                   | \$ 15                                   | \$ 9        |
| Research and development expense   | 32                                      | 19          |
| Sales and marketing expense        | 38                                      | 20          |
| General and administrative expense | 205                                     | 186         |
| Total                              | \$ 290                                  | \$ 234      |

On February 1, 2011, the Company granted 212,500 options under the Cambium Learning Group, Inc. 2009 Equity Incentive Plan (the Plan) with a total grant date fair value, net of forecasted forfeitures, of \$0.2 million. Seventy-five percent of these options have a per-share exercise price equal to \$4.50 and twenty-five percent of these options have an exercise price equal to \$6.50. These options vest equally over a four year service period and the term of the options is ten years from the date of grant. The following assumptions were used in the Black-Scholes option-pricing model to estimate the fair value of these awards:

|                               | <b>Three Months Ended March<br/>31,</b> |             |
|-------------------------------|-----------------------------------------|-------------|
|                               | <b>2011</b>                             | <b>2010</b> |
| Expected stock volatility     | 35.00%                                  | 35.00%      |
| Risk-free interest rate       | 2.50%                                   | 2.87%       |
| Expected years until exercise | 6.25                                    | 6.25        |
| Dividend yield                | 0.00%                                   | 0.00%       |

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

During the quarter ended March 31, 2011, 22,306 of the options granted on January 27, 2010 and 1,507 of the options granted on May 25, 2010 were forfeited. The impact to expense during the period as a result of these forfeitures was zero.

Restricted common stock awards of 43,855 shares were issued during the quarter ended March 31, 2011, in connection with the Company's Board of Directors compensation program. The restrictions on the common stock awards will lapse on the one-year anniversary of the grant date or upon a change in control of the Company. These awards were valued based on the Company's closing stock price on the date of grant, February 1, 2011.

During 2010, 10,000 shares of the Company's stock were issued as restricted stock awards.

**Table of Contents****Note 4 Net Loss per Common Share**

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

| <i>(in thousands)</i>     | <b>Three Months Ended March</b> |             |
|---------------------------|---------------------------------|-------------|
|                           | <b>2011</b>                     | <b>2010</b> |
| Basic                     | 44,353                          | 44,318      |
| Dilutive effect of awards |                                 |             |
| Diluted                   | 44,353                          | 44,318      |
| Antidilutive securities:  |                                 |             |
| Options                   | 3,946                           | 3,780       |
| Warrants                  | 141                             | 72          |
| Subscription rights       | 6,419                           | 5,818       |

**Note 5 Fair Value Measurements**

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

Level 1 Quoted prices for identical instruments in active markets.

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

Level 3 Valuations derived from valuation techniques in which significant value drivers are unobservable. Applicable guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

As of March 31, 2011, financial instruments include \$19.5 million of cash and cash equivalents, restricted assets of \$14.5 million, collateral investments of \$2.0 million, \$174.0 million of senior secured notes, \$0.5 million of warrants, assets held for sale of \$2.6 million, and \$7.7 million in contingent value rights (or CVRs) issued as part of the VLCY merger consideration. As of December 31, 2010, financial instruments included \$11.8 million of cash and cash equivalents, restricted assets of \$15.7 million, collateral investments of \$2.0 million, the \$95.4 million senior secured credit facility, \$56.7 million in senior unsecured notes, \$0.4 million of warrants, and \$7.4 million in CVRs. The fair market values of cash equivalents and restricted assets are equal to their carrying value, as these investments are recorded based on quoted market prices and/or other market data for the same or comparable instruments and transactions as of the end of the reporting period. The fair value of the senior secured notes is equal to its carrying value as they were issued during the quarter at market rates and there have been no factors that would indicate a change in value through the end of the quarter. The fair values of the properties held for sale were determined by an

independent appraisal conducted by a licensed realtor based on the values of similar properties in the area. These properties were acquired by the Company as a result of its recovery efforts in connection with the employee embezzlement matter described in Note 17 below.

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

| <i>(in thousands)</i><br>Description | Fair Value at Reporting Date Using |                                                                                     |                                                           |                                                    |                            |
|--------------------------------------|------------------------------------|-------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|----------------------------|
|                                      | As of March<br>31,<br>2011         | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total<br>Gains<br>(Losses) |
| Restricted Assets:                   |                                    |                                                                                     |                                                           |                                                    |                            |
| Money Market                         | \$ 14,528                          | \$ 14,528                                                                           | \$                                                        | \$                                                 | \$                         |
| Collateral Investments:              |                                    |                                                                                     |                                                           |                                                    |                            |
| Money Market                         | 901                                | 901                                                                                 |                                                           |                                                    |                            |
| Certificate of Deposit               | 1,064                              | 1,064                                                                               |                                                           |                                                    |                            |
| Warrant                              | 480                                |                                                                                     | 480                                                       |                                                    | 12                         |
| Assets held for sale                 | 2,649                              |                                                                                     | 2,649                                                     |                                                    |                            |
| CVRs                                 | 7,677                              |                                                                                     |                                                           | 7,677                                              | (308)                      |

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

In accordance with the provisions in the accounting guidance for intangibles goodwill and other, the Company's goodwill balance of \$151.9 million was tested for impairment in 2010. In the first step of the annual impairment test for fiscal 2010, the fair market value of each reporting unit was determined using an income approach and was dependent on multiple assumptions and estimates, including future cash flow projections with a terminal value multiple and the discount rate used to determine the expected present value of the estimated future cash flows. Future cash flow projections were based on management's best estimates of economic and market conditions over the projected period, including industry fundamentals such as the state of education funding, revenue growth rates, future costs and operating margins, working capital needs, capital and other expenditures, and tax rates. The discount rate applied to the future cash flows was a weighted-average cost of capital and took into consideration market and industry conditions, returns for comparable companies, the rate of return an outside investor would expect to earn, and other relevant factors. Based on the significant unobservable inputs used in this analysis, this valuation was considered a Level 3 valuation based on the fair value hierarchy described above. The first step of impairment testing for fiscal 2010 showed that the fair value of each reporting unit exceeded its carrying value by at least 10%; therefore, no second step of testing was required and no impairment was indicated. As the Company determined that no impairment indicators were present in the quarter ended March 31, 2011, no impairment analysis was conducted during the period. The fair value of the liability for the CVRs is determined using a probability weighted cash flow analysis which takes into consideration the likelihood, amount and timing of cash flows of each element of the pool of assets and liabilities included in the CVR. The determination of fair value of the CVRs involves significant assumptions and estimates, which are reviewed at each quarterly reporting date. As of March 31, 2011, a fair value of \$7.7 million has been recorded as a liability for the remaining CVR payments. During the quarter ended March 31, 2011, a loss of \$0.3 million was recorded in general and administrative expense to reflect an increase in the estimated fair value of the CVR liability. The ultimate value of the CVRs is not known at this time; however, it is not expected to be more than \$11 million and could be as low as the \$1.1 million already distributed. Future changes in the estimate of the fair value of the CVRs will impact results of operations and could be material.

The first CVR payment date was in September 2010 and \$1.1 million was distributed to the escrow agent at that time for distribution to holders of the CVRs. A second CVR distribution will be made in June 2011 and the distribution, if any, with respect to a potential tax indemnity obligation will be in October 2013. Additionally, as described in Note 14 below, any amounts due to CVR holders as a result of refunds received related to the Michigan tax payment will be

distributed upon the final resolution of this agreed contingency.



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

|                                                                          | Fair Value Measurements Using Significant Unobservable Inputs<br>(Level 3)<br>CVRs<br>(In thousands) |                                                             |                                                    |
|--------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------|-------------------------------------------------------------|----------------------------------------------------|
|                                                                          | Estimated<br>Fair Value<br>as of<br>December<br>31, 2010                                             | Loss (Gain) for<br>Changes<br>in Estimated CVR<br>Liability | Estimated Fair<br>Value<br>as of March 31,<br>2011 |
| Components of CVR Liability:                                             |                                                                                                      |                                                             |                                                    |
| Tax refunds received before closing of the merger                        | \$ 1,583                                                                                             | \$                                                          | \$ 1,583                                           |
| Other specified tax refunds                                              | 4,501                                                                                                | 248                                                         | 4,749                                              |
| Tax indemnity obligation                                                 | 1,717                                                                                                |                                                             | 1,717                                              |
| Legal receivable                                                         | 2,400                                                                                                |                                                             | 2,400                                              |
| Michigan state tax liability                                             | (1,040)                                                                                              |                                                             | (1,040)                                            |
| Other specified tax related liabilities                                  | (132)                                                                                                | 60                                                          | (72)                                               |
| Costs incurred to collect tax refunds and by stockholders representative | (554)                                                                                                |                                                             | (554)                                              |
| Estimated fair value of CVR liability                                    | 8,475                                                                                                | 308                                                         | 8,783                                              |
| Payments to holders of CVRs                                              |                                                                                                      |                                                             | 1,106                                              |
| Remaining estimated CVR liability                                        |                                                                                                      |                                                             | \$ 7,677                                           |

As of March 31, 2011, restricted assets in an escrow account for the benefit of the CVRs were \$4.1 million, with activity as follows. The escrow account includes \$3.0 million for a potential tax indemnity obligation, which, if such obligation is not triggered, will benefit the CVRs by \$1.9 million with the remainder reverting back to general cash of the Company.

|                                                                          | CVR Escrow<br>Trust<br>(In thousands) |
|--------------------------------------------------------------------------|---------------------------------------|
| Balance as of December 31, 2010                                          | \$ 4,179                              |
| Costs incurred to collect tax refunds and by stockholders representative | (47)                                  |
| Balance as of March 31, 2011                                             | 4,132                                 |

**Note 6 Comprehensive Income (Loss)**

The Company recorded other comprehensive income or loss of zero for the three month periods ended March 31, 2011 and 2010. Therefore, comprehensive income (loss) is equal to the net income (loss) for these periods.

**Note 7 Other Current Assets**

Other current assets at March 31, 2011 and December 31, 2010 consisted of the following:

As of

| <i>(in thousands)</i>   | <b>March 31,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|-------------------------|---------------------------|------------------------------|
| Prepaid expenses        | \$ 1,796                  | \$ 1,463                     |
| Deferred costs          | 1,788                     | 2,163                        |
| Income taxes receivable | 1,158                     | 249                          |
| Other current assets    | 62                        | 62                           |
| Total                   | \$ 4,804                  | \$ 3,937                     |

**Table of Contents****Note 8 Other Assets**

Other assets at March 31, 2011 and December 31, 2010 consisted of the following:

| <i>(in thousands)</i>    | <b>March 31,<br/>2011</b> | <b>As of<br/>December 31,<br/>2010</b> |
|--------------------------|---------------------------|----------------------------------------|
| Tax receivables          | \$ 10,438                 | \$ 11,168                              |
| Deferred financing costs | 8,778                     | 1,542                                  |
| Collateral investments   | 1,965                     | 1,964                                  |
| Other                    | 1,273                     | 813                                    |
| <br>                     |                           |                                        |
| Total                    | \$ 22,454                 | \$ 15,487                              |

**Note 9 Accrued Expenses**

Accrued expenses at March 31, 2011 and December 31, 2010 consisted of the following:

| <i>(in thousands)</i>                        | <b>March 31,<br/>2011</b> | <b>As of<br/>December 31,<br/>2010</b> |
|----------------------------------------------|---------------------------|----------------------------------------|
| Salaries, bonuses and benefits               | \$ 5,639                  | \$ 10,183                              |
| Accrued royalties                            | 3,283                     | 3,220                                  |
| Accrued interest                             | 2,010                     |                                        |
| Pension and post-retirement medical benefits | 1,209                     | 1,209                                  |
| Deferred compensation                        | 204                       | 525                                    |
| Other                                        | 5,816                     | 7,751                                  |
| <br>                                         |                           |                                        |
| Total                                        | \$ 18,161                 | \$ 22,888                              |

**Note 10 Other Liabilities**

Other liabilities at March 31, 2011 and December 31, 2010 consisted of the following:

| <i>(in thousands)</i>                                           | <b>March 31,<br/>2011</b> | <b>As of<br/>December 31,<br/>2010</b> |
|-----------------------------------------------------------------|---------------------------|----------------------------------------|
| Pension and post-retirement medical benefits, long-term portion | \$ 10,687                 | \$ 10,847                              |
| Long-term deferred tax liability                                | 4,529                     | 4,529                                  |
| Long-term income tax payable                                    | 795                       | 847                                    |
| Long-term deferred compensation                                 | 530                       | 613                                    |
| Other                                                           | 2,892                     | 3,111                                  |
| <br>                                                            |                           |                                        |
| Total                                                           | \$ 19,433                 | \$ 19,947                              |

**Note 11 Pension Plan**

The net pension costs of the Company's defined benefit pension plan for the three months ended March 31, 2011 and 2010 were comprised solely of interest costs and totaled \$0.1 million in each period.



**Table of Contents****Note 12 Restructuring**

As a result of the merger with VLCY on December 8, 2009, the Company has acted upon plans to reduce its combined work force and has closed its Dallas, Texas distribution facility and transferred all inventory to its distribution facility in Frederick, Colorado. The following table summarizes the amounts incurred in connection with the restructuring plan:

| <i>(in thousands)</i>         | <b>Total<br/>Amount<br/><br/>Expected to<br/>be Incurred</b> | <b>Total<br/>Incurred as<br/>of March<br/>31,<br/>2011</b> | <b>Incurred in<br/>Three<br/>Months<br/>Ended<br/>March<br/>31, 2011</b> | <b>Incurred in<br/>Year Ended<br/>December<br/>31,<br/>2010</b> |
|-------------------------------|--------------------------------------------------------------|------------------------------------------------------------|--------------------------------------------------------------------------|-----------------------------------------------------------------|
| One-time termination benefits | \$ 1,260                                                     | \$ 1,260                                                   | \$ (26)                                                                  | \$ 743                                                          |
| Warehouse move costs          | 570                                                          | 570                                                        |                                                                          | 570                                                             |
|                               | \$ 1,830                                                     | \$ 1,830                                                   | \$ (26)                                                                  | \$ 1,313                                                        |

The change in the accrual for one-time termination benefits, which does not impact a segment and so is included in unallocated shared services, for the three months ended March 31, 2011 is as follows:

| <i>(in thousands)</i>           | <b>One-Time<br/>Termination<br/>Benefits</b> |
|---------------------------------|----------------------------------------------|
| Balance as of December 31, 2010 | \$ 85                                        |
| Accrual changes                 | (26)                                         |
| Payments made                   | (59)                                         |
| Balance as of March 31, 2011    | \$                                           |

**Note 13 Uncertain Tax Positions**

The Company recognizes the financial statement impacts of a tax return position when it is more likely than not, based on technical merits, that the position will ultimately be sustained. For tax positions that meet this recognition threshold, the Company applies judgment, taking into account applicable tax laws, experience managing tax audits and relevant GAAP, to determine the amount of tax benefits to recognize in our financial statements. For each position, the difference between the benefit realized on the Company's tax return and the benefit reflected in our financial statements is recorded on our condensed consolidated balance sheet as an unrecognized tax benefit ( UTB ). The Company updates its UTBs at each financial statement date to reflect the impacts of audit settlements and other resolution of audit issues, expiration of statutes of limitation, developments in tax law and ongoing discussions with tax authorities. The balance of UTBs was \$7.1 million and \$7.2 million at March 31, 2011 and December 31, 2010, respectively. The decrease this quarter was due primarily to the expiration of statutes of limitation.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. All U.S. tax years prior to 2008 related to the VLCY-acquired entities have been audited by the Internal Revenue Service. Cambium and

its subsidiaries have been examined by the Internal Revenue Service through the end of 2006. Various state tax authorities are in the process of examining income tax returns for various tax years through 2007.

**Table of Contents****Note 14 Commitments and Contingencies**

The Company is involved in various legal proceedings incidental to its business. Management believes that the outcome of these proceedings will not have a material adverse effect upon the Company's consolidated operations or financial condition and the Company has recognized appropriate liabilities as necessary based on facts and circumstances known to management. The Company expenses legal costs related to legal contingencies as incurred. As previously reported in our Annual Report on Form 10-K for the year ended December 31, 2010, the Company is involved in a tax litigation matter related to a Michigan state tax issue. The final resolution of the tax litigation or potential settlement could result in a refund ranging from zero to approximately \$10.4 million of which fifty percent (50%), net of expenses incurred, would be payable to the holders of the CVRs. If the Company's position is not ultimately upheld, the Company could incur up to \$10.4 million of indemnification expense in future periods on its Statements of Operations, partially offset by any reduction to the CVRs liability. Management believes it is more likely than not that the Company's position will be upheld and a \$10.4 million tax receivable for the expected refund is recorded in other assets on the Condensed Consolidated Balance Sheets as of March 31, 2011.

From time to time, the Company may enter into firm purchase commitments for printed materials included in inventory which the Company expects to use in the ordinary course of business. These commitments are typically for terms less than one year and require the Company to buy minimum quantities of materials with specific delivery dates at a fixed price over the term. As of March 31, 2011, these open purchase commitments totaled \$3.7 million.

The Company has letters of credit outstanding as of March 31, 2011 in the amount of \$2.9 million to support workers compensation insurance coverage, certain credit card programs, the build-to-suit lease, and performance bonds for certain contracts. The Company maintains a \$1.1 million certificate of deposit as collateral for the workers compensation insurance and credit card program letters of credit and for Automated Clearinghouse (ACH) programs. The Company also maintains a \$0.9 million money market fund investment as collateral for a travel card program. The certificate of deposit and money market fund investment are recorded in other assets.

**Note 15 Long-Term Debt**

Long-term debt consists the following at March 31, 2011 and December 31, 2010:

| <i>(in thousands)</i>                                                                                | <b>March 31,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|------------------------------------------------------------------------------------------------------|---------------------------|------------------------------|
| \$175.0 million of 9.75% senior secured notes due February 15, 2017, interest payable semiannually   | \$ 175,000                | \$                           |
| Less: Unamortized discount                                                                           | (957)                     |                              |
| Total 9.75% senior secured notes                                                                     | 174,043                   |                              |
| \$128.0 million of floating rate senior secured notes due April 11, 2013, interest payable quarterly |                           | 95,408                       |
| \$64.2 million of 13.75% senior unsecured notes due April 11, 2014, interest payable quarterly       |                           | 56,722                       |
|                                                                                                      | 174,043                   | 152,130                      |
| Less: Current portion of long-term debt                                                              |                           | (1,280)                      |
| Total long-term debt                                                                                 | \$ 174,043                | \$ 150,850                   |

On February 17, 2011, the Company closed an offering of \$175 million aggregate principal amount of 9.75% senior secured notes due 2017 (the Notes ) and entered into a new asset-based revolving credit facility with potential for up to \$40 million in borrowing capacity. The Company used a portion of the net proceeds from the offering to repay in full outstanding indebtedness under the Company's senior facility and senior unsecured notes that existed as of yearend 2010 and to pay related fees and expenses. Total fees incurred in the closing of the Notes and revolving credit facility are expected to total \$9.1 million, including \$1.75 million paid to an affiliate of Veronis Suhler Stevenson (VSS) pursuant to the consulting fee agreement between the Company and VSS. Deferred financing costs are capitalized in other assets in the condensed consolidated balance sheets, net of accumulated amortization, and are to be amortized over the term of the related debt using the effective interest method. Unamortized capitalized deferred financing costs at March 31, 2011 were \$8.8 million.



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The Offering was a private placement exempt from the registration requirements under the Securities Act of 1933 (the Securities Act ). Interest on the Notes will accrue at a rate of 9.75% per annum from the date of original issuance and will be payable semi-annually in arrears on each February 15 and August 15, commencing on August 15, 2011, to the holders of record of the Notes on the immediately preceding February 1 and August 1. No principal repayments are due until the maturity date of the Notes.

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

*Registration Rights Agreement.* In connection with the Offering, the Company entered into a Registration Rights Agreement that requires that the Company (i) file with the SEC within 180 days after the issue date of the Notes (or February 17, 2011), a registration statement under the Securities Act (the Exchange Offer Registration Statement ), relating to an offer to exchange the Notes (the Exchange Offer ) for new notes (the Exchange Notes ) on terms substantially identical to the Notes, except that the Exchange Notes will not be subject to the same restrictions on transfer; (ii) use commercially reasonable efforts to cause the Exchange Offer Registration Statement to become effective within 270 days after the date of the Notes; and (iii) within 60 days of the Exchange Offer Registration Statement becoming effective, complete the Exchange Offer and issue the Exchange Notes in exchange for all Notes validly tendered in the Exchange Offer.

In May 2011, the Company filed the Exchange Offer Registration Statement with the SEC and anticipates the Exchange Offer Registration Statement becoming effective and the Exchange Notes being issued within the prescribed deadlines set forth in the Registration Rights Agreement.

*New Credit Facility (ABL Facility).* On February 17, 2011, the Company's wholly owned subsidiary, Cambium Learning, Inc. (together with its wholly owned subsidiaries, the ABL Credit Parties ), entered into the New Credit Facility (the ABL Facility ) pursuant to a Loan and Security Agreement (the ABL Loan Agreement ), by and among the ABL Credit Parties, Harris N.A., individually and as Agent for any ABL Lender (as hereinafter defined) which is or becomes a party to said ABL Loan Agreement, certain other lenders party thereto (together with Harris N. A. in its capacity as a lender, the ABL Lenders ), Barclays Bank PLC, individually and as Collateral Agent, and BMO Capital Markets and Barclays Capital, as Joint Lead Arrangers and Joint Book Runners. The ABL Facility consists of a four-year \$40.0 million revolving credit facility, which includes a \$5.0 million subfacility for swing line loans and a \$5.0 million subfacility for letters of credit. In addition, the ABL Facility provides that the ABL Credit Parties may increase the aggregate principal amount of the ABL Facility by up to an additional \$20.0 million, subject to the consent of the Agent (whose consent shall not be unreasonably withheld) and subject to the satisfaction of certain other conditions.

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

As of March 31, 2011, the balances of accounts receivable and inventory collateralizing the ABL Facility were \$14.1 million and \$26.5 million, respectively. This resulted in a borrowing base under the ABL Loan Agreement of up to \$20.1 million.

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

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

**Note 16 Segment Reporting**

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

***Voyager:***

Voyager offers reading, math and professional development programs targeted towards the at-risk and special education student populations. Voyager materials, offered online and via print, are tailored to meet the needs of these students and differ considerably from traditional instructional materials in design, approach and intensity. Lessons are based on scientific research and are carefully designed to effectively and efficiently address each of the strategies and skills necessary to improve the abilities of struggling students.

***Sopris:***

Sopris focuses on providing a diverse, yet comprehensive, collection of printed and electronic supplemental education materials to complement core programs and to provide intense remediation aimed at specific skill deficits. When compared to products offered by the Company's other business units, Sopris products tend to be more narrowly-tailored and target a smaller, more specific audience.

***Cambium Learning Technologies:***

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

***Other:***

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

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

|                                               | Voyager   | Sopris   | Cambium<br>Learning<br>Technologies | Other       | Consolidated |
|-----------------------------------------------|-----------|----------|-------------------------------------|-------------|--------------|
| Quarter Ended March 31, 2011                  |           |          |                                     |             |              |
| Net revenues                                  | \$ 14,692 | \$ 4,185 | \$ 11,818                           | \$          | \$ 30,695    |
| Cost of revenues                              | 7,993     | 1,670    | 1,223                               | 81          | 10,967       |
| Amortization                                  |           |          |                                     | 6,618       | 6,618        |
| Total cost of revenues                        | 7,993     | 1,670    | 1,223                               | 6,699       | 17,585       |
| Other operating expenses                      | 7,593     | 2,316    | 5,161                               | 4,358       | 19,428       |
| Embezzlement and related expense (recoveries) |           |          |                                     | (2,436)     | (2,436)      |
| Depreciation and amortization                 |           |          |                                     | 1,736       | 1,736        |
| Net interest expense                          |           |          |                                     | 4,405       | 4,405        |
| Other income, net                             |           |          |                                     | (363)       | (363)        |
| Income tax expense                            |           |          |                                     | 97          | 97           |
| Segment net income (loss)                     | \$ (894)  | \$ 199   | \$ 5,434                            | \$ (14,496) | \$ (9,757)   |
| Quarter Ended March 31, 2010                  |           |          |                                     |             |              |
| Net revenues                                  | \$ 15,872 | \$ 3,903 | \$ 8,447                            | \$          | \$ 28,222    |
| Cost of revenues                              | 7,070     | 1,587    | 1,496                               | 1,159       | 11,312       |
| Amortization                                  |           |          |                                     | 6,742       | 6,742        |
| Total cost of revenues                        | 7,070     | 1,587    | 1,496                               | 7,901       | 18,054       |
| Other operating expenses                      | 9,108     | 1,986    | 4,378                               | 7,077       | 22,549       |
| Embezzlement and related expense              |           |          |                                     | 19          | 19           |
| Depreciation and amortization                 |           |          |                                     | 2,577       | 2,577        |
| Net interest expense                          |           |          |                                     | 4,368       | 4,368        |
| Other income, net                             |           |          |                                     | 10          | 10           |
| Income tax expense                            |           |          |                                     | 85          | 85           |
| Segment net income (loss)                     | \$ (306)  | \$ 330   | \$ 2,573                            | \$ (22,037) | \$ (19,440)  |

**Note 17 Embezzlement**

On April 26, 2008, the Company began an internal investigation that revealed irregularities over the control and use of cash and certain other general ledger accounts of the Company, revealing a misappropriation of assets. These irregularities were perpetrated by a former employee over more than a three-year period beginning in 2004 and continuing through April 2008 and the losses incurred by the Company totaled \$14.0 million. Charges included in the condensed consolidated statement of operations after April 2008 represent expenses incurred by the Company to recover property purchased by the former employee using the embezzled funds, net of any recoveries.

During the three months ended March 31, 2011, the Company received cash recoveries of \$0.5 million and title to two properties purchased by the former employee with embezzled funds that have an appraised fair value of approximately \$2.6 million, net of estimated selling costs, as of March 31, 2011. These recoveries were recorded as reductions to Embezzlement and related expense (recoveries) in the condensed consolidated statements of operations and the properties are recorded in the condensed consolidated balance sheets as Assets Held for Sale. Ongoing expenses incurred related to the Company's recovery efforts totaled \$0.1 million during the quarter.

Warrants to purchase 36,531 shares of the Company's stock were issued to VSS-Cambium Holdings III, LLC as a result of the cash recoveries during the quarter. Upon the sale of the recovered properties the Company will be required to issue additional warrants based on the amount of cash received, net of related expenses. The number of warrants to be issued will equal 0.45 multiplied by the quotient of the net cash recovery divided by \$6.50. The Company will be obligated to issue these warrants upon the sale of the properties; therefore an estimated liability of \$0.6 million has been recorded as Embezzlement and related expense (recoveries) in the condensed consolidated statements of operations and Accrued expenses in the condensed consolidated balance sheets.

The charges incurred in the quarter ended March 31, 2010 relate solely to the Company's ongoing recovery efforts.

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**Note 18 Subsequent Events**

During May 2011, the Company filed a registration statement on Form S-4 to register the Exchange Notes described in Note 15. The terms of the Exchange Notes are substantially identical to the terms of the Notes in all material respects, including interest rates and maturity, except that the Exchange Notes: (i) will not contain transfer restrictions and registration rights that relate to the Notes, and (ii) will not contain provisions relating to the payment of the additional interest to be paid to the holders of the Notes under circumstances related to the registration of the Notes, as set forth in the related Registration Rights Agreement. The Company will not receive any additional proceeds from the Exchange Offer.

During May 2011, the Company filed a registration statement on Form S-3 to register 24,934,692 shares of common stock (including 596,668 shares of common stock underlying warrants) beneficially held by its majority shareholder. After the effective date of the registration statement, these shares may be sold on the principal market on which the stock is traded at the prevailing market price or in negotiated transactions. The Company will not receive proceeds from the stockholder as a result of the registration of these shares. The Company may receive proceeds from the issuance of the shares of common stock being registered pursuant to the registration statement in connection with the exercise of the warrants, if and when they are exercised, unless such warrants are exercised on a cashless basis.

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

This section should be read in conjunction with the audited Consolidated Financial Statements of Cambium Learning Group, Inc. and its subsidiaries (the Company, we, us, or our ) and the notes thereto included in our Annual Report Form 10-K for the year ended December 31, 2010.

**Cautionary Note Regarding Forward-looking Statements.**

This report contains forward-looking statements within the meaning of the federal securities laws that involve risks and uncertainties, and which are based on beliefs, expectations, estimates, projections, forecasts, plans, anticipations, targets, outlooks, initiatives, visions, objectives, strategies, opportunities, drivers and intents of our management. Such statements are made in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact included in this report, including statements regarding our future financial position, economic performance and results of operations, as well as our business strategy, objectives of management for future operations, and the information set forth under Management's Discussion and Analysis of Financial Condition and Results of Operations, are forward-looking statements.

Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as believes, expects, estimates, projects, forecasts, plans, anticipates, targets, outlooks, visions, objectives, strategies, opportunities, drivers, intends, scheduled to, seeks, may, will, or of those terms, or other variations of those terms or comparable language, or by discussions of strategy, plans, targets, models or intentions. Forward-looking statements speak only as of the date they are made, and except for our ongoing obligations under the federal securities laws, we undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events, or otherwise, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements. Accordingly, you are cautioned that any such forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Although we believe that the expectations reflected in such forward-looking statements are reasonable as of the date made, expectations may prove to have been materially different from the results expressed or implied by such forward-looking statements, as it is impossible for us to anticipate all factors that could affect our actual results. These risks and uncertainties include, but are not limited to, those described in Risk Factors in Part II, Item 1A and elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2010, and those described from time to time in our future reports filed with the SEC. Unless otherwise required by law, we also disclaim any obligation to update our view of any such risks or uncertainties or to announce publicly the results of any revisions to the forward-looking statements made in this report.

**Our Company**

We are one of the largest providers of proprietary intervention curricula, educational technologies and other research-based education solutions for students in the Pre-K through 12<sup>th</sup> grade education market in the United States. The intervention market where we focus provides supplemental education solutions to at-risk and special education students. We offer a distinctive blended intervention solution that combines different forms of current instruction techniques, including text books, education games, data management and e-learning. We believe that our approach builds a more effective learning environment that combines teacher-led instruction and technology and that this approach sets us apart from our competitors as we believe it has proven to better engage at-risk students, leading to more favorable results. Our solutions are designed to enable the most challenged learners to achieve their potential by utilizing a range of content that primarily focuses on reading and math.

Our mission is to deliver educational solutions that enable students to reach grade level academic standards. We take a holistic approach to learning and our intervention solutions address both the behavioral and cognitive needs of the students we serve. We believe our focus on the Pre-K through 12<sup>th</sup> grade intervention market and our significantly greater scale and scope of operations compared to those companies primarily focused on the intervention market gives us a competitive edge relative to our peers. Further, our products and services are highly results-oriented and enable school districts and parents across the country to improve student performance and better satisfy rigorous accountability standards.





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Our primary business units include:

Voyager, our comprehensive intervention business;

Sopris, our supplemental solutions education business; and

Cambium Learning Technologies, our technology-based education product business.

Unallocated shared services, such as accounting, legal, human resources and corporate related items, are recorded in a Shared Services category. Depreciation and amortization expense, goodwill impairment, interest income and expense, other income and expense, and taxes are included in this category.

**Overview**

We continue to experience adverse conditions in the education funding environment as a result of the continued depressed circumstance of certain state and local budgets. As school districts rely upon state and local budgets, some of our customers have found it difficult to secure alternative funding sources in the midst of these market conditions. Additionally, potential customers are more frequently utilizing a request for proposal process to complete purchases, which elongates the time required to complete a sale.

We have experienced some positive impact, both directly and indirectly, from the American Reinvestment and Recovery Act (ARRA) passed in February 2009. The ARRA provides significant new federal funding for various education initiatives through September 2011. While the education funding is for a broad set of education initiatives, we believe that schools and districts have directed, and may continue to direct, some of the new funding for programs that use our products and services. In some instances, if ARRA funding is not used directly for programs using our products, we may still be receiving an indirect benefit. When the ARRA funding is used to assist schools to meet their overall financial needs, other funds may be freed up to use for our programs. To date we have had some success in securing orders which are funded by ARRA funds, but not to a level that has been needed to offset declines. As a result of these various market forces, we have experienced a decline in order volume in the first three months of 2011 when compared with the first three months of 2010. Order volume is an internal metric of shipments of our products and orders for online subscriptions and it serves as a leading indicator of sales.

The following trends have had or may have an impact on our sales, profitability and EBITDA:

Declines have been realized in our internal order volume metric due to budgetary pressures resulting from the economic crisis faced by many states and local entities and intense competition. To some extent, we expect the crisis will continue throughout the following quarters and have a continued depressive effect on general spending and, therefore, make order volume growth challenging.

We expect continued growth in our online subscription-based products and our Sopris supplemental education materials.

We have experienced a trend of success growing our portfolio to address the math needs of the market, including products such as Vmath, Transitional Math and Gizmos (ExploreLearning).

We believe our product diversification will strengthen our ability to sustain market share in a troubled market and capture market share when the market recovers.

We believe our focus on student outcomes through product usage and an overall partnership approach with the customer to implement our solutions, in the manner that the program was designed, results in higher student success rates, and such success, if achieved, will lead to customer retention and growth through reference sales.

We believe there is a trend of student accountability resulting in greater funding being directed to at-risk children in the United States with new funding sources, such as Race to the Top, which could provide additional funds for our products and services.

In 2010, we achieved significant cost savings as part of an effort to achieve merger related synergies, which included a reduction in force. We will continue to reduce costs through productivity initiatives and process reengineering and redeploy those savings into growth investments, but the magnitude of the reductions in 2010 are not expected to be replicated.

We will focus on several key areas in 2011, including: continued investment in our digital assets such as ExploreLearning, Learning A-Z, Ticket To Read, VocabJourney and Sopris; emphasizing our new adaptive math programs; designing and launching an online individualized intervention curriculum; and investment in our student data management system.

We expect to benefit from continuity of our leadership team and sales organization, who have now worked together for more than a year.

**Table of Contents****First Quarter of Fiscal 2011 Compared to the First Quarter of Fiscal 2010**

| <i>(in thousands)</i>                                         | <b>Three Months Ended</b> |                   |                       |                   | <b>Year Over Year</b>          |              |
|---------------------------------------------------------------|---------------------------|-------------------|-----------------------|-------------------|--------------------------------|--------------|
|                                                               | <b>March 31, 2011</b>     |                   | <b>March 31, 2010</b> |                   | <b>Change</b>                  |              |
|                                                               | <b>Amount</b>             | <b>% of Sales</b> | <b>Amount</b>         | <b>% of Sales</b> | <b>Favorable/(Unfavorable)</b> | <b>%</b>     |
| Net revenues:                                                 |                           |                   |                       |                   |                                |              |
| Voyager                                                       | \$ 14,692                 | 47.9%             | \$ 15,872             | 56.2%             | \$ (1,180)                     | (7.4)%       |
| Sopris                                                        | 4,185                     | 13.6%             | 3,903                 | 13.8%             | 282                            | 7.2%         |
| Cambium Learning Technologies                                 | 11,818                    | 38.5%             | 8,447                 | 29.9%             | 3,371                          | 39.9%        |
| <b>Total net revenues</b>                                     | <b>30,695</b>             | <b>100.0%</b>     | <b>28,222</b>         | <b>100.0%</b>     | <b>2,473</b>                   | <b>8.8%</b>  |
| Cost of revenues:                                             |                           |                   |                       |                   |                                |              |
| Voyager                                                       | 7,993                     | 26.0%             | 7,070                 | 25.1%             | (923)                          | (13.1)%      |
| Sopris                                                        | 1,670                     | 5.4%              | 1,587                 | 5.6%              | (83)                           | (5.2)%       |
| Cambium Learning Technologies                                 | 1,223                     | 4.0%              | 1,496                 | 5.3%              | 273                            | 18.2%        |
| Shared Services                                               | 81                        | 0.3%              | 1,159                 | 4.1%              | 1,078                          | 93.0%        |
| Amortization expense                                          | 6,618                     | 21.6%             | 6,742                 | 23.9%             | 124                            | 1.8%         |
| <b>Total cost of revenues</b>                                 | <b>17,585</b>             | <b>57.3%</b>      | <b>18,054</b>         | <b>64.0%</b>      | <b>469</b>                     | <b>2.6%</b>  |
| Research and development expense                              | 2,379                     | 7.8%              | 3,010                 | 10.7%             | 631                            | 21.0%        |
| Sales and marketing expense                                   | 10,903                    | 35.5%             | 11,057                | 39.2%             | 154                            | 1.4%         |
| General and administrative expense                            | 5,812                     | 18.9%             | 7,938                 | 28.1%             | 2,126                          | 26.8%        |
| Shipping and handling costs                                   | 334                       | 1.1%              | 544                   | 1.9%              | 210                            | 38.6%        |
| Depreciation and amortization expense                         | 1,736                     | 5.7%              | 2,577                 | 9.1%              | 841                            | 32.6%        |
| Embezzlement and related expense (recoveries)                 | (2,436)                   | (7.9)%            | 19                    | 0.1%              | 2,455                          | 12921.1%     |
| Loss before interest, other income (expense) and income taxes | (5,618)                   | (18.3)%           | (14,977)              | (53.1)%           | 9,359                          | 62.5%        |
| Net interest expense                                          | (4,405)                   | (14.4)%           | (4,368)               | (15.5)%           | (37)                           | (0.8)%       |
| Other income (expense), net                                   | 363                       | 1.2%              | (10)                  | (0.0)%            | 373                            | 3730.0%      |
| Income tax expense                                            | (97)                      | (0.3)%            | (85)                  | (0.3)%            | (12)                           | (14.1)%      |
| <b>Net loss</b>                                               | <b>\$ (9,757)</b>         | <b>(31.8)%</b>    | <b>\$ (19,440)</b>    | <b>(68.9)%</b>    | <b>\$ 9,683</b>                | <b>49.8%</b> |

*Net Revenues.*

Our total net revenues increased \$2.5 million, or 8.8%, to \$30.7 million in the first quarter of 2011 compared to the same period in 2010. This change was impacted by a purchase accounting adjustment made to reduce deferred revenue balances to fair value at the time of the VLCY acquisition which reduced the amount of deferred revenue that would have been recognized by approximately \$0.3 million in the first quarter of 2011 and approximately \$5.2 million in the first quarter of 2010. Additionally, we experienced a decline in order volume as many school districts are awaiting final budget approvals for fiscal 2011 before making purchases.

*Voyager.* The Voyager segment's net revenues decreased \$1.2 million, or 7.4%, to \$14.7 million in the first quarter of 2011 compared to the same period in 2010 due to a decline in order volume. Additionally, a purchase accounting adjustment made to reduce deferred revenue balances to fair value at the time of the VLCY acquisition decreased the amount of deferred revenue that would have been recognized by approximately \$0.1 million in the first quarter of 2011 and approximately \$2.1 million in the first quarter of 2010.

*Sopris.* The Sopris segment's net revenues increased \$0.3 million, or 7.2%, to \$4.2 million in the first quarter of 2011 compared to the same period in 2010, which is attributable to increased order volume. We attribute this growth to investments made in products, sales and marketing for this segment in 2010 and into 2011.

*Cambium Learning Technologies.* The Cambium Learning Technologies segment's net revenues increased \$3.4 million, or 39.9%, to \$11.8 million in the first quarter of 2011 compared to the same period in 2010. A purchase accounting adjustment to reduce deferred revenue balances to fair value at the time of the VLCY acquisition decreased the amount of deferred revenue that would have been recognized by approximately \$0.2 million in the first quarter of 2011 and approximately \$3.1 million in the first quarter of 2010.

**Table of Contents***Cost of Revenues.*

Cost of revenues includes expenses to print, purchase, handle and warehouse our products, as well as royalty costs, and to provide services and support to customers. Cost of revenues, excluding amortization, decreased \$0.3 million, or 3.0%, to \$11.0 million in the first quarter of 2011 compared to the same period in 2010 due to a decline in order volume and the impact of a purchase accounting adjustment at the time of the VLCY acquisition to reduce deferred costs to zero which reduced the cost of revenues recorded in the first quarter of 2010 by approximately \$0.4 million. These factors were partially offset by an increase in product implementation and support costs.

*Voyager.* Cost of revenues for the Voyager segment increased \$0.9 million, or 13.1%, to \$8.0 million in the first quarter of 2011 compared to the same period in 2010. This increase was due to increased product implementation and support costs and the impact of a purchase accounting adjustment at the time of the VLCY acquisition to reduce deferred costs to zero which reduced the cost of revenues recorded in the first quarter of 2010 by approximately \$0.4 million. These increases more than offset the impact of a decline in order volumes.

*Sopris.* Cost of revenues for the Sopris segment increased by \$0.1 million, or 5.2%, to \$1.7 million in the first quarter of 2011 compared to the same period in 2010 commensurate with the increase in order volume.

*Cambium Learning Technologies.* Cost of revenues for the Cambium Learning Technologies segment decreased by \$0.3 million, or 18.2%, to \$1.2 million in the first quarter of 2011 compared to the same period in 2010 primarily due to a one-time royalty expense adjustment of \$0.4 million in the first quarter of 2010 that was not repeated in the first quarter of 2011.

*Shared Services.* Cost of revenues for Shared Services for the first quarter of 2011 of \$0.1 million is primarily related to the costs incurred to maintain our customer-facing software applications. The charges incurred in the first quarter of 2010 primarily related to non-recurring integration costs, which were not allocated to the segments. The integration costs primarily related to the movement of inventory from VLCY's distribution center in Dallas, Texas, to our distribution facility in Frederick, Colorado, travel related to the warehouse integration and severance costs.

*Amortization Expense.*

Amortization expense included in cost of revenues includes amortization for acquired pre-publication costs and technology, acquired publishing rights, and developed pre-publication and technology. Amortization for the first quarter of 2011 decreased \$0.1 million compared to the first quarter of 2010, or 1.8%, primarily due to the fact that a majority of our intangible assets are amortized using accelerated methodologies.

*Research and Development Expense.*

Research and development expenditures include costs to research, evaluate and develop educational products, net of capitalization. Research and development expense for the first quarter of 2011 decreased \$0.6 million, or 21.0%, to \$2.4 million compared to the first quarter of 2010 primarily due to increased capitalization due to the timing of capitalizable versus non-capitalizable activities. Additionally, the first quarter of 2010 included non-recurring integration costs of approximately \$0.2 million.

*Sales and Marketing Expense.*

Sales and marketing expenditures include all costs to maintain our various sales channels, including the salaries and commissions paid to our sales force, and costs related to our advertising and marketing efforts. Sales and marketing expense for the first quarter of 2011 decreased \$0.2 million, or 1.4%, from the first quarter of 2010 to \$10.9 million due to a decline in non-recurring integration costs partially offset by increased stock-based compensation and travel-related expenses, as a larger portion of our sales force has been allocated to field sales.

*General and Administrative Expense.*

General and administrative expenses decreased \$2.1 million, or 26.8%, to \$5.8 million compared to the first quarter of 2010 due to a decline in non-recurring integration costs of \$1.9 million. The remaining decline in general and administrative expense from the first quarter of 2010 is due to synergies achieved from the VLCY merger slightly offset by \$0.3 million recorded for an increase in the estimated CVR liability.

**Table of Contents***Net Interest Expense.*

Net interest expense was \$4.4 million in the quarters ended March 31, 2011 and 2010 as an increase in interest expense related to our long-term debt was offset by an increase in interest income recognized for our state tax receivables.

*Income Tax Provision.*

We recorded income tax expense of \$0.1 million during the first quarter of 2011 and the first quarter of 2010 for state income tax expense in states where the Company cannot file on a unitary basis. We did not record a Federal or state income tax benefit for consolidated losses incurred during either period because realization of the tax benefits from the losses is not assured beyond a reasonable doubt given the Company's recent history of cumulative losses.

Therefore the increases in net deferred tax assets in the periods were offset by increases in the valuation allowance.

**Liquidity and Capital Resources**

Because sales seasonality affects operating cash flow, we normally incur a net cash deficit from all of our activities through the early part of the third quarter of the year. We typically fund these seasonal deficits through the drawdown of cash, supplemented by borrowings on a revolving credit facility, if needed. The primary source of liquidity is cash flow from operations and the primary liquidity requirements relate to interest on our long-term debt, pre-publication costs, capital investments and working capital. We believe that based on current and anticipated levels of operating performances, cash flow from operations and availability under a revolving credit facility, we will be able to make required interest payments on our debt and fund our working capital and capital expenditure requirements for the next 12 months.

***Long-term debt***

**9.75% Senior Secured Notes.** On February 17, 2011, we completed the offering (the *Offering*) of \$175 million aggregate amount of 9.75% Senior Secured Notes (the *Notes*). After the issuance discount, we received proceeds of 99.442% of the aggregate offering price, or \$174 million. The Notes will mature on February 15, 2017. The Offering was a private placement exempt from the registration requirements under the Securities Act. We used a portion of the net proceeds from the sale of the Notes to repay in full outstanding indebtedness under our existing secured credit facility and senior unsecured notes and to pay related fees and expenses. Interest on the Notes will accrue at a rate of 9.75% per annum from the date of original issuance and will be payable semi-annually in arrears on each February 15 and August 15, commencing on August 15, 2011, to the holders of record of the Notes on the immediately preceding February 1 and August 1. Pursuant to a Registration Rights Agreement entered into in connection with the Offering, we have agreed to file a registration statement with the SEC that would enable holders of the Notes to exchange the privately placed Notes for publicly registered notes with substantially identical terms. The Notes are secured by (i) a first priority lien on substantially all of our assets (other than inventory and accounts receivable and related assets of the ABL Credit Parties in connection with the ABL Facility (each as defined and discussed below) and subject to certain exceptions), including capital stock of the guarantors (which are certain of the Company's subsidiaries), and (ii) a second-priority lien on substantially all of the inventory and accounts receivable and related assets of the ABL Credit Parties, in each case, subject to certain permitted liens. The Notes also contain customary covenants, including limitations on our ability to incur debt, and events of default as defined by the indenture governing the Notes. We may, at our option, redeem the Notes prior to their maturity based on the terms included in the indenture governing the Notes.

**Registration Rights Agreement.** In connection with the Offering, we entered into a Registration Rights Agreement that requires us to (i) file with the SEC within 180 days after the issue date of the Notes (or February 17, 2011), a registration statement under the Securities Act (the *Exchange Offer Registration Statement*), relating to an offer to exchange the Notes (the *Exchange Offer*) for new notes (the *Exchange Notes*) on terms substantially identical to the Notes, except that the Exchange Notes will not be subject to the same restrictions on transfer; (ii) use commercially reasonable efforts to cause the Exchange Offer Registration Statement to become effective within 270 days after the date of the Notes; and (iii) within 60 days of the Exchange Offer Registration Statement becoming effective, complete the Exchange Offer and issue the Exchange Notes in exchange for all Notes validly tendered in the Exchange Offer.



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In May 2011, the Company filed the Exchange Offer Registration Statement with the SEC and anticipates the Exchange Offer Registration Statement becoming effective and the Exchange Notes being issued within the prescribed deadlines set forth in the Registration Rights Agreement.

*New Credit Facility (ABL Facility).* On February 17, 2011, our wholly owned subsidiary, Cambium Learning, Inc. (together with its wholly owned subsidiaries, the ABL Credit Parties ), entered into a new asset-backed revolving credit facility (the ABL Facility ) pursuant to a Loan and Security Agreement (the ABL Loan Agreement ), by and among the ABL Credit Parties, Harris N.A., individually and as Agent for any ABL Lender (as hereinafter defined) which is or becomes a party to said ABL Loan Agreement, certain other lenders party thereto (together with Harris N. A. in its capacity as a lender, the ABL Lenders ), Barclays Bank PLC, individually and as Collateral Agent, and BMO Capital Markets and Barclays Capital, as Joint Lead Arrangers and Joint Book Runners. The ABL Facility consists of a four-year \$40.0 million revolving credit facility, which includes a \$5.0 million subfacility for swing line loans and a \$5.0 million subfacility for letters of credit. In addition, the ABL Facility provides that the ABL Credit Parties may increase the aggregate principal amount of the ABL Facility by up to an additional \$20.0 million, subject to the consent of the Agent (whose consent shall not be unreasonably withheld) and subject to the satisfaction of certain other conditions specified in the ABL Facility.

As the ABL Facility's borrowing base is determined by eligible inventory and eligible accounts receivable, seasonality will cause the available amount to fluctuate. The balances of accounts receivable and inventory collateralizing the ABL facility as of March 31, 2011 were \$14.1 million and \$26.5 million, respectively. As of March 31, 2011, we have a borrowing base under the ABL Loan Agreement of up to \$20.1 million.

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

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

The ABL Facility contains a financial covenant that generally requires the ABL Credit Parties to maintain, on a consolidated basis, either (i) excess availability of at least the greater of \$8 million and 15% of the revolver commitment or (ii) a fixed charge coverage ratio of 1.1 to 1.0. The ABL Credit Parties will be required to pay, quarterly in arrears, an unused line fee equal to the product of (x) either 0.375% or 0.50% (depending upon the ABL Credit Parties' fixed charge coverage ratio at the time) and (y) the average daily unused amount of the revolver. As of March 31, 2011, we were in compliance with this covenant.



**Table of Contents*****Cash flows***

Cash from operations is seasonal, with more cash generated in the second half of the year than in the first half of the year. Cash is historically generated during the second half of the year because the buying cycle of school districts generally starts at the beginning of each new school year in the fall. Cash provided by (used in) our operating, investing and financing activities is summarized below:

| <i>(in thousands)</i> | Three Months Ended March 31, |            |
|-----------------------|------------------------------|------------|
|                       | 2011                         | 2010       |
| Operating activities  | \$ (3,444)                   | \$ (6,982) |
| Investing activities  | (3,354)                      | (2,101)    |
| Financing activities  | 14,461                       | 4,535      |

*Operating activities.* Cash used in operations was \$3.4 million and \$7.0 million for the three month periods ended March 31, 2011 and 2010, respectively. Overall, cash used in operations was \$3.5 million lower in 2011 due to collection in the first quarter of significant accounts receivable balances outstanding at year end 2010 and the impact of significant merger-related costs incurred in the first quarter of 2010.

*Investing activities.* Cash used in investing activities for capital expenditures was \$3.4 million in the first quarter of 2011 compared to \$2.1 million in the first quarter of 2010.

*Financing activities.* Cash provided by financing activities was \$14.5 million in the first quarter of 2011 and \$4.5 million in the first quarter of 2010. Net proceeds received from the issuance of the 9.75% senior secured notes in February 2011 was \$174 million offset by repayment of \$152.1 million of existing notes and payments of \$7.3 million related to the debt financing. During the first quarter of 2010, we borrowed \$5 million under a revolving credit facility and made a principal payment of \$0.3 million.

***Contingencies***

As previously reported in our Annual Report on Form 10-K for the year ended December 31, 2010, the Company is involved in a tax litigation matter related to a Michigan state tax issue. The final resolution of the tax litigation or potential settlement could result in a refund ranging from zero to approximately \$10.4 million of which fifty percent (50%), net of expenses incurred, would be payable to the holders of the CVRs. If the Company's position is not ultimately upheld, the Company could incur up to \$10.4 million of indemnification expense in future periods on its Statements of Operations, partially offset by any reduction to the CVRs liability. Management believes it is more likely than not that the Company's position will be upheld and a \$10.4 million tax receivable for the expected refund is recorded in other assets on the Condensed Consolidated Balance Sheets as of March 31, 2011.

**Non-GAAP Measures**

The net losses for the Company as reported on a GAAP basis for both 2011 and 2010 include material non-recurring and non-operational items. We believe that earnings (loss) from operations before interest and other income (expense), income taxes, and depreciation and amortization, or EBITDA, and Adjusted EBITDA, which further excludes non-recurring and non-operational items, provide useful information for investors to assess the results of the ongoing business of the Company.

EBITDA and Adjusted EBITDA are not prepared in accordance with GAAP and may be different from similarly named, non-GAAP financial measures used by other companies. Non-GAAP financial measures should not be considered a substitute for, or superior to, measures of financial performance prepared in accordance with GAAP. We believe that Adjusted EBITDA provides useful information to investors because it reflects the underlying performance of the ongoing operations of the Company and provides investors with a view of the Company's operations from management's perspective. Adjusted EBITDA removes significant one-time or certain non-cash items from earnings. We use Adjusted EBITDA to monitor and evaluate the operating performance of the Company and as the basis to set and measure progress towards performance targets, which directly affect compensation for employees and executives. We generally use these non-GAAP measures as measures of operating performance and not as measures of liquidity. Our presentation of EBITDA and Adjusted EBITDA should not be construed as an indication that our future results will be unaffected by unusual or nonrecurring items.



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Below are reconciliations between net loss and Adjusted EBITDA for the three month periods ended March 31, 2011 and 2010:

**Reconciliation Between Net Revenues to Adjusted Net Revenues and Between Net Loss and Adjusted EBITDA for the Three Months Ended March 31, 2011 and 2010**

|                                                                                                                                    | <b>Three Months Ended March</b> |             |
|------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|-------------|
|                                                                                                                                    | <b>31,</b>                      |             |
|                                                                                                                                    | <b>2011</b>                     | <b>2010</b> |
|                                                                                                                                    | <i>(In thousands)</i>           |             |
|                                                                                                                                    | <i>(Unaudited)</i>              |             |
| Total net revenues                                                                                                                 | \$ 30,695                       | \$ 28,222   |
| Non-recurring and non-operational costs included in net revenues but excluded from adjusted net revenues:                          |                                 |             |
| Adjustments related to purchase accounting <sup>(a)</sup>                                                                          | 332                             | 5,152       |
| Adjusted net revenues                                                                                                              | \$ 31,027                       | \$ 33,374   |
| Net loss                                                                                                                           | \$ (9,757)                      | \$ (19,440) |
| Reconciling items between net loss and EBITDA:                                                                                     |                                 |             |
| Depreciation and amortization                                                                                                      | 8,354                           | 9,319       |
| Net interest expense                                                                                                               | 4,405                           | 4,368       |
| Other (income) expense                                                                                                             | (363)                           | 10          |
| Income tax                                                                                                                         | 97                              | 85          |
| Income (loss) from operations before interest and other income (expense), income taxes, and depreciation and amortization (EBITDA) | 2,736                           | (5,658)     |
| Non-recurring, non-operational, and certain non-cash costs included in EBITDA but excluded from Adjusted EBITDA:                   |                                 |             |
| Integration and merger-related costs <sup>(b)</sup>                                                                                |                                 | 3,443       |
| Legacy VLCY corporate <sup>(c)</sup>                                                                                               | 311                             | 300         |
| Stock-based compensation and expense <sup>(d)</sup>                                                                                | 290                             | 234         |
| Embezzlement and related expenses (recoveries) <sup>(e)</sup>                                                                      | (2,436)                         | 19          |
| Adjustments related to purchase accounting <sup>(a)</sup>                                                                          | 288                             | 4,359       |
| Adjustments to CVR liability <sup>(f)</sup>                                                                                        | 308                             |             |
| Adjusted EBITDA                                                                                                                    | \$ 1,497                        | \$ 2,697    |

- (a) Under applicable accounting guidance for business combinations, an acquiring entity is required to recognize all of the assets acquired and liabilities assumed in a transaction at the acquisition date fair value. Net revenues have been reduced by \$0.3 million and \$5.2 million, respectively, for the quarters ended March 31, 2011 and 2010 in the historical financial statements due to the write-down of deferred revenue to its estimated fair value as of the merger date. The write-down was determined by estimating the cost to fulfill the related future customer obligations plus a normal profit margin. Partially offsetting this impact, cost of revenues and sales and marketing expenses were reduced for other purchase accounting adjustments, primarily a write-down of deferred costs to

zero at the acquisition date. During the quarters ended March 31, 2011 and 2010, the historical cost of revenues was reduced by \$0.1 million and \$0.4 million, respectively, and the historical sales and marketing expenses were reduced by zero and \$0.4 million, respectively. The adjustment of deferred revenue and deferred costs to fair value is required only at the purchase accounting date; therefore, its impact on net revenues, cost of revenues, and sales and marketing expense is non-recurring.

- (b) Costs directly associated with the integration of the Company and VLCY, including severance and other costs incurred to achieve synergies and the cost of retention and change in control agreements directly related to the merger. The cost for retention and change in control agreements included was \$1.1 million for the quarter ended March 31, 2010.
- (c) Legacy VLCY corporate costs representing corporate costs related to legacy VLCY liabilities such as pension and severance costs for former VLCY employees.
- (d) Stock-based compensation and expense is related to our outstanding options, restricted stock awards, warrants, and stock appreciation rights (SARs).

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- (e) During 2008, we discovered certain irregularities relating to the control and use of cash and certain other general ledger items which resulted from a substantial misappropriation of assets over more than a three-year period beginning in 2004 and continuing through April 2008. These irregularities were perpetrated by a former employee, resulting in embezzlement losses, net of recoveries.
- (f) Adjustments to the CVR liability as a result of the amendments of the merger agreement and the related escrow agreement, the expiration of the statute of limitations on potential tax liabilities and changes in likelihood of collecting potential tax receivables included in the estimate of the fair value of the CVRs.

The deferred revenue balances as reported on a GAAP basis beginning in the fourth quarter of 2009 include material purchase accounting adjustments related to the VLCY acquisition. We believe that the adjusted deferred revenue balances, which exclude the effect of the purchase accounting adjustment, provide useful information for investors to assess the results of the ongoing business of the combined company.

Adjusted deferred revenue is not prepared in accordance with GAAP and may be different from non-GAAP financial measures used by other companies. Non-GAAP financial measures should not be considered a substitute for, or superior to, measures of financial performance prepared in accordance with GAAP. We believe that adjusted deferred revenue provides useful information to investors for assessing the impact of deferred revenue changes on our reported GAAP and adjusted net revenues.

Cambium Learning Group, Inc.  
Change in Adjusted Deferred Revenue  
(in thousands)  
Unaudited

|                                           | December<br>31,<br>2009 | March<br>31,<br>2010 | June 30,<br>2010 | As of:<br>September,<br>30<br>2010 | December<br>31,<br>2010 | March<br>31,<br>2011 |
|-------------------------------------------|-------------------------|----------------------|------------------|------------------------------------|-------------------------|----------------------|
| Deferred revenue                          | \$ 24,181               | \$ 21,842            | \$ 23,643        | \$ 33,301                          | \$ 37,556               | \$ 30,779            |
| Purchase accounting fair value adjustment | 14,374                  | 9,222                | 4,662            | 2,262                              | 1,437                   | 1,105                |
| Adjusted deferred revenue                 | 38,555                  | 31,064               | 28,305           | 35,563                             | 38,993                  | 31,884               |
| Change in adjusted deferred revenue       |                         | \$ (7,491)           | \$ (2,759)       | \$ 7,258                           | \$ 3,430                | \$ (7,109)           |

**Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements as of March 31, 2011 that have or are reasonably likely to have a current or future material effect on the Company's financial condition, changes in financial conditions, sales or expenses, results of operations, liquidity, capital expenditures or capital resources.

**Contractual Obligations**

As described in Note 15 to our condensed consolidated financial statements, in February 2011, we closed an offering of \$175 million aggregate principal amount of Notes due 2017 and entered into a new \$40 million asset-based revolving credit facility. We used a portion of the net proceeds from the offering to repay in full outstanding indebtedness under the secured credit facility and senior unsecured notes that existed as of December 31, 2010. There have been no other material changes in the contractual obligations disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010.



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### **Recently Issued Financial Accounting Standards**

In December 2010, new guidance was issued regarding the disclosure of supplementary pro forma information for business combinations. This guidance specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The guidance also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. This guidance is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010 with early adoption permitted. The Company will make the required disclosures for any business combination that closes on or after January 1, 2011.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

#### **Interest Rate Risk**

As described in Note 15 to our condensed consolidated financial statements, in February 2011, we closed an offering of \$175 million aggregate principal amount of Notes (fixed rate) due 2017 and entered into a new \$40 million asset-based revolving credit facility. We used a portion of the net proceeds from the offering to repay in full outstanding indebtedness under the secured credit facility and senior unsecured notes that existed as of December 31, 2010. We have no amounts outstanding under the revolving credit facility, which is our only variable interest debt. Therefore, as of March 31, 2011 we have no material interest rate risk.

#### **Foreign Currency Risk**

The Company does not have material exposure to changes in foreign currency rates. As of March 31, 2011, the Company does not have any outstanding foreign currency forwards or option contracts.

### **Item 4. Controls and Procedures.**

#### **Evaluation of Disclosure Controls and Procedures**

Management of the Company, with the participation of the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported on a timely basis and that such information is communicated to management, including the Chief Executive Officer, Chief Financial Officer and its Board of Directors, to allow timely decisions regarding required disclosure.

Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2011.

#### **Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **Part II. Other Information**

### **Item 1. Legal Proceedings.**

As previously reported in our Annual Report on Form 10-K for the year ended December 31, 2010, the Company is involved in a tax litigation matter related to a Michigan state tax issue. The final resolution of the tax litigation or potential settlement could result in a refund ranging from zero to approximately \$10.4 million of which fifty percent (50%), net of expenses incurred, would be payable to the holders of the CVRs. If the Company's position is not ultimately upheld, the Company could incur up to \$10.4 million of indemnification expense in future periods on its Statements of Operations, partially offset by any reduction to the CVRs liability. Management believes it is more likely than not that the Company's position will be upheld and a \$10.4 million tax receivable for the expected refund is recorded in other assets on the Condensed Consolidated Balance Sheets as of March 31, 2011.





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**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 the Company's Annual Report on Form 10-K for the year ended December 31, 2010, as such factors could materially affect the Company's business, financial condition, or future results. In the three months ended March 31, 2011, there were no material changes to the risk factors disclosed in the Company's 2010 Annual Report on Form 10-K. The risks described in the Annual Report on Form 10-K are not the only risks the Company faces. Additional risks and uncertainties not currently known to the Company, or that the Company currently deems to be immaterial, also may have a material adverse impact on the Company's business, financial condition, or results of operations.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

The following is a description of the Company's securities that were issued or sold by the Company during the period covered by this report and which were not registered under the Securities Act of 1933, as amended (the Securities Act).

***9.75% Senior Secured Notes***

On February 17, 2011, we completed the offering (the Offering) of \$175 million aggregate amount of 9.75% Senior Secured Notes (the Notes). After the issuance discount, we received proceeds of 99.442% of the aggregate offering price, or \$174 million. The Notes will mature on February 15, 2017. The Offering was a private placement exempt from the registration requirements under the Securities Act. The Notes were offered inside the United States only to qualified institutional buyers in reliance on Rule 144A under the Securities Act and to persons outside the United States in reliance on Regulation S under the Securities Act.

We used a portion of the net proceeds from the sale of the Notes to repay in full outstanding indebtedness under our existing secured credit facility and senior unsecured notes and to pay related fees and expenses. Interest on the Notes will accrue at a rate of 9.75% per annum from the date of original issuance and will be payable semi-annually in arrears on each February 15 and August 15, commencing on August 15, 2011, to the holders of record of the Notes on the immediately preceding February 1 and August 1.

Pursuant to a Registration Rights Agreement entered into in connection with the Offering, we have agreed to file a registration statement with the SEC that would enable holders of the Notes to exchange the privately placed Notes for publicly registered notes with substantially identical terms. The Notes are secured by (i) a first priority lien on substantially all of our assets, other than inventory and accounts receivable and related assets of the ABL Credit Parties in connection with the ABL Facility (each as defined and discussed under the heading *Long-term debt* in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this Quarterly Report on Form 10-Q) and subject to certain exceptions, including capital stock of the guarantors (which are certain of the Company's subsidiaries), and (ii) a second-priority lien on substantially all of the inventory and accounts receivable and related assets of the ABL Credit Parties, in each case, subject to certain permitted liens. The Notes also contain customary covenants, including limitations on our ability to incur debt, and events of default as defined by the indenture governing the Notes. We may, at our option, redeem the Notes prior to their maturity based on the terms included in the indenture governing the Notes (the Indenture). A copy of the Indenture and related form of Note have been filed as Exhibits 4.1 and 4.2, respectively, to the Company's Current Report on Form 8-K dated February 17, 2011, and are incorporated by reference as Exhibits 4.1 and 4.2 to this Quarterly Report on Form 10-Q.

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As noted, pursuant to the Registration Rights Agreement, we are required to (i) file with the SEC within 180 days after the issue date of the Notes (or February 17, 2011) a registration statement under the Securities Act (the Exchange Offer Registration Statement ), relating to an offer to exchange the Notes (the Exchange Offer ) for new notes (the Exchange Notes ) on terms substantially identical to the Notes, except that the Exchange Notes will not be subject to the same restrictions on transfer; (ii) use commercially reasonable efforts to cause the Exchange Offer Registration Statement to become effective within 270 days after the date of the Notes; and (iii) within 60 days of the Exchange Offer Registration Statement becoming effective, complete the Exchange Offer and issue the Exchange Notes in exchange for all Notes validly tendered in the Exchange Offer. In May 2011, the Company filed the Exchange Offer Registration Statement with the SEC and anticipates the Exchange Offer Registration Statement becoming effective and the Exchange Notes being issued within the deadlines set forth in the Registration Rights Agreement.

***Warrants to Purchase Common Stock***

During the quarter ended March 31, 2011, the number of shares of common stock of the Company underlying the warrant issued to VSS-Cambium Holdings III, LLC, the sole stockholder of VSS-Cambium Holdings II Corp. ( Cambium ) immediately prior to the Company s acquisition of Cambium, as part of the merger consideration payable to such stockholder in connection with the Cambium merger, was increased by 36,531 shares. The increase resulted from cash recoveries during the quarter in connection with the employee embezzlement matter, in accordance with the terms of the warrant. The warrant is exercisable for shares of common stock at an exercise price of \$0.01 per share, and expires on December 8, 2014. The number of shares of common stock issuable under the warrant may be further increased in the future upon the occurrence of certain events described in the warrant. The issuance of these securities of to VSS-Cambium Holdings III, LLC was exempt from registration under Section 4(2) of the Securities Act. During May 2011, the Company filed a registration statement on Form S-3 to register the shares of common stock beneficially held by VSS-Cambium Holdings III, LLC, its majority stockholder, including the shares of common stock underlying the warrant. After the effective date of this registration statement, these shares may be sold on the principal market on which the stock is traded at the prevailing market price or in negotiated transactions. The Company will not receive proceeds from the stockholder as a result of the registration of these shares. The Company may receive proceeds from the issuance of the shares of common stock being registered pursuant to the registration statement in connection with the exercise of the warrants, if and when they are exercised, unless such warrants are exercised on a cashless basis.

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**Item 6. Exhibits.**

The following exhibits are filed as part of this report.

| <b>Exhibit Number</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|-----------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.1                   | Indenture, dated as of February 17, 2011, by and among Cambium Learning Group, Inc., the Guarantors named therein and Wells Fargo Bank, National Association, as Trustee (incorporated by reference to Exhibit 4.1 of Cambium Learning Group, Inc. s Current Report on Form 8-K dated February 17, 2011 (File No. 001-34575)).                                                                                                                                         |
| 4.2                   | Form of 9.75% Senior Secured Note due 2017 (incorporated by reference to Exhibit 4.2 of Cambium Learning Group, Inc. s Current Report on Form 8-K dated February 17, 2011 (File No. 001-34575)).                                                                                                                                                                                                                                                                       |
| 4.3                   | Loan and Security Agreement, dated as of February 17, 2011, by and among Harris N.A. as Lender and as Agent, Barclay s Bank PLC as Collateral Agent, and Cambium Learning, Inc. as Borrower (incorporated by reference to Exhibit 4.3 of Cambium Learning Group, Inc. s Annual Report on Form 10-K for the year ended December 31, 2010 (File No. 001-34575)).                                                                                                         |
| 4.4                   | Purchase Agreement, dated as of February 14, 2011, for \$175,000,000 Cambium Learning Group, Inc. 9.75% Senior Secured Notes due 2017 (incorporated by reference to Exhibit 4.4 of Cambium Learning Group, Inc. s Annual Report on Form 10-K for the year ended December 31, 2010 (File No. 001-34575)).                                                                                                                                                               |
| 4.5                   | Registration Rights Agreement, dated as of February 17, 2011, by and among Cambium Learning Group, Inc., as the Guarantors and Barclays Capital Inc. and BMO Capital Markets Corp., as representatives of the several initial purchasers (incorporated by reference to Exhibit 4.4 of Cambium Learning Group, Inc. s Annual Report on Form 10-K for the year ended December 31, 2010 (File No. 001-34575)).                                                            |
| 31.1                  | Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                            |
| 31.2                  | Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                            |
| 32.1                  | Certification of Chief Executive Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                      |
| 32.2                  | Certification of Senior Vice President and Chief Financial Officer Pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                            |
| 99.1                  | Amendment No. 1 to Stockholders Agreement, made as of April 12, 2011, to that certain Stockholders Agreement, dated as of December 8, 2009, by and among Cambium Learning Group, Inc. (f/k/a Cambium Holdings, Inc.), VSS-Cambium Holdings III, LLC, and Vowel Representative, LLC, as Stockholders Representative (incorporated by reference to Exhibit 99.1 of Cambium Learning Group, Inc. s Current Report on Form 8-K dated April 12, 2011 (File No. 001-34575)). |



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**SIGNATURES**

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

**Date:** May 16, 2011

CAMBIUM LEARNING GROUP, INC.

/s/ Bradley C. Almond  
Bradley C. Almond,  
Senior Vice President and Chief Financial  
Officer  
(Principal Financial Officer)

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**EXHIBIT INDEX**

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