



CENGAGE LEARNING HOLDINGS II, INC.

**First Quarter Report
Three Months Ended June 30, 2019**

During the period covered by this report, Cengage Learning Holdings II, Inc. and its consolidated subsidiaries (the "Company") were not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended. However, the Company does have an obligation to comply with the terms of its Shareholder Agreement, dated as of March 31, 2014 (the "Shareholder Agreement"). The Shareholder Agreement includes references to certain provisions of the U.S. Securities and Exchange Commission's reporting requirements with modifications as agreed by all parties. The Company has complied with its obligations under the Shareholder Agreement and this report is made available pursuant to such obligations.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. You can identify forward-looking statements because they contain words such as “believe,” “expect,” “may,” “will,” “should,” “could,” “seek,” “intend,” “plan,” “estimate,” “project,” “foresee,” “likely,” or “anticipate” or similar expressions that concern our strategies, objectives, plans, or goals. Although the forward-looking statements contained in this report reflect management’s current beliefs based upon information currently available to management and upon assumptions which management believes to be reasonable, actual results may differ materially from those stated in or implied by these forward-looking statements.

A number of factors could cause actual results or performance to differ materially from the results expressed or implied in the forward-looking statements, including the factors described in this quarterly report and those listed in the “Risk Factors” section of the Company’s Annual Report for the fiscal year ended March 31, 2019. These factors should be considered carefully and readers should not place undue reliance on the forward-looking statements. These risks and uncertainties include, without limitation:

- the impact of competition from significant established competitors and nontraditional competitors including various technology providers and online distributors, including the impact of new and enhanced product and service offerings and technology and competitors’ acquiring additional businesses in key sectors in order to broaden their offerings;
- the impact of business combinations in the industry in which we compete;
- our ability to introduce new products, services or technologies;
- the impact of used textbook and/or rental textbook programs and our ability to compete with them;
- the effect of increased accessibility of free or relatively inexpensive information and materials on pricing and demand for our products and services;
- increased availability of lower priced international versions of our products in the domestic market or higher prices for our products overseas may cause our sales to decline;
- changes in the availability and prices of paper and unanticipated increases in other operating costs;
- our ability to attract and retain key authors, retain rights to our authors’ works, and avoid disputes with our authors;
- our ability to attract and retain content providers and employees;
- our dependence on third-party distributors, representatives and retailers;
- termination of at-will contracts to which we are a party could harm our business;
- our ability and willingness to maintain licensing agreements with third-party content providers;
- our reliance on third-party providers of outsourced services and any failure of such providers to provide services effectively on a timely basis;
- reductions in enrollments at colleges and universities;
- adverse changes in domestic and global economic and political conditions, including those related to the availability of credit, government and private loans for students and consequential decline in consumer demand for our products;
- the effect of changes in government programs and private lending practices relating to student aid and library funding;
- the impact of changes to laws and regulations applicable to us and our customers, including rules that could result in decreased programs offered by, and limit enrollments in, institutions of higher and continuing education including for-profit schools, as well as the enactment of the Tax Cuts and Jobs Act of 2017 (the “Tax Act”)
- our ability to win state adoptions, cancellation or postponement of adoptions, and changes in state funding;
- our ability to expand and conduct our operations outside the United States;
- the effect of fluctuations between foreign currencies and the United States dollar and our ability to effectively manage foreign currency exposure;
- the seasonality of our business;
- our ability to successfully implement our business strategy;

- our ability to identify, acquire and successfully integrate future acquisition targets;
- the impact of the Cengage Learning Holdings II, Inc. and McGraw-Hill Education, Inc., proposed merger (the “Merger”), see Note 1, “Basis of Presentation,” to our accompanying unaudited condensed consolidated financial statements which includes our ability to obtain timely regulatory approval, recruit and retain employees, and significant operating costs, expenses and fees;
- the Merger, which limits our flexibility in operating our business including, our ability to respond effectively to competitive pressures, industry developments and future opportunities;
- failures or disruptions of our and our third-party providers’ hosting facilities and electronic delivery systems for our products and services;
- the impact of technology developments and our ability to continue to make effective investments in our technology infrastructure;
- technology failures;
- potential security breaches or cyberattacks involving our technology infrastructure, our products and services, or our customers’ credit and debit card and private data, which could subject us to material claims and additional costs and harm our reputation;
- our ability to adequately manage and develop our operational and managerial systems and processes including our enterprise resource planning software;
- our ability to comply with privacy laws;
- our ability to adequately protect, maintain and enforce our intellectual property rights and proprietary rights and the adequacy of protections of our intellectual property under applicable laws;
- liabilities resulting from, and costs of defending against, litigation including piracy and intellectual property infringement claims;
- our debt agreements, which limit our flexibility in operating our business including, among other things, our ability under certain circumstances to engage in mergers or consolidations, sell assets and use the proceeds of such sale, pay distributions to our equity owners and/or buy back debt;
- the impact of being controlled by Principal Equityholders, whose interests may conflict with other stockholders;
- incurrence of impairment charges for goodwill, long-lived assets and identifiable intangible assets;
- our ability to react to changes in the economy or our industry;
- changes in our credit ratings or macroeconomic conditions; and
- our ability to maintain effective internal controls over financial reporting.

Although we have attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in or implied by our forward-looking statements, other factors and risks may cause actions, events or results to differ materially from those anticipated, estimated or intended. We cannot assure you that forward-looking statements will prove to be accurate, as actual actions, results and future events could differ materially from those anticipated or implied by such statements. All forward-looking statements included in this report are expressly qualified in their entirety by the foregoing cautionary statements. These forward-looking statements are made as of the date of this report and, except as required by law, we undertake no obligation to update, amend, clarify or revise them to reflect new events or circumstances.

CENGAGE LEARNING HOLDINGS II, INC.
FIRST QUARTER REPORT
THREE MONTHS ENDED JUNE 30, 2019
(UNAUDITED)

TABLE OF CONTENTS

	<u>Page No</u>
Financial Statements (unaudited)	
Condensed Consolidated Balance Sheets	2
Condensed Consolidated Statements of Operations	3
Condensed Consolidated Statements of Comprehensive Loss	4
Condensed Consolidated Statements of Cash Flows	5
Condensed Consolidated Statements of Change in Stockholders' Equity	6
Notes to the Condensed Consolidated Financial Statements	7
Management's Discussion and Analysis of Financial Condition and Results of Operations	20
Quantitative and Qualitative Disclosures about Market Risk	30
Legal Proceedings	30
Risk Factors	30
Purchases of Equity Securities by the Issuer	30

CENGAGE LEARNING HOLDINGS II, INC.
Condensed Consolidated Balance Sheets
(UNAUDITED)

	As of	
	June 30, 2019	March 31, 2019
<i>(in millions, except share and per share amounts)</i>		
Assets		
Cash and cash equivalents	\$ 170.0	\$ 335.8
Accounts receivable, net	186.1	202.3
Inventories	114.8	109.6
Prepaid expenses and other current assets	74.5	77.7
Total current assets	545.4	725.4
Property, equipment and capitalized internal-use software, net	156.7	146.2
Pre-publication costs, net	210.9	215.8
Author advances	17.6	16.9
Identifiable intangible assets, net	891.5	912.7
Goodwill	1,627.2	1,629.1
Deferred tax assets	6.5	6.6
Deferred financing costs	2.0	2.3
Other non-current assets	22.4	23.3
Total assets	\$ 3,480.2	\$ 3,678.3
Liabilities and Stockholders' Equity		
Accounts payable and accrued expenses	\$ 259.0	\$ 312.2
Deferred revenue	137.9	182.9
Current portion of long-term debt	17.1	17.2
Income taxes payable	5.6	5.8
Other current liabilities	18.7	25.4
Total current liabilities	438.3	543.5
Long-term debt	2,232.4	2,234.8
Deferred tax liabilities	17.4	38.3
Other non-current liabilities	58.0	57.7
Total liabilities	2,746.1	2,874.3
Commitments and contingencies (Note 13)		
Preferred stock (\$0.01 par value, 50,000,000 shares authorized, none issued)	—	—
Common stock (\$0.01 par value, 300,000,000 shares authorized, 61,821,499 and 61,547,310 shares issued and outstanding as of June 30, 2019 and March 31, 2019, respectively)	0.6	0.6
Additional paid-in capital	1,225.9	1,225.3
Accumulated deficit	(433.7)	(367.9)
Accumulated other comprehensive loss	(58.7)	(54.0)
Total stockholders' equity	734.1	804.0
Total liabilities and stockholders' equity	\$ 3,480.2	\$ 3,678.3

See accompanying notes to the condensed consolidated financial statements.

CENGAGE LEARNING HOLDINGS II, INC.
Condensed Consolidated Statements of Operations
(UNAUDITED)

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018
Revenues	\$ 282.6	\$ 288.3
Cost of revenues, excluding amortization of pre-publication costs and identifiable intangible assets and depreciation stated below	142.1	148.3
Amortization of pre-publication costs	23.7	24.9
Amortization of identifiable intangible assets	1.2	1.2
Total cost of revenues, excluding depreciation stated below	167.0	174.4
Selling, general and administrative expenses, excluding depreciation stated below	108.0	116.8
Merger-related costs	9.2	—
Operational restructuring and other charges, net	4.9	4.1
Depreciation	15.6	17.0
Amortization of identifiable intangible assets	19.2	22.5
Total costs and expenses	323.9	334.8
Operating loss	(41.3)	(46.5)
Other income, net	1.6	1.8
Interest income	1.5	0.9
Interest expense	(45.3)	(43.1)
Loss before taxes	(83.5)	(86.9)
Benefit from income taxes	17.7	18.4
Net loss	\$ (65.8)	\$ (68.5)

See accompanying notes to the condensed consolidated financial statements.

CENGAGE LEARNING HOLDINGS II, INC.
Condensed Consolidated Statements of Comprehensive Loss

(UNAUDITED)

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018
Net loss	\$ (65.8)	\$ (68.5)
Other comprehensive loss:		
Foreign currency translation adjustments	(4.7)	(11.1)
Comprehensive loss	\$ (70.5)	\$ (79.6)

See accompanying notes to the condensed consolidated financial statements.

CENGAGE LEARNING HOLDINGS II, INC.
Condensed Consolidated Statements of Cash Flows
(UNAUDITED)

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018
Cash Flows from Operating Activities		
Net loss	\$ (65.8)	\$ (68.5)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of pre-publication costs	23.7	24.9
Depreciation	15.6	17.0
Amortization of identifiable intangible assets	20.4	23.7
Amortization of debt discounts and deferred financing costs	2.1	2.1
Non-cash equity-based compensation expense	0.8	2.4
Operational restructuring and other charges, net	4.9	4.1
Cash payments for operational restructuring charges	(8.5)	(3.3)
Deferred income taxes	(20.8)	(19.9)
Changes in operating assets and liabilities, net of acquisitions	(78.7)	(64.8)
Other, net	0.6	—
Net cash used in operating activities	(105.7)	(82.3)
Cash Flows from Investing Activities		
Additions to pre-publication costs	(23.9)	(24.4)
Additions to property, equipment and capitalized internal-use software	(28.1)	(15.5)
Other, net	(0.1)	(0.6)
Net cash used in investing activities	(52.1)	(40.5)
Cash Flows from Financing Activities		
Repayments of long-term debt	(4.3)	(0.1)
Dividend equivalents paid	(3.4)	(4.2)
Proceeds from exercise of stock options	0.1	—
Common stock repurchases for tax withholding for net settlement of equity awards	(0.3)	(2.3)
Net cash used in financing activities	(7.9)	(6.6)
Impact on Cash and Cash Equivalents from Changes in Foreign Currency	(0.1)	(1.2)
Net Decrease in Cash and Cash Equivalents	(165.8)	(130.6)
Cash and Cash Equivalents		
Beginning of period	335.8	319.3
End of period	\$ 170.0	\$ 188.7

See accompanying notes to the condensed consolidated financial statements.

CENGAGE LEARNING HOLDINGS II, INC.
Condensed Consolidated Statements of Changes in Stockholders' Equity
(UNAUDITED)

<i>(in millions)</i>	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares Issued	Par Value				
Balance at March 31, 2019	61.5	\$ 0.6	\$ 1,225.3	\$ (367.9)	\$ (54.0)	\$ 804.0
Net loss	—	—	—	(65.8)	—	(65.8)
Foreign currency translation adjustment	—	—	—	—	(4.7)	(4.7)
Proceeds from exercise of stock options	—	—	0.1	—	—	0.1
Issuance of common stock under share based compensation plan and shares withheld to cover tax withholding requirements	0.3	—	(0.3)	—	—	(0.3)
Equity-based compensation	—	—	0.8	—	—	0.8
Balance at June 30, 2019	61.8	\$ 0.6	\$ 1,225.9	\$ (433.7)	\$ (58.7)	\$ 734.1

<i>(in millions)</i>	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares Issued	Par Value				
Balance at March 31, 2018	61.0	\$ 0.6	\$ 1,224.7	\$ (270.9)	\$ (39.4)	\$ 915.0
Net loss	—	—	—	(68.5)	—	(68.5)
Foreign currency translation adjustment	—	—	—	—	(11.1)	(11.1)
Issuance of common stock under share based compensation plan and shares withheld to cover tax withholding requirements	0.4	—	(2.3)	—	—	(2.3)
Equity-based compensation	—	—	2.4	—	—	2.4
Balance at June 30, 2018	61.4	\$ 0.6	\$ 1,224.8	\$ (339.4)	\$ (50.5)	\$ 835.5

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

1. BASIS OF PRESENTATION

Basis of Presentation

Cengage Learning Holdings II, Inc., together with its consolidated subsidiaries (the “Company”), is a leading education and technology company built for learners, serving the higher education, school, professional, library and workforce training markets worldwide.

The Company has prepared the accompanying unaudited condensed consolidated financial statements (“condensed consolidated financial statements”) and accompanying footnotes in accordance with the accounting policies described in its Annual Report for the fiscal year ended March 31, 2019 (the “2019 Annual Report”). Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted. You should read these condensed consolidated financial statements in conjunction with the consolidated financial statements included in the 2019 Annual Report.

In the opinion of management, the condensed consolidated financial statements include all adjustments (consisting of normal recurring adjustments) considered necessary by management to fairly state the financial position, results of operations and cash flows for the periods presented. The results of operations for the three months ended June 30, 2019 are not necessarily indicative of the results for the fiscal year ending March 31, 2020.

Proposed Merger

On May 1, 2019, Cengage Learning Holdings II, Inc. (“Cengage”), Cengage Learning Holdco, Inc. (“Cengage Intermediate Holdco”), Cengage Learning, Inc. (“Cengage Issuer”), McGraw-Hill Education, Inc. (“McGraw-Hill”), and McGraw-Hill Global Educations Holdings, LLC (“McGraw-Hill Issuer”) entered into an Agreement and Plan of Merger (the “Merger Agreement”). Pursuant to and subject to the terms and conditions of the Merger Agreement, upon completion of the proposed transaction, Cengage will merge with and into McGraw-Hill Issuer (the “Merger”), with McGraw-Hill Issuer continuing as the surviving entity following the Merger. At the effective time of the Merger (the “Effective Time”) (1) each share of McGraw-Hill common stock, par value \$0.01 per share, will convert into one share of Class A Common Stock of the combined company, and (2) each share of Cengage common stock, par value \$0.01 per share, will convert into a certain number of shares of Class B Common Stock of the combined company such that, as of the Effective Time, the aggregate number of issued and outstanding shares of Class A Common Stock will equal the aggregate number of issued and outstanding shares of Class B Common Stock. Accordingly, the legacy stockholders of McGraw-Hill and the legacy stockholders of Cengage will, as of the Effective Time, each collectively own exactly 50% of the issued and outstanding shares of voting common stock of the combined company.

The proposed transaction is subject to certain closing conditions, including receipt of regulatory approvals. Cengage and McGraw-Hill submitted Hart-Scott-Rodino Act filings with the U.S. Department of Justice and Federal Trade Commission on May 31, 2019. Cengage is working towards closing the transaction in early 2020.

Cengage has also agreed to various customary covenants and agreements, including, among others, to conduct its business in the ordinary course during the period between the execution of the Merger Agreement and the Effective Time, and to use reasonable best efforts to obtain all requisite regulatory approvals.

Merger-related costs are expensed as incurred and consist of integration planning costs, legal fees, rating agency fees, and professional services. For the three months ended June 30, 2019, merger-related costs were \$9.2 million, of which \$7.1 million remains unpaid and included in accounts payable in the condensed consolidated balance sheets as of June 30, 2019.

Cengage estimates contingent fees and expenses upon successful merger closing are estimated to be approximately \$20 million, none of which have been accrued as of June 30, 2019.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these condensed consolidated financial statements and accompanying notes. Although these estimates are based on management’s best knowledge of current events and actions that the Company may undertake in the future, actual results could differ from those estimates. These estimates include, but are not limited to, reserves for sales returns and inventory obsolescence, the allowance for doubtful accounts, deferred tax assets and liabilities, the valuation allowances for deferred tax assets, operational restructuring and other charges, legal and tax contingencies,

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

purchase accounting and equity-based compensation, as well as future cash flows and fair values used in the assessment of the realizability of long-lived assets, goodwill and identifiable intangible assets.

Seasonality and Comparability

The Company's revenues, operating profit and operating cash flows are impacted by the inherent seasonality of the academic calendar. This seasonality affects the Company's working capital requirements and hence its overall financing needs. For example, the Company typically incurs a net cash deficit from all of its activities in the first and fourth quarters of the fiscal year. In addition, changes in customer ordering patterns may impact the comparison of the Company's results in a quarter with the same quarter of the previous year, or in a fiscal year with the prior fiscal year, where its customers may shift the timing of material orders for a number of reasons, including, but not limited to, changes in academic semester start dates, changes in inventory management practices, and a shift in customer base driven by an increase in direct to student subscription products.

As the Company continues to migrate its service offerings towards hosted digital solutions that are delivered over a period of time, the associated revenues will be recognized ratably over the applicable subscription period, with amounts billed in excess of revenues recognized reflected as deferred revenue. This represents a change from traditional print products where revenues are typically recognized upon shipment of the material to the customer. Reported revenues will shift from being driven by sales in the same period to deferred recognition as revenues attributable to hosted digital solutions are recognized in subsequent periods. Deferred revenue represents amounts billed in advance to customers that will be recognized as revenues in subsequent periods as products and services are delivered to customers. The current portion of deferred revenue was \$137.9 million and \$182.9 million as of June 30, 2019 and March 31, 2019, respectively, and the non-current portion of deferred revenue was \$33.9 million and \$32.9 million as of June 30, 2019 and March 31, 2019, respectively.

Concentration of Credit Risk

No customer was individually greater than 10% of the Company's total gross accounts receivable as of June 30, 2019 and March 31, 2019. Additionally, no customer was individually greater than 10% of the Company's consolidated revenue for the three months ended June 30, 2019 and 2018.

New Accounting Standards and Accounting Changes

In August 2018, the Financial Accounting Standards Board ("FASB") issued guidance on accounting for implementation costs incurred in a cloud computing arrangement that is a service contract. This update aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The amendments in this update are effective for fiscal years beginning after December 15, 2020 and interim periods within fiscal years beginning after December 15, 2021, with early adoption permitted. The Company is evaluating the impact of this update on its consolidated financial position, results of operations and cash flows.

In November 2016, the FASB issued guidance on the classification and presentation of restricted cash in the statement of cash flows which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated cash flows.

In August 2016, the FASB issued guidance on the classification of certain cash flow transactions, consisting of the following: debt prepayment or debt extinguishment costs; the settlement of zero-coupon debt instruments; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and the application of the predominance principle. The amendments provide guidance for each of the eight issues for which GAAP guidance was previously unclear or did not exist, thereby reducing the current and potential future diversity in practice. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated cash flows.

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

In June 2016, the FASB issued guidance and an update to add Accounting Standard Codification (“ASC”) Topic 326, “Credit Losses”. There was a subsequent amendment in November 2018 to amend and clarify the initial guidance. Topic 326 requires measurement and recognition of expected credit losses for financial assets held. Under this model, entities will be required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. The guidance is effective for fiscal years beginning after December 15, 2021, and interim periods within that fiscal year, with early adoption permitted for fiscal years beginning after December 15, 2018. The Company is evaluating the impact of this update on its consolidated financial statements.

In February 2016, the FASB issued an updated standard to add Accounting Standard Codification ASC Topic 842, “Leases”, which will replace most of the existing leasing guidance in U.S. GAAP when it becomes effective. One of the most significant changes this update will institute is that for all leases the lessees will be required to recognize at the commencement date: a) a lease liability; and b) a right-of-use asset. The lease liability represents the lessee’s obligation to make lease payments and it is measured on a discounted basis. The right-of-use asset represents the lessee’s right to use, or control the use of, the underlying leased asset during the term of the lease. Additionally, the guidance requires improved disclosures to help users of financial statements better understand the nature and magnitude of lessees’ lease obligations. Entities were required to adopt the new leases standard using a modified retrospective transition method, initially applying the new leases standard (subject to specific transition requirements and optional practical expedients) at the beginning of the earliest period presented in the financial statements. In July 2018, the FASB issued updated guidance, which provided an additional transition option that allows companies to continue applying the guidance under the current lease standard in the comparative periods presented in the consolidated financial statements. Companies that elect this option would record a cumulative-effect adjustment to the opening balance of retained earnings on the date of adoption. The amendments in this update are effective for the Company for fiscal years beginning after December 15, 2019 and interim periods within fiscal years beginning after December 15, 2020. The Company is in the process of determining which transition method to apply and evaluating the impact of this update on its consolidated financial position, balance sheet, results of operations and cash flows.

In May 2014, the FASB issued an update to add ASC Topic 606, “Revenue from Contracts with Customers”, which will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The authoritative guidance provides that an entity should recognize revenues to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services through the application of the following steps:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Additionally, the guidance requires improved disclosures to help users of financial statements better understand the nature, amount, timing, and uncertainty of revenues that are recognized. The amendments in this update are to be applied on a retrospective basis, utilizing one of two different alternatives. Entities can adopt the standard using a full retrospective approach, which requires statements of comparative prior periods, or modified retrospective approach, in which the standard is applied to open contracts at the date of adoption. In August 2015, the FASB approved a one year deferral of the effective date of the amended revenue recognition guidance. As a result, the amendments in this update are effective for the Company in the fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early application is permitted, with certain limitations. The Company is evaluating the potential effect of this new standard on its major revenue streams and contracts with customers, as well as the impact on its consolidated financial position, results of operations and cash flows. The new standard provides explicit guidance on how to account for contract modifications, eliminates the cash basis accounting model, requires an estimate of variable consideration, an assessment of any significant financing components, and provides criteria for assessing whether a performance obligation is satisfied at a point in time or over time. In addition to impacting the way we recognize revenue, the new standard will also impact the accounting for direct and incremental commission costs of obtaining contracts. Under the new standard, we will defer incremental commission costs on contracts greater than one year in duration. We expect to amortize these costs on a straight-line basis over the period of economic benefit. The Company plans to utilize the modified retrospective approach in implementing the new standard.

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

2. INVENTORIES

Inventories consisted of the following:

<i>(in millions)</i>	As of	
	June 30, 2019	March 31, 2019
Raw materials	\$ 0.1	\$ 0.1
Work-in-progress	0.3	0.2
Finished goods	114.4	109.3
Total inventories	<u>\$ 114.8</u>	<u>\$ 109.6</u>

3. OTHER BALANCE SHEET ACCOUNTS

The sales returns reserve and allowance for doubtful accounts included in accounts receivable, net, in the accompanying condensed consolidated balance sheets were as follows:

<i>(in millions)</i>	As of	
	June 30, 2019	March 31, 2019
Sales returns reserve	\$ 37.1	\$ 42.8
Allowance for doubtful accounts	12.4	12.6

The provision for estimated sales returns is reflected as a reduction of revenue during the period in which the revenue is recognized. The Company records the returns against its sales returns reserve in the period of receipt.

Accounts payable and accrued expenses consisted of the following:

<i>(in millions)</i>	As of	
	June 30, 2019	March 31, 2019
Accounts payable	\$ 104.3	\$ 104.5
Accrued royalties	63.3	61.4
Accrued bonuses	21.9	66.3
Accrued interest payable	4.4	20.5
Other accrued expenses	65.1	59.5
	<u>\$ 259.0</u>	<u>\$ 312.2</u>

4. IDENTIFIABLE INTANGIBLE ASSETS

The Company's identifiable intangible assets, net were as follows:

<i>(in millions)</i>	As of			As of		
	June 30, 2019			March 31, 2019		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Copyrights	\$ 726.7	\$ (257.9)	\$ 468.8	\$ 727.6	\$ (249.2)	\$ 478.4
Customer relationships	366.5	(127.5)	239.0	367.0	(121.6)	245.4
Trademarks	232.6	(81.5)	151.1	232.8	(77.6)	155.2
Technology and author/content rights	46.0	(13.4)	32.6	45.9	(12.2)	33.7
Total identifiable intangible assets	<u>\$ 1,371.8</u>	<u>\$ (480.3)</u>	<u>\$ 891.5</u>	<u>\$ 1,373.3</u>	<u>\$ (460.6)</u>	<u>\$ 912.7</u>

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

5. GOODWILL

The following table shows the changes in the carrying amounts of goodwill by segment:

<i>(in millions)</i>	<u>Learning</u>	<u>Gale</u>	<u>International</u>	<u>Total</u>
Balance as of March 31, 2019	\$ 1,326.1	\$ 203.9	\$ 99.1	\$ 1,629.1
Foreign currency translation adjustments	—	(0.5)	(1.4)	(1.9)
Balance as of June 30, 2019	<u>\$ 1,326.1</u>	<u>\$ 203.4</u>	<u>\$ 97.7</u>	<u>\$ 1,627.2</u>

6. OPERATIONAL RESTRUCTURING AND OTHER CHARGES

Fiscal Year 2020

During the first quarter of fiscal year 2020, the Company exited an existing lease and ceased use of the space. As a result, the Company recorded a restructuring charge of \$1.9 million, representing the relative portion of remaining future lease payments, along with other exit costs related to the facility closure, and net of a \$0.9 million non-cash write-off of the related deferred rent and landlord inducement liability. The remaining future lease payments will be paid over the underlying remaining lease term.

Also, during the first quarter of fiscal year 2020, the Company incurred additional charges in connection with a restructuring program that was initiated in fiscal year 2019 in its Learning segment to streamline operations. The Company incurred \$3.6 million and \$0.8 million of severance related costs during the fourth quarter of fiscal year 2019 and the first quarter of fiscal year 2020, respectively, with cash payments expected to be made through the fourth quarter of fiscal year 2020. In connection with this initiative, in fiscal year 2019, the Company vacated an office and recorded \$5.2 million of charges, net of non-cash write-offs and net of sublease estimates. Additionally, in the first quarter of fiscal year 2020 the Company incurred \$0.2 million of other exit costs related to the facility closure. Remaining lease payments are to be paid over the underlying remaining lease terms and other exit costs are expensed as incurred.

Also, during the first quarter of fiscal year 2020, the Company incurred additional charges in connection with a restructuring program that was initiated in fiscal year 2019 in its Learning, Gale and International segments to continue the alignment of its operations to support the evolution of its changing business model, including Cengage Unlimited and its customer-focused approach. The Company incurred \$8.0 million and \$1.8 million of severance related costs during fiscal year 2019 and the first quarter of fiscal year 2020, respectively, with cash payments expected to be made through the fourth quarter of fiscal year 2020. Additionally, the Company incurred \$0.6 million and \$0.2 million of process reengineering consulting costs during fiscal year 2019 and the first quarter of fiscal year 2020, respectively. Process reengineering consulting costs are expensed as incurred.

Fiscal Year 2019

During the first quarter of fiscal year 2019, the Company initiated a restructuring program in its Gale and International segments to better align its operations to current industry conditions and position the business for growth. The Company incurred \$4.1 million of severance related costs in the first quarter of fiscal 2019 and \$4.5 million in the aggregate in fiscal year 2019.

In the remainder of fiscal year 2019, the Company initiated a restructuring program in its Learning and International segments to continue the alignment of its operations to support the evolution of its changing business model, including Cengage Unlimited and its customer-focused approach resulting in a total of \$1.0 million of severance related costs in the aggregate in fiscal year 2019. The Company also recorded a \$0.4 million increase in estimated future sublease income on the floors within its offices that were vacated during fiscal year 2018.

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements

Operational restructuring and other charges recognized in the accompanying condensed consolidated statements of operations by segment were as follows:

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018
Learning	\$ 1.3	\$ —
Gale	0.5	3.9
International	0.1	0.2
Corporate	3.0	—
Total operational restructuring and other charges, net	4.9	4.1
Less: non-cash write-off	(0.9)	—
Total charges expected to be settled in cash	<u>\$ 5.8</u>	<u>\$ 4.1</u>

The following table summarizes cash activity for restructuring reserves, which is included in other current liabilities and other non-current liabilities in the accompanying condensed consolidated balance sheets:

<i>(in millions)</i>	Process reengineering consulting				Lease Exit and Other		Total	
	Severance							
Balance as of March 31, 2019	\$ 10.0	\$ —	\$ 7.0	\$ 17.0				
Charges, net	2.6	0.2	2.1	4.9				
Non-cash write-off	—	—	0.9	0.9				
Cash payments	(6.8)	(0.2)	(1.5)	(8.5)				
Balance as of June 30, 2019	<u>\$ 5.8</u>	<u>\$ —</u>	<u>\$ 8.5</u>	<u>\$ 14.3</u>				
Balance as of March 31, 2018	\$ 2.7	\$ —	\$ 3.7	\$ 6.4				
Charges, net	4.1	—	—	4.1				
Cash payments	(2.9)	—	(0.4)	(3.3)				
Balance as of June 30, 2018	<u>\$ 3.9</u>	<u>\$ —</u>	<u>\$ 3.3</u>	<u>\$ 7.2</u>				

The Company's total restructuring liability was reported as follows:

<i>(in millions)</i>	As of	
	June 30, 2019	March 31, 2019
Other current liabilities	\$ 11.5	\$ 14.0
Other non-current liabilities	2.8	3.0
Total restructuring liability	<u>\$ 14.3</u>	<u>\$ 17.0</u>

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

7. DEBT

Debt, related maturities and interest rates were as follows as of June 30, 2019 and March 31, 2019:

<i>(in millions)</i>	Original Maturity	Interest Rate as of		June 30, 2019	March 31, 2019
		June 30, 2019	March 31, 2019		
Current portion:					
Term Loan	2023	6.65%	6.74%	\$ 17.1	\$ 17.1
Capital lease	2019			—	0.1
Total current portion of long-term debt				17.1	17.2
Non-current portion:					
Senior Notes	2024	9.50%	9.50%	620.0	620.0
Term Loan	2023	6.65%	6.74%	1,641.6	1,645.9
Unamortized Term Loan discount				(9.6)	(10.2)
Unamortized deferred financing costs				(19.6)	(20.9)
Total non-current portion of long-term debt				2,232.4	2,234.8
Total debt				\$ 2,249.5	\$ 2,252.0

Scheduled principal payments due on the Company's debt as of June 30, 2019 for each of the years ended March 31 are as follows:

<i>(in millions)</i>	
Fiscal Years Ending March 31,	
Remainder of fiscal year 2020	\$ 12.8
2021	17.1
2022	17.1
2023	17.1
2024	1,594.6
Thereafter	620.0
Total	\$ 2,278.7

On June 7, 2016, Cengage Learning, Inc., a wholly-owned subsidiary of the Company, issued 9.50% senior notes ("Senior Notes") and amended and restated its senior secured term loan facility ("Term Loan") and its asset based lending revolving line of credit ("ABL Revolving Credit Facility").

In February 2017, the Company's Board of Directors approved an authorization of up to \$100 million to purchase in the open market its 9.50% Senior Notes and/or Term Loan.

Senior Notes

On June 7, 2016, Cengage Learning, Inc. issued \$620.0 million aggregate principal amount Senior Notes in a private placement, maturing June 15, 2024. The Senior Notes bear interest at a rate of 9.50% per annum, payable semi-annually in arrears on June 15 and December 15 of each year. The Company has the option to redeem the Senior Notes, in whole or in part, at any time, at certain redemption prices as defined in the indenture. In addition, under the terms of the Senior Notes the Company may repurchase the Senior Notes in part, at any time, in the open market, in accordance with federal securities regulations.

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

The indenture related to the Senior Notes contains certain covenants that the Company may be subject to which restrict its and its subsidiaries' ability to, among other things: incur additional indebtedness or issue certain disqualified shares and preferred shares; create liens; pay dividends or distributions or redeem or repurchase equity; prepay subordinated debt or make certain investments; transfer and sell assets; engage in a consolidation or merger or sell, transfer or otherwise dispose of all or substantially all of its assets; and enter into certain transactions with affiliates. The Company will not be subject to these covenants if (i) the Senior Notes have Investment Grade Ratings from the relevant rating agencies, as defined in the terms of the Senior Notes, and (ii) no default has occurred and is continuing under the indenture. As of June 30, 2019, no default has occurred and the Company is compliant with all of the covenants of the indenture.

Term Loan

The Term Loan provides for senior secured term loans in an aggregate principal amount of \$1,710.0 million and matures on June 7, 2023. In addition, the Company may request one or more incremental credit facilities in an aggregate amount of up to \$500.0 million, plus additional amounts subject to certain requirements. Borrowings under the Term Loan bear interest at a rate equal to, at the Company's option, either (a) a LIBOR rate determined by reference to the costs of funds for Eurodollar deposits for the interest period relevant to such borrowing, adjusted for certain additional costs, subject to a 1.00% floor ("Eurocurrency Rate Loan"), or (b) a base rate determined by reference to the highest of (i) the federal funds rate plus 0.50%, (ii) the prime rate and (iii) the one-month adjusted LIBOR rate plus 1.00%, in each case plus an applicable margin. As of June 30, 2019, the Company elected to carry the Term Loan as a Eurocurrency Rate Loan with an effective interest rate of 6.65%.

The Company is required to repay 0.25% of the original principal amount of the Term Loan on the last business day of each quarter. Following the end of each fiscal year the Company must prepay a percentage between 0% and 50%, based on its total leverage ratio, of its Excess Cash Flow, as defined in the Term Loan agreement, within five business days after delivery of the financial statements. Based on the Company's consolidated financial statements for the fiscal year ended March 31, 2019, the Company determined there was no prepayment due under the Excess Cash Flow provision. Prepayments made under the Excess Cash Flow provision are used to satisfy prospective mandatory quarterly principal repayments. The Company is also required to prepay loans with net proceeds from asset sales, casualty events, or issuances of indebtedness, subject to, in the case of asset sales and casualty events, reinvestment rights by the Company within certain time restrictions. The Company may prepay or repurchase the Term Loan, in whole or in part, at any time, without penalty.

ABL Revolving Credit Facility

The availability of credit under the amended and restated five-year ABL Revolving Credit Facility, which expires on June 7, 2021, is equal to the lesser of (i) \$250.0 million and (ii) the Company's borrowing base. The borrowing base equals the sum of (i) 90% of eligible credit card receivables, plus (ii) 85% of eligible receivables, plus (iii) 85% of the orderly liquidation value of eligible inventory, plus (iv) 100% of cash not to exceed \$35.0 million. As of June 30, 2019 and March 31, 2019, the ABL Revolving Credit Facility had no outstanding borrowings and \$21.7 million and \$22.8 million, respectively, in issued and outstanding letters of credit. The Company's available borrowing base as of June 30, 2019, which is based on the balance sheet at May 31, 2019, was \$94.0 million, net of letters of credit.

The unused commitment fee will range between 0.25% and 0.375%, based upon the average facility usage for the most recently ended fiscal quarter. Outstanding letters of credit are also subject to a quarterly letter of credit participation fee will vary between 1.75% and 2.25%, depending on the average daily availability. For both the three months ended June 30, 2019 and 2018, the commitment and participation fees were insignificant.

8. EQUITY

Share Repurchase Programs

The Company repurchases shares from certain employees in order to satisfy employee tax withholding requirements in connection with the vesting of restricted stock units and delivery of the underlying shares. During the three months ended June 30, 2019 and 2018, the Company spent \$0.3 million and \$2.3 million, respectively, to acquire shares in connection with equity-based awards.

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

9. EQUITY-BASED COMPENSATION

The following table summarizes the Company’s equity-based compensation expense recognized in selling, general and administrative expenses, excluding depreciation in the accompanying condensed consolidated statements of operations:

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018
Stock options	\$ 0.3	\$ 0.4
Restricted stock units	0.5	2.0
Equity-based compensation expense	\$ 0.8	\$ 2.4

2014 Equity Incentive Plan

As of June 30, 2019, there was approximately \$9.1 million of total unrecognized compensation cost related to stock options and restricted stock units (“RSUs”) granted under the equity incentive plan adopted by the Company in 2014 (the “2014 Equity Incentive Plan”) expected to be recognized over a weighted-average vesting period of 2.7 years. In addition, there was approximately \$4.0 million of unrecognized compensation cost related to non-vested performance-based RSUs granted under the 2014 Equity Incentive Plan, which will not be recognized until the performance condition is probable of being achieved.

2018 Equity Incentive Plan

As of June 30, 2019, there was approximately \$11.8 million of unrecognized compensation costs related to non-vested performance-based stock options and performance-based RSUs granted under the equity incentive plan adopted by the Company's Board of Directors and the majority shareholders effective as of November 15, 2018 (the “2018 Equity Incentive Plan”) which will not be recognized until the performance condition is probable of being achieved.

10. INCOME TAXES

For interim income tax reporting, the Company estimates its annual effective tax rate and applies it to year-to-date ordinary income (loss). Tax jurisdictions with a projected or year-to-date loss for which a tax benefit cannot be realized are excluded. The tax effects of unusual or infrequently occurring items are reported in the interim period in which they occur. The effect of a change in tax laws or rates on a deferred tax liability or asset is recognized in the quarter in which the tax legislation is enacted.

The benefit from income taxes was \$17.7 million and \$18.4 million for the three months ended June 30, 2019 and 2018, respectively with a corresponding effective income tax rate of 21.2% for both periods presented.

As of March 31, 2019, the Company had estimated federal net operating loss (“NOL”) carryforwards of \$566.0 million that will begin to expire in 2035 if not utilized. In addition, the Company had estimated state NOL carryforwards of \$765.6 million that will begin to expire in 2020 if not utilized. These NOL carryforwards can be used to offset taxable income in future periods and reduce the Company's income taxes payable in those future periods. At this time, the Company considers it more likely than not that the Company will have sufficient future taxable income in the form of reversals of existing taxable temporary differences that will allow the Company to realize these tax attributes. However, it is possible that in a future period, the generation of deferred tax assets will exceed the taxable temporary differences and at that point a valuation allowance against the Company's federal and state net deferred tax asset may be required.

11. FAIR VALUE MEASUREMENTS

Recurring Measurements

As of June 30, 2019 and March 31, 2019, the Company had no assets and liabilities measured at fair value on a recurring basis.

Non-Recurring Measurements

Non-financial assets and liabilities, which include goodwill, identifiable intangible assets, property, equipment and capitalized internal-use software, net, and various liabilities, are not required to be measured at fair value on a recurring basis. However, if an impairment test is required, the Company evaluates the non-financial assets and liabilities for impairment. If

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

impairment is determined to have occurred, the asset or liability is required to be written down to its estimated fair value. During the three months ended June 30, 2019 and 2018, the Company did not recognize any impairments of its non-financial assets and liabilities.

Other Fair Value Disclosures

In addition to fair value disclosure requirements related to financial instruments carried at fair value, accounting standards require disclosures regarding the fair value of all of the Company's financial instruments. The carrying value and estimated fair value of long-term debt, including the current portion, is as follows:

	<u>As of</u>		<u>As of</u>	
	<u>June 30, 2019</u>		<u>March 31, 2019</u>	
<i>(in millions)</i>	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Senior Notes ⁽¹⁾	\$ 614.3	\$ 585.1	\$ 614.0	\$ 506.6
Term Loan ⁽²⁾	1,635.2	1,569.8	1,637.9	1,470.0

⁽¹⁾ The carrying amount for the Senior Notes is presented net of the unamortized deferred financing costs of \$5.7 million and \$6.0 million as of June 30, 2019 and March 31, 2019, respectively.

⁽²⁾ The carrying amount for the Term Loan as of June 30, 2019 and March 31, 2019, is presented net of the unamortized original issue discount and deferred financing costs of \$23.5 million and \$25.1 million, respectively.

The estimated fair values of the Company's Senior Notes and Term Loan are based on information from a pricing service or broker quotes and may not represent prices on which such debt may be transacted. Therefore, the debt is classified as Level 3 in the fair value hierarchy. The carrying values of cash and cash equivalents approximated their fair values as of June 30, 2019 and March 31, 2019, due to the short-term nature of these instruments.

12. SUPPLEMENTAL CASH FLOW INFORMATION

Details of "Changes in operating assets and liabilities, net of acquisitions" in the condensed consolidated statements of cash flows were as follows:

<i>(in millions)</i>	<u>Three Months Ended June 30,</u>	
	<u>2019</u>	<u>2018</u>
Accounts receivable, net	\$ 15.7	\$ 11.3
Inventories	(5.5)	(5.6)
Prepaid expenses and other current assets	4.0	(4.8)
Author advances	(0.8)	2.5
Accounts payable and accrued expenses	(29.6)	(6.3)
Accrued interest payable	(16.1)	(15.4)
Deferred revenue	(43.6)	(44.8)
Income taxes payable	(0.1)	(0.6)
Other, net	(2.7)	(1.1)
	<u>\$ (78.7)</u>	<u>\$ (64.8)</u>

Non-cash Investing Activities

Additions to pre-publication costs and property, equipment and capitalized internal-use software included in accounts payable and accrued expenses in the condensed consolidated balance sheets were as follows:

<i>(in millions)</i>	<u>Three Months Ended June 30,</u>	
	<u>2019</u>	<u>2018</u>
Additions to pre-publication costs	\$ 4.1	\$ 3.9
Additions to property, equipment and capitalized internal-use software	6.5	2.2

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

13. COMMITMENTS AND CONTINGENCIES

Claims, Disputes and Legal and Regulatory Actions

From time to time, the Company may become involved in various claims, disputes and legal or regulatory proceedings that arise in the ordinary course of business or that relate to contractual and other obligations. The Company assesses its potential contingent and other liabilities by analyzing claims, disputes and legal and regulatory matters using available information and develops its views on estimated losses in consultation with its legal and other advisors. The Company determines whether a loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. If the contingency is not probable or cannot be reasonably estimated, disclosure of the contingency shall be made when there is at least a reasonable possibility that a material loss for which the Company is responsible may have been incurred.

Adverse developments relating to claims, disputes and legal and regulatory proceedings in which the Company is or becomes involved could cause a change in its determination as to an unfavorable outcome and result in the need to recognize a material accrual. Should any of these matters result in a final adverse judgment, settlement or other final resolution involving material amounts, it could have a material adverse effect on the Company's financial position, results of operations and cash flows.

Based on a review of the information available at this time, the Company does not expect the total cost of resolving all other current claims, disputes and legal and regulatory proceedings will have a material adverse effect on the condensed consolidated financial position, results of operations or cash flows.

Warranties

The Company's standard terms and conditions of sale warrants ownership of and/or licensing rights to the Company's products and provides certain warranties and indemnifications. The Company is not aware of any instances that would result in any material payments being made as a result of these warranties and indemnifications, and therefore, no reserve has been recorded in the condensed consolidated financial statements.

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

14. SEGMENT INFORMATION

The Company is organized into three reportable segments on the basis of production process and products and services provided by each segment, identified as follows:

Learning—in the United States, the Company produces a variety of digital and print educational solutions and associated services for the academic, skills and school industries.

Gale—the Company offers research platforms around the world which provide access to its original content, collections of primary source materials and aggregated periodicals to learners at libraries, colleges, universities, schools and businesses.

International—the Company distributes educational solutions across all major academic disciplines, provides English language teaching (“ELT”) products and adapts its Learning offerings for use in multiple countries and territories around the world.

When determining reportable segments, the Company aggregated operating segments based on their similar economic and operating characteristics.

The accounting policies applied by the segments are the same as those applied by the Company. All transactions between reportable segments are eliminated upon consolidation. The Company allocates its corporate and shared services costs to each of its segments using either number of employees, specific identification or activity, or revenue. The Company discloses information about its reportable segments based on the measures used in assessing the performance of those reportable segments. These measures are on a constant currency basis, which removes the impact of changes in foreign currency exchange rates. To calculate constant currency basis, the Company converts current period and prior period results from local currency to U.S. dollars using standard internal currency exchange rates held constant for each year. As needed, the Company recasts segment information for the prior period based on its internally-derived standard currency exchange rates used for the current period in order to remove the impact of foreign currency exchange fluctuation.

The Company uses Adjusted Revenues and Adjusted EBITDA less Pre-Publication Costs to measure the operating performance of its segments because it believes that these measures provide a meaningful basis for reviewing the results of operations by eliminating the effects of financing decisions, as well as excluding the impact of activities not related to its ongoing operating business. Adjusted Revenues is defined as revenues before the impact of changes in foreign currency exchange rates. Adjusted EBITDA less Pre-Publication Costs is defined as net income (loss) before: benefit from (provision for) income taxes; interest expense, net; amortization of identifiable intangible assets; depreciation; operational restructuring and other charges, net; amortization of pre-publication costs; other income (expense), net, below operating income (loss); equity-based compensation expense; non-core other operating expense; and merger-related costs, in the accompanying condensed consolidated statements of operations, less additions to pre-publication costs on an accrual basis. This measure also removes the impact of changes in foreign currency exchange rates on the items noted above. By reducing Adjusted EBITDA by pre-publication costs, the Company includes the impact of re-investment within the segments, primarily for content and digital platform technology.

Segment Adjusted Revenues, which only includes revenues from external customers, and the reconciliation to total revenues per the condensed consolidated statements of operations is as follows:

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018⁽¹⁾
Learning ⁽²⁾	\$ 177.7	\$ 181.2
Gale	46.2	50.6
International ⁽²⁾	59.3	54.4
Segment Adjusted Revenues	283.2	286.2
Impact of foreign currency	(0.6)	2.1
Total Revenues	<u>\$ 282.6</u>	<u>\$ 288.3</u>

(1) Prior year amounts have been recast to current year standard internal currency exchange rates.

(2) Prior year amounts have been recast to conform to current year presentation for an immaterial product line transfer.

CENGAGE LEARNING HOLDINGS II, INC.
Notes to the Condensed Consolidated Financial Statements
(UNAUDITED)

Segment Adjusted EBITDA less Pre-Publication Costs and the reconciliation to net loss per the condensed consolidated statements of operations is as follows:

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018⁽¹⁾
Learning ⁽²⁾	\$ 5.8	\$ (1.2)
Gale	5.0	9.4
International ⁽²⁾	5.5	0.7
Total Segment Adjusted EBITDA less Pre-Publication Costs	16.3	8.9
Additions to pre-publication costs ⁽³⁾	19.3	18.7
Impact of foreign currency	(0.3)	0.4
Equity-based compensation expense	(0.8)	(2.4)
Non-core other operating expenses ⁽⁴⁾	(2.0)	(2.4)
Merger-related costs	(9.2)	—
Amortization of pre-publication costs	(23.7)	(24.9)
Operational restructuring and other charges, net	(4.9)	(4.1)
Depreciation	(15.6)	(17.0)
Amortization of identifiable intangible assets	(20.4)	(23.7)
Other income, net	1.6	1.8
Interest expense, net	(43.8)	(42.2)
Benefit from income taxes	17.7	18.4
Net loss	\$ (65.8)	\$ (68.5)

(1) Prior year amounts have been recast to current year standard internal currency exchange rates.

(2) Prior year amounts have been recast to conform to current year presentation for an immaterial product line transfer.

(3) Additions to pre-publication costs are excluded from segment Adjusted EBITDA less Pre-Publication Costs on a constant currency and accrual basis. The impact of foreign currency exchange related to additions to pre-publication costs was less than \$0.1 million in all periods presented.

(4) For the three months ended June 30, 2019 and 2018, non-core other operating expenses includes primarily bank fees, duplicate rent expense, net, incurred during the build-out phase of the Company's new headquarters in Boston, and management fees.

15. SUBSEQUENT EVENTS

There were no material subsequent events identified through August 7, 2019, the date these condensed consolidated financial statements were issued.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to facilitate an understanding of the results of operations and financial condition of Cengage Learning Holdings II, Inc. and its consolidated subsidiaries ("us," "we" and "our").

Overview

We are a leading global provider of high-quality content and innovative digital learning solutions for the global academic, school, skills and research markets. We are a publisher of course materials in the United States higher education segment of the academic market, with strong positions across all major disciplines. Our offerings to customers include technology and academic services, including digital homework solutions and support services for use of our digital products, in response to market demand for more fully integrated solutions. In addition, operating under our Gale brand, we are a leading global provider of library reference materials with a vast collection of primary source content.

We are organized into three reportable segments on the basis of production process and products and services provided by each segment, identified as follows:

Learning—in the United States, we produce a variety of digital and print educational solutions and associated services for the academic, skills and school industries.

Gale—we offer research platforms around the world which provide access to our original content, collections of primary source materials and aggregated periodicals to learners at libraries, colleges, universities, schools and businesses.

International—we distribute educational solutions across all major academic disciplines, provide English language teaching ("ELT") products and adapt our Learning offerings for use in multiple countries and territories around the world.

When determining reportable segments, the Company aggregated operating segments based on their similar economic and operating characteristics.

This MD&A is provided as a supplement to, and should be read in conjunction with, our condensed consolidated financial statements and the accompanying notes and our Annual Report for the fiscal year ended March 31, 2019 (the "2019 Annual Report"). The following discussion and analysis of our financial condition and results of operations may contain forward-looking statements about our business, operations and industry that involve risks and uncertainties, such as statements regarding our plans, objectives, expectations and intentions. Our future results and financial condition may differ materially from those we currently anticipate. See "Special Note Regarding Forward-Looking Statements" earlier in this report. We refer to our fiscal year ended March 31, 2019, as fiscal year 2019, and fiscal year ended March 31, 2020, as fiscal year 2020.

Management reviews segment performance on a constant currency basis, which removes the impact of changes in foreign currency exchange rates by converting current period and prior period amounts from local currency to U.S. dollars using standard internal currency exchange rates held constant for each year. This allows us to evaluate underlying current operating performance in comparison to past operating performance. As needed, we recast segment information for the prior period based on our internally-derived standard currency exchange rates used for the current period in order to remove the impact of foreign currency exchange fluctuation.

To supplement our condensed consolidated financial statements presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"), we have presented certain non-GAAP financial measures in addition to our GAAP results. We believe that these non-GAAP financial measures provide useful information for evaluating our business performance. We believe that the presentation of Adjusted Revenues and Adjusted EBITDA is appropriate to provide additional information to investors about certain material non-cash items and about unusual items that we do not expect to continue at the same level in the future as well as other items. Further, we believe Adjusted EBITDA provides a meaningful measure of operating profitability because we use it for evaluating our business performance and understanding certain significant items. This information should be considered as supplemental in nature and should not be considered in isolation or as a substitute for the related financial information prepared in accordance with GAAP. In addition, these non-GAAP financial measures may not be the same as similarly entitled measures reported by other companies.

Our definition of Adjusted EBITDA allows us to add back certain non-cash and other charges or costs that are deducted in calculating net income from continuing operations. However, these are expenses that may recur, vary greatly and can be difficult to predict. They can represent the effect of long-term strategies as opposed to short-term results. In addition, certain of these expenses can represent the reduction of cash that could be used for other corporate purposes.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

We present the following non-GAAP financial measures in this report:

Measure	Definition
Adjusted Revenues	This measure is defined as revenues before the impact of changes in foreign currency exchange rates.
Adjusted EBITDA	This measure is defined as net income (loss) before: (benefit from) provision for income taxes; interest expense, net; amortization of identifiable intangible assets; depreciation; operational restructuring and other charges, net; amortization of pre-publication costs; other income (expense), net, below operating income (loss); equity-based compensation expense; non-core other operating expenses; and merger-related costs. This measure also removes the impact of changes in foreign currency exchange rates on the items noted above.
Adjusted EBITDA less Pre-Publication Costs	This measure reflects Adjusted EBITDA less additions to pre-publication costs on an accrual basis, which are costs incurred prior to the publication date of a title or release date of a product and represent activities associated with product development not limited to editorial review and fact verification, graphic art design and layout and the process of conversion from print to digital media or within various formats of digital media. In addition, pre-publication costs include the cost to procure perpetual rights for the use of content which have been developed by third parties and are to be included in our products. Costs are capitalized when the title is expected to generate probable future economic benefits and are amortized upon publication of the title over its estimated operating life cycle.
Adjusted EBITDA less Capital Expenditures	This measure reflects Adjusted EBITDA less additions to pre-publication costs and property, equipment and capitalized internal-use software on an accrual basis.

See "Reconciliations of Non-GAAP Financial Measures" for reconciliations to the most directly comparable financial measures prepared in accordance with GAAP.

Proposed Merger

On May 1, 2019, we entered into a definitive agreement with McGraw-Hill, pursuant to which, at the Effective Time and subject to the terms and conditions of the Merger Agreement, Cengage and McGraw-Hill will combine in a "merger of equals" transaction and our stockholders will receive shares of capital stock representing exactly 50% of the issued and outstanding shares of voting common stock of the combined company. We have agreed to operate our business in the ordinary course during the period between the execution of the Merger Agreement and the Effective Time, subject to certain agreed exceptions. Completion of the Merger is subject to certain conditions, including receipt of regulatory approvals. Cengage and McGraw-Hill submitted Hart-Scott-Rodino Act filings with the U.S. Department of Justice and Federal Trade Commission on May 31, 2019. We are working towards closing the transaction in early 2020.

Cengage estimates contingent fees and expenses upon successful merger closing are estimated to be approximately \$20 million, none of which have been accrued as of June 30, 2019.

Seasonality and Comparability

Our revenues, operating profit and operating cash flows are impacted by the inherent seasonality of the academic calendar. This seasonality affects our working capital requirements and hence our overall financing needs. For example, we typically incur a net cash deficit from all of the activities in our first and fourth quarters of our fiscal year which ends on March 31. In addition, changes in our customers' ordering patterns may impact the comparison of our results in a quarter with the same quarter of the previous year, or in a fiscal year with the prior fiscal year, where our customers may shift the timing of material orders for a number of reasons, including, but not limited to, changes in academic semester start dates, changes in inventory management practices, and a shift in customer base driven by an increase in direct to student subscription products.

As we continue to migrate our service offerings towards hosted digital solutions that are delivered over a period of time, the associated revenues will be recognized ratably over the applicable subscription period, with amounts billed in excess of revenues recognized reflected as deferred revenue. This represents a change from traditional print products where revenues are typically recognized upon shipment of the material to the customer. Reported revenues will shift from being driven by sales in the same period to deferred recognition as revenues attributable to hosted digital solutions are recognized in subsequent periods. Deferred revenue represents amounts billed in advance from our customers that will be recognized as revenues in subsequent periods as products and services are delivered to customers. The current portion of deferred revenue was \$137.9 million and \$182.9 million as of June 30, 2019 and March 31, 2019, respectively, and the non-current portion of deferred revenue was \$33.9 million and \$32.9 million as of June 30, 2019 and March 31, 2019, respectively.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in these condensed consolidated financial statements and accompanying notes. Although these estimates are based on management's best knowledge of current events and actions that we may undertake in the future, actual results could differ from those estimates. These estimates include, but are not limited to, reserves for sales returns and inventory obsolescence, the allowance for doubtful accounts, deferred tax assets and liabilities, the valuation allowances for deferred tax assets, operational restructuring and other charges, legal and tax contingencies, purchase accounting and equity-based compensation, as well as future cash flows and fair values used in the assessment of the realizability of long-lived assets, goodwill and identifiable intangible assets.

Operational Restructuring and Other Charges

Fiscal Year 2020

During the first quarter of fiscal year 2020, we exited an existing lease and ceased use of the space. As a result, we recorded a restructuring charge of \$1.9 million, representing the relative portion of remaining future lease payments, along with other exit costs related to the facility closure, and net of a \$0.9 million non-cash write-off of the related deferred rent and landlord inducement liability. The remaining future lease payments will be paid over the underlying remaining lease term.

Also, during the first quarter of fiscal year 2020, we incurred additional charges in connection with a restructuring program that was initiated in fiscal year 2019 in our Learning segment to streamline operations. We incurred \$3.6 million and \$0.8 million of severance related costs during the fourth quarter of fiscal year 2019 and the first quarter of fiscal year 2020, respectively. In connection with this initiative, in fiscal year 2019, we vacated an office and recorded \$5.2 million of charges, net of non-cash write-offs and net of sublease estimates, additionally in the first quarter of fiscal year 2020, we incurred \$0.2 million of other exit costs related to the facility closure. Remaining lease payments are to be paid over the underlying remaining lease terms and other exit costs are expensed as incurred.

Also, during the first quarter of fiscal year 2020, we incurred additional charges in connection with a restructuring program that was initiated in fiscal year 2019 in our Learning, Gale and International segments to continue the alignment of its operations to support the evolution of its changing business model, including Cengage Unlimited and its customer-focused approach. We incurred \$8.0 million and \$1.8 million of severance related costs during fiscal year 2019 and the first quarter of fiscal year 2020, respectively. Additionally, we incurred \$0.6 million and \$0.2 million of process reengineering consulting costs during the fiscal year 2019 and the first quarter of fiscal year 2020, respectively.

Fiscal Year 2019

During the first quarter of fiscal year 2019, we initiated a restructuring program in our Gale and International segments to better align our operations to current industry conditions and position the business for growth. We incurred \$4.1 million of severance related costs in the first quarter of fiscal 2019 and \$4.5 million in the aggregate in fiscal year 2019.

In the remainder of fiscal year 2019, we initiated a restructuring program in our Learning and International segments to continue the alignment of our operations to support the evolution of our changing business model, including Cengage Unlimited and its customer-focused approach resulting in \$1.0 million of severance related costs in the aggregate in fiscal year 2019. We also recorded a \$0.4 million increase in estimated future sublease income on the floors within our offices that were vacated during the fiscal year ended March 31, 2018.

Additional information on operational restructuring and other charges is provided in Note 6, "Operational Restructuring and Other Charges" to our condensed consolidated financial statements.

Critical Accounting Policies

There were no significant changes to our critical accounting policies during the three months ended June 30, 2019. For further information on our critical accounting policies, refer to our 2019 Annual Report.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Financial Performance

Consolidated Results of Operations

The Three Months Ended June 30, 2019 Compared with June 30, 2018

<i>(in millions)</i>	Three Months Ended June 30,		Change	
	2019	2018	\$	%
Revenues	\$ 282.6	\$ 288.3	\$ (5.7)	(2.0)%
Cost of revenues, excluding amortization of pre-publication costs and identifiable intangible assets and depreciation stated below	142.1	148.3	(6.2)	(4.2)%
Amortization of pre-publication costs	23.7	24.9	(1.2)	(4.8)%
Amortization of identifiable intangible assets	1.2	1.2	—	— %
Total cost of revenues, excluding depreciation stated below	167.0	174.4	(7.4)	(4.2)%
Selling, general and administrative expenses, excluding depreciation stated below	108.0	116.8	(8.8)	(7.5)%
Merger-related costs	9.2	—	9.2	NM
Operational restructuring and other charges, net	4.9	4.1	0.8	19.5 %
Depreciation	15.6	17.0	(1.4)	(8.2)%
Amortization of identifiable intangible assets	19.2	22.5	(3.3)	(14.7)%
Total costs and expenses	323.9	334.8	(10.9)	(3.3)%
Operating loss	(41.3)	(46.5)	5.2	(11.2)%
Other income, net	1.6	1.8	(0.2)	(11.1)%
Interest income	1.5	0.9	0.6	66.7 %
Interest expense	(45.3)	(43.1)	(2.2)	5.1 %
Loss before taxes	(83.5)	(86.9)	3.4	(3.9)%
Benefit from income taxes	17.7	18.4	(0.7)	(3.8)%
Net loss	\$ (65.8)	\$ (68.5)	\$ 2.7	(3.9)%
Adjusted Revenues ⁽¹⁾⁽²⁾	\$ 283.2	\$ 286.2	\$ (3.0)	(1.0)%
Adjusted EBITDA ⁽¹⁾⁽²⁾	\$ 35.6	\$ 27.6	\$ 8.0	29.0 %
Adjusted EBITDA less Pre-Publication Costs ⁽¹⁾⁽²⁾	\$ 16.3	\$ 8.9	\$ 7.4	83.1 %
Adjusted EBITDA less Capital Expenditures ⁽¹⁾⁽²⁾	\$ (9.9)	\$ (5.3)	\$ (4.6)	86.8 %

⁽¹⁾ See “Overview” for the definition of this non-GAAP financial measure, “Segment Operating Results” for discussion and “Reconciliations of Non-GAAP Financial Measures” for reconciliations to the most directly comparable financial measures prepared in accordance with GAAP.

⁽²⁾ Prior year amounts have been recast to current year standard internal currency exchange rates.

NM = Not meaningful

The Three Months Ended June 30, 2019 Compared with June 30, 2018

Revenues

Revenues for the three months ended June 30, 2019 decreased \$5.7 million, or 2.0%, to \$282.6 million, compared to the prior year period. The decrease was primarily due to a \$3.5 million decline in the Learning segment related to a decrease of sales into the higher education non-profit market; a \$4.4 million decline in the Gale segment related to decreases in sales in the higher education and school channels in the United States and timing of orders in EMEA; and a \$2.7 million reduction in

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

revenue due to adverse foreign exchange fluctuations. These decreases were partially offset by an increase in revenue from our International segment, which increased \$4.9 million primarily due to the timing of orders of school product in Australia.

Operating Costs and Expenses

Cost of Revenues

Total cost of revenues, excluding amortization of prepublication costs, amortization of intangible assets and depreciation for the three months ended June 30, 2019 decreased \$6.2 million, or 4.2%, compared to the prior year period. The decrease was primarily due to a \$3.1 million decrease in royalty expense driven by lower sales and movement in reserves for anticipated returns; a \$2.7 million decrease in software development costs; a \$1.4 million decrease in employee compensation and related costs substantially due to a reduction in headcount; a \$1.0 million decrease in distribution related expenses; and a \$0.5 million decrease in inventory obsolescence expense. These increases were partially offset by a \$1.7 million increase in print, paper and binding costs that is primarily attributable to the increased sales of school products in Australia and a \$1.4 million increase in technology infrastructure maintenance.

Amortization of prepublication costs decreased \$1.2 million, or 4.8%, during the three months ended June 30, 2019, primarily related to certain assets becoming fully depreciated.

Amortization of intangible assets was \$1.2 million for both the three months ended June 30, 2019 and 2018.

Operating Expenses

Selling, general and administrative expenses, excluding depreciation decreased \$8.8 million, or 7.5%, to \$108.0 million for the three months ended June 30, 2019, primarily due to a \$5.1 million decrease in employee compensation and related costs substantially due to a reduction in headcount; a \$1.6 million decrease in equity-based compensation expenses due to certain equity awards becoming fully vested; a \$1.4 million decrease in sales and marketing expenses; a \$1.0 million decrease in rent expense related to the San Francisco office closure, which is now recorded within operational restructuring and other charges, net; and a \$0.8 million decrease in technology infrastructure expenses. These decreases were partially offset by a \$0.7 million increase in outside service fees and a \$0.5 million increase in rent expense, net, incurred during the build-out phase of our new headquarters in Boston.

Merger-related costs was \$9.2 million in the three months ended June 30, 2019, primarily related to integration planning costs, legal fees, rating agency fees and professional services associated with the proposed merger with McGraw-Hill.

Operational restructuring and other charges, net was \$4.9 million in the three months ended June 30, 2019. The \$4.9 million, net, is primarily related to \$2.6 million of severance costs, \$0.2 million of process reengineering consulting costs, and \$2.1 million of net lease exit costs. Charges in the prior year period of \$4.1 million, net, was primarily related to severance costs incurred under the restructuring program in our Gale segment.

Depreciation decreased \$1.4 million, or 8.2%, during the three months ended June 30, 2019, primarily related to leasehold improvement assets that were accelerated in the prior year in readiness for the relocation of the corporate headquarters in Boston.

Amortization of identifiable intangible assets decreased \$3.3 million, or 14.7%, in the three months ended June 30, 2019, primarily related to certain assets becoming fully amortized.

Non-Operating Items

Other income, net for the three months ended June 30, 2019 and 2018 was \$1.6 million and \$1.8 million, respectively, primarily related to foreign currency transaction gains.

Interest expense increased \$2.2 million, or 5.1%, to \$45.3 million for the three months ended June 30, 2019, primarily due to an increase in the LIBOR rate applicable to our Term Loan.

Benefit from Income Tax

Benefit from income taxes was \$17.7 million and \$18.4 million for the three months ended June 30, 2019 and 2018, respectively. The current year decrease in the tax benefit compared with the prior year period is primarily due to a lower pre-tax loss for the three months ended June 30, 2019.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Segment Operating Results

The Three Months Ended June 30, 2019 Compared with June 30, 2018

<i>(in millions)</i>	Three Months Ended June 30,		Change	
	2019	2018 ⁽¹⁾	\$	%
Adjusted Revenues ⁽²⁾				
Learning ⁽³⁾	\$ 177.7	\$ 181.2	\$ (3.5)	(1.9)%
Gale	46.2	50.6	(4.4)	(8.7)%
International ⁽³⁾	59.3	54.4	4.9	9.0 %
Total	\$ 283.2	\$ 286.2	\$ (3.0)	(1.0)%
Adjusted EBITDA ⁽²⁾⁽⁴⁾				
Learning ⁽³⁾	\$ 15.7	\$ 8.0	\$ 7.7	96.3 %
Gale	10.0	14.8	(4.8)	(32.4)%
International ⁽³⁾	9.9	4.8	5.1	106.3 %
Total	\$ 35.6	\$ 27.6	\$ 8.0	29.0 %
Adjusted EBITDA less Pre-Publication Costs ⁽²⁾⁽⁴⁾				
Learning ⁽³⁾	\$ 5.8	\$ (1.2)	\$ 7.0	NM
Gale	5.0	9.4	(4.4)	(46.8)%
International ⁽³⁾	5.5	0.7	4.8	NM
Total	\$ 16.3	\$ 8.9	\$ 7.4	83.1 %
Adjusted EBITDA less Capital Expenditures ⁽²⁾⁽⁴⁾				
Learning ⁽³⁾	\$ (16.3)	\$ (13.2)	\$ (3.1)	23.5 %
Gale	3.3	8.1	(4.8)	(59.3)%
International ⁽³⁾	3.1	(0.2)	3.3	NM
Total	\$ (9.9)	\$ (5.3)	\$ (4.6)	86.8 %

(1) Prior year amounts have been recast to current year standard internal currency exchange rates.

(2) See "Overview" for the definition of this Non-GAAP financial measure and "Reconciliations of Non-GAAP Financial Measures" for reconciliations to the most directly comparable financial measures prepared in accordance with GAAP.

(3) Prior year amounts have been recast to conform to current year presentation for an immaterial product line transfer.

(4) We allocate our corporate and shared services costs to each of our segments using either number of employees, specific identification or activity, or revenue.

NM = Not meaningful

The Three Months Ended June 30, 2019 Compared with June 30, 2018

Learning Adjusted Revenues for the three months ended June 30, 2019 decreased \$3.5 million, or 1.9%, primarily due to a decrease of sales into the higher education non-profit market; partially offset by the recognition of deferred digital sales.

Gale Adjusted Revenues for the three months ended June 30, 2019 decreased \$4.4 million, or 8.7%, primarily driven by a decrease in sales in the United States mostly attributable to eBook sales in the higher education and school channels and a decrease of archive sales related to a non-repeatable deal in the prior year, and a decrease in EMEA mainly attributable to university budgets and the timing of their orders.

International Adjusted Revenues for the three months ended June 30, 2019 increased \$4.9 million, or 9.0%, primarily due to the timing of order of school products in Australia; partially offset by a decline of higher education product sales in EMEA.

Learning Adjusted EBITDA less Pre-Publication Costs for the three months ended June 30, 2019 increased \$7.0 million, primarily due to a decrease in employee compensation and related costs, a decrease in travel and entertainment expenses, a decrease in software developments costs, and a decrease in sales and marketing expenses. These decreases were partially offset by the lower contribution of Learning Adjusted Revenue and an increase in pre-publication spend costs.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Gale Adjusted EBITDA less Pre-Publication Costs for the three months ended June 30, 2019 decreased \$4.4 million, or 46.8%, primarily due to the decrease in Gale Adjusted Revenue, an increase in travel and entertainment expenses, partially offset by a decrease in outside service fees and a reduction in pre-publication spend costs.

International Adjusted EBITDA less Pre-Publication Costs for the three months ended June 30, 2019 increased \$4.8 million, due to the flow through of increased International Adjusted Revenues, a decrease in employee compensation and related costs, and a decrease in royalty reserve expense, partially offset by an increase in paper, print and binding costs.

Reconciliations of Non-GAAP Financial Measures

The following table reconciles revenues to Adjusted Revenues:

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018⁽¹⁾
Revenues	\$ 282.6	\$ 288.3
Impact of foreign currency	0.6	(2.1)
Adjusted Revenues	<u>\$ 283.2</u>	<u>\$ 286.2</u>

⁽¹⁾ Prior year amounts have been recast to current year standard internal currency exchange rates.

The following table reconciles net loss to Adjusted EBITDA, Adjusted EBITDA less Pre-Publication Costs and Adjusted EBITDA less Capital Expenditures:

<i>(in millions)</i>	Three Months Ended June 30,	
	2019	2018⁽¹⁾
Net loss	\$ (65.8)	\$ (68.5)
Impact of foreign currency	0.3	(0.4)
Equity-based compensation expense	0.8	2.4
Non-core other operating expenses ⁽²⁾	2.0	2.4
Merger-related costs	9.2	—
Amortization of pre-publication costs	23.7	24.9
Operational restructuring and other charges, net	4.9	4.1
Depreciation	15.6	17.0
Amortization of identifiable intangible assets	20.4	23.7
Other income, net	(1.6)	(1.8)
Interest expense, net	43.8	42.2
Benefit from income taxes	(17.7)	(18.4)
Adjusted EBITDA	<u>35.6</u>	<u>27.6</u>
Additions to pre-publication costs ⁽³⁾	(19.3)	(18.7)
Adjusted EBITDA less Pre-Publication Costs	<u>16.3</u>	<u>8.9</u>
Additions to property, equipment and capitalized internal-use software ⁽³⁾	(26.2)	(14.2)
Adjusted EBITDA less Capital Expenditures	<u>\$ (9.9)</u>	<u>\$ (5.3)</u>

⁽¹⁾ Prior year amounts have been recast to current year standard internal currency exchange rates.

⁽²⁾ For the three months ended June 30, 2019 and 2018, non-core other operating expenses includes primarily bank fees, duplicate rent expense, net, incurred during the build-out phase of our new headquarters in Boston, and management fees.

⁽³⁾ Additions to pre-publication costs and property, equipment and capitalized internal-use software are excluded from segment Adjusted EBITDA less Pre-Publication Costs and Adjusted EBITDA less Capital Expenditures on a constant currency basis and accrual basis. The impact of foreign currency exchange related to additions to pre-publication costs and the impact of foreign currency exchange related to additions to property, equipment and capitalized internal-use software costs were immaterial in all periods presented.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Liquidity and Capital Resources

<i>(in millions)</i>	As of	
	June 30, 2019	March 31, 2019
Cash and cash equivalents	\$ 170.0	\$ 335.8
Current portion of long-term debt	17.1	17.2
Long-term debt	2,232.4	2,234.8

Our principal sources of liquidity have historically been cash flows from operations and borrowings under our revolving credit facilities. Since our cash flows from operations are impacted by the inherent seasonality of our business whereby we typically generate operating cash during the second and third quarters of our fiscal year and utilize cash for operating activities throughout the first and fourth quarters of our fiscal year, the borrowings under our revolving credit facility may vary accordingly.

Our principal uses of cash are to fund operating costs and capital expenditures, including investments in product and technology offerings, strategic acquisitions, the payment of interest and principal on our outstanding debt, and share repurchases. We expect our cash flows from operations, combined with availability under our revolving credit facility, to provide sufficient liquidity to fund our current obligations, debt service requirements, share repurchase program, projected working capital requirements, restructuring obligations, and capital spending over the next twelve months. In February 2017, our Board of Directors approved an authorization of up to \$100 million to purchase in the open market our 9.50% senior notes and/or senior secured term loan.

Long-term Debt

On June 7, 2016, Cengage Learning, Inc., our wholly owned subsidiary, issued senior notes (“Senior Notes”) and amended and restated its senior secured term loan facility (“Term Loan”) and its asset based lending revolving line of credit (“ABL Revolving Credit Facility”).

Senior Notes

On June 7, 2016, Cengage Learning, Inc., our wholly owned subsidiary, issued \$620.0 million aggregate principal amount Senior Notes in a private placement, maturing June 15, 2024. The Senior Notes bear interest at a rate of 9.50% per annum, payable semi-annually in arrears on June 15 and December 15 of each year. We have the option to redeem the Senior Notes, in whole or in part, at any time, at certain redemption prices as defined in the indenture. In addition, under the terms of the Senior Notes we may repurchase the Senior Notes in part, at any time, in the open market, in accordance with federal securities regulations.

All material, wholly owned domestic subsidiaries of Cengage Learning, Inc., subject to certain exceptions, will guarantee the Senior Notes, up to applicable legal limits. To date, there are no subsidiary guarantors of the Senior Notes.

The indenture related to the Senior Notes contains certain covenants that we may be subject to which restrict our and our subsidiaries’ ability to, among other things: incur additional indebtedness or issue certain disqualified shares and preferred shares; create liens; pay dividends or distributions or redeem or repurchase equity; prepay subordinated debt or make certain investments; transfer and sell assets; engage in a consolidation or merger or sell, transfer or otherwise dispose of all or substantially all of our assets; and enter into certain transactions with affiliates. We will not be subject to these covenants if (i) the Senior Notes have Investment Grade Ratings from the relevant rating agencies, as defined in the terms of the Senior Notes, and (ii) no default has occurred and is continuing under the indenture. As of June 30, 2019, no default has occurred and we are compliant with all of the covenants of the indenture.

Term Loan

The Term Loan provides for senior secured term loans in an aggregate principal amount of \$1,710.0 million and matures on June 7, 2023. In addition, we may request one or more incremental credit facilities in an aggregate amount of up to \$500.0 million, plus additional amounts subject to certain requirements. Borrowings under the Term Loan bear interest at a rate equal to, at our option, either (a) a LIBOR rate determined by reference to the costs of funds for Eurodollar deposits for the interest period relevant to such borrowing, adjusted for certain additional costs, subject to a 1.00% floor (“Eurocurrency Rate Loan”), or (b) a base rate determined by reference to the highest of (i) the federal funds rate plus 0.50%, (ii) the prime rate and (iii) the one-month adjusted LIBOR rate plus 1.00%, in each case plus an applicable margin. As of June 30, 2019, we elected to carry the Term Loan as a Eurocurrency Rate Loan with an effective interest rate of 6.65%.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

We are required to repay 0.25% of the original principal amount of the Term Loan on the last business day of each quarter. Following the end of each fiscal year, we must prepay a percentage between 0% and 50%, based on our total leverage ratio, of our Excess Cash Flow, as defined in the Term Loan agreement, within five business days after delivery of the financial statements. Prepayments made under the Excess Cash Flow provision are used to satisfy prospective mandatory quarterly principal repayments. We are also required to prepay loans with net proceeds from asset sales, casualty events, or issuances of indebtedness, subject to, in the case of asset sales and casualty events, reinvestment rights by us within certain time restrictions. In accordance with the Excess Cash Flow provisions of the Term Loan facility, there was no prepayment due for fiscal year 2019. We may prepay or repurchase the Term Loan, in whole or in part, at any time, without penalty.

The obligations under the Term Loan are unconditionally guaranteed by Cengage Learning Holdco, Inc., a Delaware corporation, on a limited recourse basis, and all of our direct and indirect material, wholly owned domestic restricted subsidiaries, subject to certain exceptions. The obligations will be secured by (i) second-priority security interests in all accounts receivable, loans receivable, other receivables, inventory, related books and records, certain related general intangibles (excluding intellectual property and equity interests), deposit accounts (other than deposit accounts holding solely proceeds of Non-ABL priority collateral (as defined below)), cash and proceeds of the foregoing of Cengage Learning, Inc. and each subsidiary guarantor (collectively, the "ABL priority collateral"), with the ABL Revolving Credit Facility secured by first-priority security interests therein, and (ii) first-priority security interests in substantially all assets of Cengage Learning, Inc. and each subsidiary guarantor, in each case whether owned on the closing date or thereafter acquired, other than the ABL priority collateral, including a pledge of our capital stock (prior to an IPO), the capital stock of future subsidiary guarantors and 65% of the voting capital stock of first-tier foreign subsidiaries that are not subsidiary guarantors, in each case subject to exceptions (collectively, the "Non-ABL priority collateral"), with the ABL Revolving Credit Facility secured by second-priority security interests therein.

The Term Loan agreement contains certain customary conditions to borrowing, restrictions, affirmative covenants, negative covenants and events of default. The Term Loan does not contain any financial maintenance covenants.

ABL Revolving Credit Facility

The availability of credit under the amended and restated five-year ABL Revolving Credit Facility, which expires on June 7, 2021, is equal to the lesser of (i) \$250.0 million and (ii) our borrowing base. The borrowing base equals the sum of (i) 90% of eligible credit card receivables, plus (ii) 85% of eligible receivables, plus (iii) 85% of the orderly liquidation value of eligible inventory, plus (iv) 100% of cash not to exceed \$35.0 million. As of June 30, 2019 and March 31, 2019, the ABL Revolving Credit Facility had no outstanding borrowings and \$21.7 million and \$22.8 million, respectively, in issued and outstanding letters of credit. Our available borrowing base as of June 30, 2019, which is based on the balance sheet at May 31, 2019, was \$94.0 million, net of letters of credit.

The unused commitment fee will range between 0.25% and 0.375%, based upon the average facility usage for the most recently ended fiscal quarter. Outstanding letters of credit are also subject to a quarterly letter of credit participation fee which will vary between 1.75% and 2.25%, depending on the average daily availability. For both the three months ended June 30, 2019 and 2018, the commitment and participation fees were insignificant.

We have the right to prepay outstanding borrowings under the ABL Revolving Credit Facility, in whole or in part, from time to time, without premium or penalty.

The obligations under the ABL Revolving Credit Facility are unconditionally guaranteed by Cengage Learning Holdco, Inc., on a limited recourse basis, and all of our future direct and indirect material, wholly owned domestic restricted subsidiaries, subject to certain exceptions. The guarantees of those obligations will be secured by (i) first-priority security interests in the ABL priority collateral, with the term loan facility secured by second-priority security interests therein, and (ii) second-priority security interests in the Non-ABL priority collateral, with the term loan facility secured by first-priority security interests therein.

The ABL Revolving Credit Facility also contains certain other customary conditions to borrowing, restrictions, affirmative covenants, negative covenants and events of default.

CENGAGE LEARNING HOLDINGS II, INC.
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Summary of Cash Flows

The following table sets forth our cash flows from operating, investing and financing activities:

<i>(in millions)</i>	Three Months Ended June 30,		Change	
	2019	2018	\$	%
Net cash used in				
Operating activities	\$ (105.7)	\$ (82.3)	\$ (23.4)	28.4 %
Investing activities	(52.1)	(40.5)	(11.6)	28.6 %
Financing activities	(7.9)	(6.6)	(1.3)	19.7 %
Impact on cash and cash equivalents from changes in foreign currency	(0.1)	(1.2)	1.1	(91.7)%
Net decrease in cash and cash equivalents	\$ (165.8)	\$ (130.6)	\$ (35.2)	27.0 %

Operating activities. Net cash used in operating activities for the three months ended June 30, 2019 increased \$23.4 million, primarily due to an increase in cash used for net working capital. The increase in cash used for net working capital was primarily driven by fiscal year 2019 incentive compensation payments made during the first quarter of fiscal year 2020 and a decrease in accrual and trade payable balance due to the timing of purchases and payments. These uses of cash were partially offset by lower accounts receivable related to a decline in sales and lower prepaid deposits and advances.

Investing activities. Net cash used in investing activities for the three months ended June 30, 2019 increased \$11.6 million primarily driven by an increase in capital expenditures spend.

Financing activities. Net cash used in financing activities for the three months ended June 30, 2019 increased \$1.3 million, primarily due to \$4.3 million of scheduled quarterly principal loan payments; partially offset by a decrease of cash used in the current period of \$0.8 million of dividend equivalents paid in connection with the delivery of shares under vested restricted stock units, and a decrease of \$2.0 million to acquire shares in connection with net settlement of equity-based awards compared with the prior year period.

New Accounting Standards and Accounting Changes

See Note 1, "Basis of Presentation," to our condensed consolidated financial statements for a description of new accounting standards and accounting changes.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of June 30, 2019, we had \$1,658.7 million in outstanding variable rate debt under our Term Loan at face value. The effective interest rate for our Term Loan is based on a contractual minimum base interest rate, or LIBOR floor of 1.0%, plus the applicable margin. Currently, LIBOR is above the LIBOR floor and the debt is subject to variable rates. A 50 basis point increase in LIBOR on our current Term Loan balance would increase our annual interest expense by approximately \$8.3 million. Additionally, as of June 30, 2019, we had \$620.0 million in outstanding debt at a fixed rate of 9.50%.

LEGAL PROCEEDINGS

From time to time we may become involved in various claims, disputes and legal or regulatory proceedings that arise in the ordinary course of business and/or may be related to contractual or other obligations of ours. We assess our potential contingent and other liabilities by analyzing our claims, disputes and legal and regulatory matters using all available information. We also develop our views on estimated losses, if any, in consultation with our legal and other advisors. We determine whether a loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. If the contingency is not probable or cannot be reasonably estimated, disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss may have been incurred by us.

Adverse developments relating to claims, disputes and legal and regulatory proceedings in which we are or become involved could cause a change in our determination as to an unfavorable outcome and result in the need to recognize a material accrual. Should any of these matters result in a final adverse judgment, settlement or other final resolution involving material amounts, it could have a material adverse effect on our financial condition, results of operations and/or cash flows.

Based on a review of the information available at this time, we do not expect that the total cost of resolving current claims, disputes and legal regulatory proceedings will have a material adverse effect on our consolidated financial condition, results of operations or cash flows. For additional information, see Note 13, "Commitments and Contingencies" to our condensed consolidated financial statements.

RISK FACTORS

We encourage you to carefully consider the risk factors identified in the "Risk Factors" section in our 2019 Annual Report. These risk factors could materially affect our business, financial condition, and future results and could cause our actual business and financial results to differ materially from those contained in forward-looking statements made in this Quarterly Report or elsewhere by management from time to time. There have been no material changes during the three months ended June 30, 2019 to the risk factors disclosed in our 2019 Annual Report.

PURCHASES OF EQUITY SECURITIES BY THE ISSUER

There were no purchases of common stock by the Company during the first quarter of fiscal year 2020.