

# **TL HOLDINGS II L.P.**

**(As successor to Thomson Learning,  
a combination of certain assets and liabilities of The Thomson Corporation)**

## **Second Quarter Report Three and Six Months Ended June 30, 2007**

Unaudited Combined Financial Statements and  
Management's Discussion and Analysis

As of June 30, 2007, the end of the quarter to which this quarterly report relates, Thomson Learning was comprised of wholly-owned indirect subsidiaries and divisions of The Thomson Corporation (“TOC”), representing the assets, liabilities, revenues and expenses directly attributed to TOC’s Domestic Higher Education and Domestic Library Reference businesses as well as certain international businesses, managed together by a single management team (hereafter collectively referred to as “Thomson Learning”). The financial statements of Thomson Learning are combined on the basis of common control.

On July 5, 2007, TL Holdings II L.P. acquired the stock of certain companies and assets of certain companies of Thomson Learning from TOC in exchange for cash consideration of \$7,108.9 million (hereafter referred to as the “Acquisition”). Except as otherwise noted, this quarterly report does not reflect the impact of the acquisition of Thomson Learning.

As of the end of the period covered by this report, TL Holdings II L.P. was not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended. Consequently, this quarterly report has not and will not be filed with the Securities and Exchange Commission (“SEC”). However, TL Holdings II L.P. is obligated pursuant to the indentures, dated as of July 5, 2007, among TL Acquisitions, Inc. (a wholly owned subsidiary of TL Holdings II L.P.), the guarantors named therein and The Bank of New York as trustee, to post, on a publicly accessible page on Thomson Learning’s website, financial information that Thomson Learning would be required to file with the SEC were it subject to Sections 13 or 15(d) of the Securities Exchange Act of 1934, as amended, subject to exceptions consistent with the presentation of financial information in the TL Acquisitions, Inc. Offering Memorandum, dated June 22, 2007, relating to the \$1,215,600,000 10.50% Senior Notes due 2015 and the \$519,000,000 13.25% Senior Subordinated Discount Notes due 2015 (the “Offering Memorandum”). Those indentures require that the first period that such financial information is required to be presented is the quarter ended June 30, 2007. This report is made available pursuant to such obligation and is presented on the basis of TL Holdings II L.P. as successor entity to Thomson Learning.

**“Safe Harbor” Statement Under the  
Private Securities Litigation Reform Act of 1995**

This quarterly 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. These forward-looking statements are not based on historical facts, but rather reflect our current expectations concerning future results and events. These forward-looking statements generally can be identified by the use of statements that include phrases such as “believe,” “expect,” “anticipate,” “intend”, “estimate”, “plan”, “project”, “foresee”, “likely”, “will” or other words or phrases with similar meanings. Similarly, statements that describe our objectives, plans or goals are, or may be, forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be different from any future results, performance and anticipated achievements expressed or implied by these statements. Except as required by law, we do not intend to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In addition, forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from Thomson Learning’s historical experience and our present expectations or projections. These risks and uncertainties include, but are not limited to, those described in the Offering Memorandum.

**TL HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**

**QUARTERLY REPORT**  
**June 30, 2007**

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**TL HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**COMBINED BALANCE SHEETS (UNAUDITED)**  
(In thousands of U.S. dollars unless otherwise indicated)

	<u>June 30,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 18,774	\$ 36,056
Accounts receivable (less allowances of \$118,028 and \$198,839, respectively)	236,693	354,396
Notes receivable from TOC	23,820	37,187
Inventories	185,476	161,152
Deferred tax asset	93,585	93,585
Prepaid expenses and other current assets	40,611	35,990
Total current assets	<u>598,959</u>	<u>718,366</u>
Property, equipment and capitalized software for internal use, net	150,306	147,956
Pre-publication costs, net	233,862	218,583
Identifiable intangible assets, net	572,325	585,428
Goodwill	1,384,753	1,366,996
Deferred tax asset	4,760	4,760
Other non-current assets	42,626	44,561
Total assets	<u>\$ 2,987,591</u>	<u>\$ 3,086,650</u>
<b>Liabilities and owners' equity</b>		
Accounts payable and accrued expenses	\$ 241,186	\$ 347,468
Deferred revenue	133,694	157,232
Current portion of long-term debt	35,000	35,000
Capital lease obligation	26,022	26,040
Notes payable to TOC	693,877	466,809
Current taxes payable	12,355	11,722
Other current liabilities	22,136	18,219
Total current liabilities	<u>1,164,270</u>	<u>1,062,490</u>
Long-term debt	14,915	34,831
Deferred tax liability	286,170	301,031
Other non-current liabilities	10,760	13,850
Total liabilities	<u>1,476,115</u>	<u>1,412,202</u>
Contingencies (Note 15)		
Net investment of TOC	1,460,266	1,628,724
Accumulated other comprehensive income	51,210	45,724
Total liabilities and owners' equity	<u>\$ 2,987,591</u>	<u>\$ 3,086,650</u>

The accompanying notes are an integral part of these Combined Financial Statements.

**TL HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**COMBINED STATEMENTS OF OPERATIONS (UNAUDITED)**  
**(In thousands of U.S. dollars unless otherwise indicated)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenues:				
Products	\$ 214,058	\$ 218,562	\$ 399,114	\$ 394,785
Services and other	96,335	84,322	177,767	155,374
Total revenues	<u>310,393</u>	<u>302,884</u>	<u>576,881</u>	<u>550,159</u>
Cost of revenues, excluding depreciation and amortization stated below:				
Products	133,961	129,641	259,286	249,550
Services and other	25,364	23,939	47,680	44,145
Total cost of revenues, excluding depreciation and amortization stated below	<u>159,325</u>	<u>153,580</u>	<u>306,966</u>	<u>293,695</u>
Amortization of pre-publication costs	24,950	24,790	46,951	45,508
Selling, general & administrative, excluding depreciation and amortization stated below	132,441	102,294	250,929	206,700
Allocation of management costs from TOC (Note 14)	13,677	10,443	25,274	21,804
Depreciation and impairment	16,341	12,978	30,227	25,864
Amortization of identifiable intangible assets	10,432	10,183	20,729	20,099
Impairment of identifiable intangible assets	1,744	-	1,744	-
Total costs and expenses	<u>358,910</u>	<u>314,268</u>	<u>682,820</u>	<u>613,670</u>
Operating loss	(48,517)	(11,384)	(105,939)	(63,511)
Interest expense with TOC	4,875	6,017	9,380	20,118
Interest expense	1,641	2,294	2,167	2,615
Loss before taxes	(55,033)	(19,695)	(117,486)	(86,244)
Benefit from income taxes	19,763	7,624	42,841	33,087
Equity losses of investee, net of taxes	(3,199)	(1,971)	(4,851)	(3,997)
Net loss	<u>\$ (38,469)</u>	<u>\$ (14,042)</u>	<u>\$ (79,496)</u>	<u>\$ (57,154)</u>

The accompanying notes are an integral part of these Combined Financial Statements.

**TL HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**COMBINED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
**(In thousands of U.S. dollars unless otherwise indicated)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities</b>				
Net loss	\$ (38,469)	\$ (14,042)	\$(79,496)	\$ (57,154)
Adjustments to reconcile net loss to net cash used by operating activities:				
Amortization of pre-publication costs	24,950	24,790	46,951	45,508
Depreciation and impairment	16,341	12,978	30,227	25,864
Amortization of identifiable intangible assets	10,432	10,183	20,729	20,099
Impairment of identifiable intangible assets	1,744	-	1,744	-
Benefit from deferred taxes	(7,016)	(1,122)	(15,036)	(4,963)
Equity losses of investee, net of taxes	3,199	1,971	4,851	3,997
Other, net	623	(135)	2,325	995
Changes in working capital and other items, net of acquisitions:				
(Increase) decrease in accounts receivable, net	(38,622)	(46,116)	118,503	121,309
Increase in inventories	(12,512)	(8,932)	(22,496)	(20,818)
(Increase) decrease in prepaid expenses and other current assets	(5,863)	(1,315)	(4,321)	1,429
Increase (decrease) in accounts payable and accrued expenses	15,632	6,453	(114,393)	(167,788)
Decrease in deferred revenue	(2,966)	(2,633)	(26,548)	(18,192)
Other, net	(596)	64	(1,521)	(734)
Decrease in author advances	3,726	3,402	6,849	8,240
Net cash used by operating activities	<u>(29,397)</u>	<u>(14,454)</u>	<u>(31,632)</u>	<u>(42,208)</u>
<b>Cash flows from investing activities</b>				
Acquisitions of business, less cash therein of \$0, \$4, \$1,193 and \$4, respectively	(1,687)	(2,307)	(27,534)	(5,201)
Capital infusion into equity investee	(5,224)	-	(5,224)	-
Additions to pre-publication costs	(35,533)	(29,323)	(61,279)	(56,170)
Additions to property, equipment and capitalized software for internal use, net of proceeds from disposals of \$528, 596, \$651 and \$670, respectively	(19,497)	(10,534)	(26,135)	(16,205)
Other, net	(1,116)	(1,058)	(1,178)	(1,161)
Net cash used by investing activities	<u>(63,057)</u>	<u>(43,222)</u>	<u>(121,350)</u>	<u>(78,737)</u>
<b>Cash flows from financing activities</b>				
Repayments of long-term debt	(20,018)	(20,018)	(20,018)	(20,018)
Change in cash overdrafts	(19,257)	(34,315)	3,917	248
Proceeds (repayments) from notes payable/receivable to TOC, net	163,094	(750,966)	240,435	(683,326)
(Decrease) increase in net investment of TOC	(51,699)	862,819	(89,482)	818,146
Net cash provided by financing activities	<u>72,120</u>	<u>57,520</u>	<u>134,852</u>	<u>115,050</u>
<b>Impact on cash and cash equivalents from</b>				
<b>change in foreign currency</b>	<u>640</u>	<u>411</u>	<u>848</u>	<u>114</u>
<b>Net (decrease) increase in cash and cash equivalents</b>	(19,694)	255	(17,282)	(5,781)
<b>Cash and cash equivalents</b>				
Beginning of period	38,468	24,695	36,056	30,731
End of period	<u>\$ 18,774</u>	<u>\$ 24,950</u>	<u>\$ 18,774</u>	<u>\$ 24,950</u>

The accompanying notes are an integral part of these Combined Financial Statements.

**TL HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**COMBINED STATEMENTS OF OWNERS' EQUITY AND COMPREHENSIVE LOSS (UNAUDITED)**  
**(In thousands of U.S. dollars unless otherwise indicated)**

	Net investment of TOC	Accumulated other comprehensive income	Total owners' equity	Other comprehensive loss
December 31, 2005	\$ 671,947	\$ 32,981	\$ 704,928	
Increase in net investment of TOC	818,738		818,738	
Net loss	(57,154)		(57,154)	\$ (57,154)
Foreign currency translation adjustment		1,337	1,337	1,337
Comprehensive loss				<u>\$ (55,817)</u>
June 30, 2006	<u>\$ 1,433,531</u>	<u>\$ 34,318</u>	<u>\$ 1,467,849</u>	
December 31, 2006	\$ 1,628,724	\$ 45,724	\$ 1,674,448	
Decrease in net investment of TOC	(88,962)		(88,962)	
Net loss	(79,496)		(79,496)	\$ (79,496)
Foreign currency translation adjustment		5,710	5,710	5,710
Unrealized gain on derivative instruments		(224)	(224)	(224)
Comprehensive loss				<u>\$ (74,010)</u>
June 30, 2007	<u>\$ 1,460,266</u>	<u>\$ 51,210</u>	<u>\$ 1,511,476</u>	

The accompanying notes are an integral part of these Combined Financial Statements.

**TL HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**NOTES TO COMBINED FINANCIAL STATEMENTS (UNAUDITED)**  
**(In thousands of dollars unless otherwise indicated)**

**1. BASIS OF PRESENTATION**

Thomson Learning is the predecessor of TL Holdings II L.P. and is comprised of wholly-owned indirect subsidiaries and divisions of The Thomson Corporation (“TOC”) managed together by a single management team. The accompanying financial statements reflect the assets, liabilities, revenues and expenses directly attributed to TOC’s Domestic Higher Education and Domestic Library Reference businesses as well as certain international businesses (hereafter referred to as “Thomson Learning”). The financial statements of Thomson Learning for the periods presented herein are combined on the basis of common control. Thomson Learning owns 50% of Universitas 21 Global (“U21”), a joint venture between Thomson Learning and a consortium of 19 universities from around the world, which it accounts for using the equity method.

The accompanying unaudited interim Combined Financial Statements have been prepared on a basis consistent with the audited financial statements for the year ended December 31, 2006. Certain information and note disclosure normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been omitted. These unaudited interim Combined Financial Statements should be read in conjunction with the Combined Financial Statements as of and for the years ended December 31, 2006, 2005 and 2004.

In the opinion of management, the unaudited interim Combined Financial Statements include all adjustments (consisting of normal recurring adjustments) considered necessary by management to fairly state the results of operations, financial position and cash flows. With the exception of the adoption of recent accounting pronouncements discussed in Note 5, the Combined Financial Statements were prepared using the same accounting policies and methods as those used in Thomson Learning’s Combined Financial Statements as of and for the years ended December 31, 2006, 2005 and 2004.

As described in Note 14, Thomson Learning and other subsidiaries of TOC engage in extensive intercompany transactions, and Thomson Learning relies on TOC for some of its administrative support for which it is allocated costs using methodologies that management believes are reasonable. The amounts recorded for these transactions and allocations are not necessarily representative of the amounts that would have been reflected in the Combined Financial Statements had Thomson Learning been an entity operated independently of TOC. In addition, a variety of transactions occur between Thomson Learning, TOC and other subsidiaries of TOC. Other than those transactions reflected as a note payable to or receivable from TOC, these transactions are presented in the Combined Financial Statements as related party transactions, the net effect of which is presented within “Net investment of TOC” on the Combined Balance Sheet. All transactions recorded through the “Net investment of TOC” are reflected as financing activities in the accompanying Combined Statement of Cash Flows.

**Taxes Collected from Customers and Remitted to Governmental Agencies**

Thomson Learning records taxes on customer transactions but due to governmental agencies as a receivable and a liability on the Combined Balance Sheet.

**Notes Receivable and Notes Payable with TOC**

Thomson Learning periodically lends to or borrows money from various subsidiaries of TOC as part of TOC's overall cash management and capitalization program. These arrangements are subject to written loan agreements specifying repayment terms and interest payments. These notes are reflected separately in the Combined Balance Sheet based on their legal form. As the balances pursuant to these notes fluctuate on a frequent basis, Thomson Learning has classified both the “Notes receivable from TOC” and “Notes payable to TOC” as a current asset and a current liability, respectively. As these notes are part of TOC's overall capitalization of Thomson Learning, changes in the notes’ balances have been reflected as financing activities in the Combined Statement of Cash Flows. (See Note 2, “Acquisition of Thomson Learning”.)

**2. ACQUISITION OF THOMSON LEARNING**

On May 11, 2007, certain indirect wholly-owned subsidiaries of TOC entered into a Stock and Asset Purchase Agreement (the “Acquisition Agreement”) with Apax/TL Holdings LLC, an affiliate of Apax Partners and OMERS Capital Partners and certain of their affiliates. Pursuant to the Acquisition Agreement, Apax/TL Holdings LLC assigned its rights and obligations among certain affiliates, including TL Holdings II L.P.

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**NOTES TO COMBINED FINANCIAL STATEMENTS (UNAUDITED)**  
**(In thousands of dollars unless otherwise indicated)**

On July 5, 2007, TL Holdings II L.P. acquired the stock of certain companies and assets of certain companies of Thomson Learning from TOC in exchange for cash consideration of \$7,108.9 million (the "Acquisition").

The Acquisition was financed through (i) a common equity capital contribution of \$1,703.1 million (the "Equity Contribution") and (ii) \$5,580.2 million in aggregate gross proceeds of debt financing (the "Financing Transactions") as follows:

- \$3,440.0 million of borrowings under \$3,740.0 million of senior secured credit facilities, consisting of a \$3,440.0 million term loan facility with a seven-year maturity and a \$300.0 million revolving credit facility with a six-year maturity;
- \$1,215.6 million aggregate principal amount (\$1,200.1 million gross proceeds) of 10.50% senior notes due 2015;
- \$519.0 million aggregate principal amount at maturity (\$400.1 million gross proceeds) of 13.25% senior subordinated discount notes due 2015, for which no cash interest will accrue between the date of original issuance and July 15, 2009; and
- \$540.0 million of borrowings under a senior unsecured Payment In Kind ("PIK") credit facility with an eight-year maturity.

The Financing Transactions, together with the Acquisition and Equity Contribution, are hereinafter referred to as the "Transactions", which represent a subsequent event to the financial statements.

#### **Senior Secured Credit Facilities**

The revolving credit facility includes borrowing capacity available for letters of credit and for short-term borrowings referred to as swing line borrowings. In addition, the senior secured credit facilities also provide TL Holdings II L.P. with the option to raise, subject to certain limitations, incremental term loan facilities of up to \$750.0 million plus the amount of any voluntary prepayments of the term loans (and with the ability to raise additional incremental term facilities subject to certain secured leverage tests).

Borrowings under the term loan facility and the revolving credit facility bear interest, at TL Holdings II L.P.'s option, at a rate equal to a margin over either (a) a base rate determined by reference to the higher of (1) the rate of interest announced publicly by The Royal Bank of Scotland plc, from time to time, as its prime rate and (2) the federal funds effective rate plus 1/2 of 1% or (b) a LIBOR rate determined by reference to the costs of funds for deposits in the currency of such borrowing for the interest period relevant to such borrowing. For term loans, the margin is currently (i) 1.75%, in the case of base rate loans and (ii) 2.75%, in the case of LIBOR rate loans. For revolving credit loans, the margin is currently (i) 1.75%, in the case of base rate loans and (ii) 2.75%, in the case of LIBOR rate loans. The applicable margin for borrowings under both the term loan facility and the revolving credit facility may be reduced subject to attaining certain leverage ratios.

The senior secured credit facilities contain certain customary affirmative covenants and events of default.

#### **Senior Notes and Senior Subordinated Discount Notes**

The indentures that govern the senior notes and senior subordinated discount notes contain certain covenants, agreements and events of default which are customary with respect to non-investment grade debt securities.

#### **Unsecured Payment in Kind Credit Facility**

Borrowings under the senior unsecured floating rate PIK credit facility bear interest at a rate of LIBOR plus 7.75% per annum, increasing to LIBOR plus 8.25% six months after the consummation of the Acquisition and to LIBOR plus 8.75% nine months after the consummation of the Acquisition, subject to a maximum interest limitation.

The senior unsecured floating rate PIK credit facility contains certain affirmative covenants and events of default which are customary with respect to financings of such type.

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**NOTES TO COMBINED FINANCIAL STATEMENTS (UNAUDITED)**  
**(In thousands of dollars unless otherwise indicated)**

**Preliminary Allocation of the Purchase Price**

A preliminary allocation of the purchase price was performed using information currently available and is based on preliminary estimates of the fair value of assets acquired and liabilities assumed in connection with the Transactions. The final purchase price allocation is dependent upon, among other things, the finalization of asset and liability valuations. A final determination of these fair values will reflect consideration of a final valuation prepared by third-party appraisers and will be based on the actual net tangible and identifiable intangible assets that existed as of the closing date of the Acquisition. Any final adjustment will change the allocations of purchase price, which could affect the fair values assigned to the assets and liabilities, including a change to goodwill.

The estimated values of assets and liabilities have been based on a preliminary purchase price which was calculated as follows:

	(in millions)
Acquisition consideration	\$ 7,108.9
Transaction costs (a)	97.7
Total preliminary allocable purchase price	\$ 7,206.6
	<b>Estimated Allocation of Purchase Price<sup>(1)</sup></b>
	(in millions)
Company net assets	\$ 1,511.5
Assets and liabilities retained by TOC, net (b)	747.6
Deferred tax adjustments (c)	101.4
Historical net investment of TOC as adjusted for assets and liabilities not acquired	2,360.5
Purchase accounting adjustments:	
Reverse historical intangibles and goodwill (d)	(1,957.1)
Deferred taxes relating to purchase accounting (e)	(823.1)
Deferred revenue	34.4
Other non-current liabilities	5.0
	(380.3)
Identifiable intangible assets (f)	3,249.0
Goodwill (g)	4,337.9
	\$ 7,206.6

<sup>(1)</sup> As of June 30, 2007.

- (a) Includes \$36.4 million of fees paid to an affiliate of Apax Partners, a related party, in connection with the Acquisition.
- (b) Pursuant to the Acquisition Agreement, TL Holdings II L.P. did not acquire notes receivable from TOC, notes payable to TOC, current and long-term portions of long-term debt, current taxes payable and certain other indebtedness related to management retention plans.
- (c) Historical deferred taxes and liabilities of one of the Thomson Learning entities are eliminated upon the consummation of the Acquisition because the acquisition of the entity is accounted for as an asset purchase for income tax purposes.

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**(In thousands of dollars unless otherwise indicated)**

- (d) Historical intangibles and goodwill are eliminated upon the consummation of the Acquisition.
- (e) Represents recognition of deferred income taxes relating to the Acquisition.
- (f) Based on management's estimate including the consideration of preliminary external valuation of identifiable intangible assets consisting primarily of content and customer relationships with a weighted average life of 19 years.
- (g) Represents the excess purchase price over the estimated fair value of net identifiable assets acquired. Goodwill will be allocated to Thomson Learning's three segments.

Concurrent with the consummation of the Acquisition, TL Holdings II L.P. entered into a Transition Services Agreement with a subsidiary of TOC. Under the Transition Services Agreement, the TOC subsidiary will provide to TL Holdings II L.P., or cause to be provided to TL Holdings II L.P., various services, including services relating to financial consolidation and reporting, payroll, technology infrastructure, real estate, treasury and cash management, telecommunications and information technology. Under the Transition Services Agreement, the cost of each transition service generally will be based on a flat fee.

Unless specifically indicated below, all services to be provided under the Transition Services Agreement will be provided for a specified period of time, and TL Holdings II L.P. can generally terminate those services in advance upon 30 days written notice without penalty and in certain circumstances, the TOC subsidiary can terminate some services.

Concurrent with the consummation of the Acquisition, TL Holdings II L.P. also entered into a Human Resources Services Agreement with the same TOC subsidiary. Under the Human Resources Services Agreement, the TOC subsidiary will provide to TL Holdings II L.P., or cause to be provided to TL Holdings II L.P., certain employee benefit plan, payroll, administration and other human resources services. Under the terms of the agreement, TL Holdings II L.P. is required to establish and maintain certain employee benefit plans pursuant to an administrative service contract, insurance or other arrangement entered into between Thomson Learning and a vendor approved by the TOC subsidiary and the third-party service provider to be used by the TOC subsidiary in providing the services under the agreement.

The cost of each service provided under the Human Resources Services Agreement is based on either a flat fee or an allocation (based on size or usage) of the cost incurred by Thomson Learning providing the service. All services to be provided under the Human Resources Services Agreement will be provided for a specified period of time, generally two years from the date of the Acquisition, and TL Holdings II L.P. does not have the ability to terminate those services or the Human Resources Services Agreement in advance. The TOC subsidiary can generally terminate the services upon six months prior notice.

### **3. SEASONALITY AND COMPARABILITY**

Typically, a greater portion of Thomson Learning's revenue, operating profit and operating cash flow is derived in the second half of the year. Customer buying patterns are concentrated in the second half of the year, while costs are incurred more evenly throughout the year. As a result, operating margins generally increase as the year progresses. For these reasons, the performance of Thomson Learning's businesses may not be comparable quarter to consecutive quarter and should be considered on the basis of results for the whole year or by comparing results in a quarter with results in the same quarter for the previous year.

In connection with TOC's sale of Thomson Learning to TL Holdings II L.P. as discussed in Note 2, Thomson Learning incurred costs of \$18,903 and \$28,442 during the three and six month periods ended June 30, 2007, respectively, for employee retention bonuses and professional services fees, which were recorded in "Selling, general & administrative, excluding depreciation and amortization stated below" on the Combined Statement of Operations.

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**NOTES TO COMBINED FINANCIAL STATEMENTS (UNAUDITED)**  
**(In thousands of dollars unless otherwise indicated)**

#### **4. CRITICAL ACCOUNTING POLICIES**

##### **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 Combined Financial Statements and accompanying notes. Although these estimates are based on management's best knowledge of current events and actions that Thomson Learning may undertake in the future, actual results could differ from those estimates. These estimates include, but are not limited to, allowance for doubtful accounts, reserve for sales returns, realization of deferred tax assets, the allocation of certain expenses to Thomson Learning and the determination of fair values used in the assessment of the realizability of long-lived assets, goodwill and identifiable intangible assets.

##### **Revenue recognition**

Thomson Learning delivers learning solutions for universities, students, professors, libraries, professionals and corporations around the world. These solutions are delivered through specialized content, applications and services. Although printed materials continue to be the most widely-sold learning resource, Thomson Learning is increasingly providing customers with electronic resources. Services and other revenues include revenues from the delivery of content in electronic format and administrative services (e.g., distribution, warehousing and payroll). Thomson Learning recognizes revenue when the following four criteria are met:

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the fee is fixed or determinable; and
- collectibility is probable.

*Print products.* Revenue from the sale of print products, less estimated returns, is recognized when the product is shipped and title passes to the customer. Amounts billed to customers for shipping and handling are classified as revenue.

*Subscription-based products.* Revenues from sales of subscription-based products are recognized ratably over the term of the subscription. Subscription revenue received or receivable in advance of the delivery of services or publications is included in deferred revenue. Incremental costs that are directly related to the subscription revenue are deferred and amortized over the subscription period.

*Multiple element arrangements.* When a sales arrangement requires the delivery of more than one product or service, the individual deliverables are accounted for separately, if applicable criteria are met. Specifically, the revenue is allocated to each deliverable if reliable and objective evidence of fair value for each deliverable is available. The amount allocated to each unit is then recognized when each unit is delivered, provided that all other relevant revenue recognition criteria are met with respect to that unit. If, however, evidence of fair value is only available for undelivered elements, the revenue is allocated first to the undelivered items, with the remainder of the revenue being allocated to the delivered items, according to a calculation known as the residual method. Amounts allocated to delivered items are deferred if there are further obligations with respect to the delivered items. If evidence of fair value is only available for the delivered items, but not the undelivered items, the arrangement is considered a single element arrangement and revenue is recognized as the relevant recognition criteria are met.

##### **Allowance for doubtful accounts and reserve for sales returns**

Most of Thomson Learning's accounts receivable are due from universities, bookstores, students, professors, libraries, professionals and corporations. Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Accounts receivable are reflected net of an allowance for doubtful accounts and sales returns. Thomson Learning periodically assesses the allowance for doubtful accounts and estimates the amount of future returns by evaluating general factors such as the length of time individual receivables are past due, historical collections and sales returns experience and the economic and competitive environment.

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**Inventories**

Inventories, which are principally comprised of books, compact discs and other print products, are stated at lower of cost or market value, with cost determined generally using the weighted average method. Allowances are established to reduce the cost of excess and obsolete inventories to their estimated net realizable value.

**Pre-publication costs**

Pre-publication costs are costs to create a book, compact disc or other media and include costs for the associated delivery method when such media is electronic. Such costs are amortized over the period that the majority of sales relating to the content is expected to be generated. This period of time begins on the publication date and normally ranges from one to six years. See “—Impairment of long-lived assets” below.

**Identifiable intangible assets and goodwill**

Upon acquisition, identifiable intangible assets are recorded at fair value. Identifiable intangible assets with finite lives are amortized over their estimated useful lives. The carrying values of these identifiable intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. The initial test for impairment compares the carrying amounts with the sum of undiscounted cash flows related to the identifiable intangible asset. If the carrying value is greater than the undiscounted cash flows of the asset, the identifiable intangible asset is written down to its estimated fair value.

Goodwill represents the excess of the cost of acquired businesses over fair values attributed to underlying net tangible assets and identifiable intangible assets. The carrying value of goodwill is tested at least annually for impairment on a “reporting unit” level, using a two-step approach. In the first step, the fair value of each reporting unit is determined. If the fair value of a reporting unit is less than its carrying value, this is an indicator that the goodwill assigned to that reporting unit may be impaired. In this case, the second step is to allocate the fair value of the reporting unit to the assets and liabilities of the reporting unit as if it had just been acquired in a business combination, and as if the purchase price was equivalent to the fair value of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is referred to as the implied fair value of goodwill. The implied fair value of the reporting unit’s goodwill is then compared to the actual carrying value of goodwill. If the implied fair value is less than the carrying value, an impairment loss is recognized for that excess.

**Impairment of long-lived assets**

Management evaluates the impairment of long-lived assets whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The initial test for impairment compares the carrying amounts with the sum of undiscounted cash flows related to the asset. If the carrying value is greater than the undiscounted cash flows of the asset, the asset is written down to its estimated fair value.

**Income taxes**

Thomson Learning accounts for income taxes in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 109, *Accounting for Income Taxes*. Income taxes are presented as if the subsidiaries were operated as separate stand-alone tax-paying entities (separate return basis).

Deferred income taxes are determined based on the temporary differences between the financial reporting and tax bases of assets and liabilities using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse. A valuation allowance is recorded against deferred income tax assets if management determines that it is more likely than not that such deferred income tax assets will not be realized. The income tax provision for the period shown is the taxes payable or receivable for the period and the change during the period in deferred income tax assets and liabilities.

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**5. RECENT ACCOUNTING PRONOUNCEMENTS**

**Income Taxes**

Effective January 1, 2007, Thomson Learning adopted the provisions of the Financial Accounting Standards Board (“FASB”) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”). As a result of this change in accounting policy, Thomson Learning recorded a non-cash charge of \$2,125 to its opening retained earnings as of January 1, 2007 with an offsetting increase to Net Investment of TOC.

Under its previous policy, Thomson Learning would reserve for tax contingencies if it was probable that an uncertain position would not be upheld. Under FIN 48, Thomson Learning evaluates a tax position using a two-step process. First, Thomson Learning determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, Thomson Learning presumes that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. Secondly, a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

Thomson Learning recognizes interest and penalties related to income tax matters as a component of income tax expense.

**Other Pronouncements**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements, to be applied under other accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective as of the beginning of the first fiscal year after November 15, 2007. Thomson Learning is currently evaluating the impact of this standard on its Combined Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of SFAS 115*. This guidance provides the option to measure and report certain assets and liabilities at their fair value. SFAS No. 159 is effective as of the beginning of the first fiscal year after November 15, 2007. Thomson Learning is currently evaluating the impact of this standard on its Combined Financial Statements.

**6. INVENTORIES**

Inventories consist of the following:

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
Raw materials	\$ 7,955	\$ 7,422
Work-in-progress	4,534	8,185
Finished goods	236,662	211,515
	<u>249,151</u>	<u>227,122</u>
Obsolescence reserve	(63,675)	(65,970)
Inventories, net	<u>\$ 185,476</u>	<u>\$ 161,152</u>

**7. RESTRUCTURING**

In 2006, Thomson Learning initiated a plan to centralize the Domestic Higher Education and Domestic Library Reference editorial production and manufacturing processes into one function. The total restructuring costs of \$3,369 (Domestic Higher Education - \$584; Domestic Library Reference - \$2,785) included severance and relocation of employees as well as contract cancellation costs and property and equipment write downs associated with the closure of associated

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facilities and are included in “Selling, general & administrative, excluding depreciation and amortization stated below” on the Combined Statement of Operations. The restructuring was completed in 2007 and the payments are expected to be completed in 2009.

In 2005, the Domestic Higher Education segment initiated a plan to consolidate three of its office locations and restructure the management of two businesses. The total restructuring costs of \$2,010, which were incurred in 2005 and 2006, are included in “Selling, general & administrative, excluding depreciation and amortization stated below” on the Combined Statement of Operations. Such costs included severance and relocation of employees as well as contract cancellation costs associated with the closure of these facilities. The restructuring was completed in 2006 and payments are expected to be completed in 2009.

The following is a roll-forward of liabilities during the periods ended June 30, 2007 and 2006 associated with these restructurings:

	<b>Severance</b>	<b>Contract Cancellation Costs and other</b>	<b>Total</b>
December 31, 2005	\$ 276	\$ -	\$ 276
Additions	3,688	1,240	4,928
Utilization	(1,257)	(109)	(1,366)
Adjustments	-	-	-
June 30, 2006	<u>\$ 2,707</u>	<u>\$ 1,131</u>	<u>\$ 3,838</u>
December 31, 2006	\$ 769	\$ 1,151	\$ 1,920
Additions	-	-	-
Utilization	(541)	(226)	(767)
Adjustments	(72)	-	(72)
June 30, 2007	<u>\$ 156</u>	<u>\$ 925</u>	<u>\$ 1,081</u>

## 8. BENEFIT PLANS

### Defined Benefit Pension Plans

Certain employees participate in a defined benefit pension plan sponsored and administered by TOC. Under these defined benefit plans, Thomson Learning’s cost of contributing to the plans for Thomson Learning employees is determined by TOC and is charged to expense as incurred. Thomson Learning’s expense, as allocated by TOC to Thomson Learning and other TOC businesses based primarily on the number of participants in the plan, was \$3,973 and \$3,399 for the three months ended June 30, 2007 and 2006, respectively, and \$7,939 and \$6,912 for the six months ended June 30, 2007 and 2006, respectively.

Additionally, select employees participate in supplemental executive retirement plans. These plans provide qualified employees with additional retirement benefits above that received from the TOC qualified plans. The expense associated with these plans was \$409 and \$429 for the three months ended June 30, 2007 and 2006, respectively, and \$818 and \$859 for the six months ended June 30, 2007 and 2006, respectively.

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**Other Post-Retirement Benefits Plans**

Certain employees in the United States of America participate in a defined post-retirement benefit plan sponsored and administered by TOC. The plan calls for certain medical costs, after deductibles, to be paid for after an eligible employee's retirement. The plan has been closed to new participants since 1993. Thomson Learning's expense, as allocated by TOC to Thomson Learning and other TOC businesses based primarily on the number of participants in the plan, was \$511 and \$420 for the three months ended June 30, 2007 and 2006, respectively, and \$1,022 and \$840 for the six months ended June 30, 2007 and 2006, respectively.

Certain employees based outside the United States of America participate in similar plans sponsored by TOC. Under these defined benefit plans, Thomson Learning's cost of contributing to the plans for Thomson Learning employees is determined by TOC and is charged to expense as incurred. The expense associated with these plans was not significant during the periods.

**9. ACQUISITIONS**

The following is a brief description of significant acquisitions completed during the period:

During March 2007, Thomson Learning's Domestic Higher Education segment acquired Aplia, Inc. for cash consideration of \$27,040. Aplia, Inc. is a provider of online educational content and interactive tools for economics and finance courses.

During May 2007, Thomson Learning's Domestic Higher Education segment acquired the assets of Outcomes Assessment Solutions LLC ("TrueOutcomes") for cash consideration of \$3,000 (\$1,500 payable upon satisfaction of certain conditions). TrueOutcomes is a web-based provider of universal assessment tools.

Pro forma financial information and details of net assets acquired have not been included as the acquisitions were not deemed material. However, additions to goodwill and identifiable intangible assets from acquisitions during the period were \$14,829 and \$8,394, respectively.

**10. INVESTMENTS**

During April 2007, Thomson Learning made a capital infusion of \$5,224 into U21. Subsequent to the cash infusion and as a result of the decision to dispose of its interest in U21, Thomson Learning performed an evaluation of the fair value thereof. In performing this evaluation, Thomson Learning considered general market conditions in the industry, the status of U21's product development efforts, the ability of U21 to meet business milestones and its financial condition and near-term prospects, including the rate at which it is utilizing cash and the potential for additional funding requirements. The result of this evaluation was that the carrying value of the interest had experienced an other-than-temporary decline and Thomson Learning recorded an impairment charge of \$1,706 which is presented within "Equity losses of investee, net of taxes" in the Combined Statements of Operations.

**11. IDENTIFIABLE INTANGIBLE ASSETS**

In June 2007, Thomson Learning performed a recoverability analysis of identifiable intangible assets associated with a business unit within the International segment that provides vocational training course materials for which customers are entitled to a subsidy from the local government. This business unit has recently been experiencing declining revenues and cash flows resulting from a change in the government's funding policy of certain courses offered to its customers. Using a projected cash flow approach to determine the fair value, Thomson Learning recognized an impairment of \$1,744. The identifiable intangible assets impaired were Database / Content of \$1,633 and Customer relationships of \$111.

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**12. CAPITALIZED SOFTWARE FOR INTERNAL USE**

Thomson Learning is continuously developing software for internal use designed to provide access to our electronic content through digital portals and recorded an impairment loss of \$1,862 associated with specific software assets which, as a result of changing technologies, no longer support our business operations. The impairment is included in “Depreciation and impairment” on the Combined Statement of Operations and reported within the “Corporate and other” operating segment.

**13. INCOME TAXES**

As discussed in Note 5, Thomson Learning adopted a new policy for accounting for uncertain income tax positions effective January 1, 2007. As a result of this change, Thomson Learning recorded a non-cash charge of \$2,125 to its opening retained earnings as of January 1, 2007 with an offsetting increase to Net investment of TOC. Such unrecognized tax benefits are recognized in “Net investment of TOC” in the accompanying Combined Balance Sheet as the liabilities will remain with TOC subsequent to the disposition of Thomson Learning.

Inclusive of the impact of the change in accounting policy, Thomson Learning had \$9,796 of unrecognized tax benefits as of January 1, 2007. If recognized, all of these benefits would favorably affect Thomson Learning’s income tax expense. As of January 1, 2007, Thomson Learning had accrued \$1,510 for interest and penalties associated with tax positions.

The entities within these Combined Financial Statements are included within consolidated tax returns filed by certain TOC affiliates. As of June 30, 2007, the tax years subject to examination for these TOC affiliates by major jurisdiction are as follows:

<b>Jurisdiction</b>	<b>Tax Year</b>
United States – Federal	2003-2006
United Kingdom	2005-2006

**14. RELATED PARTY TRANSACTIONS**

In accordance with Securities and Exchange Commission Staff Accounting Bulletin 1-B, *Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity*, the Combined Financial Statements include an allocation of TOC corporate expenses. The nature of these costs relate to the office of the chief executive and chief financial officers, internal and external audit fees, treasury, investor relations, strategic sourcing and risk management. Such costs have been allocated to Thomson Learning based on Thomson Learning’s revenue in proportion to the total revenue of TOC. The amounts allocated to Thomson Learning for the three months ended June 30, 2007 and 2006 were \$13,677 and \$10,443, respectively. The amounts allocated to Thomson Learning for the six months ended June 30, 2007 and 2006 were \$25,274 and \$21,804, respectively. Such amounts are selling, general & administrative in nature and are included in “Allocation of management costs from TOC” on the Combined Statement of Operations.

Thomson Learning generated revenue from related parties of \$2,609 and \$2,518 during the three months ended June 30, 2007 and 2006, respectively, and \$4,946 and \$5,064 during the six months ended June 30, 2007 and 2006, respectively.

Because of the related party relationships outlined above and elsewhere within these Combined Financial Statements, it is possible that the terms of these transactions are not the same as those that would result from transactions among wholly unrelated parties.

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**15. CONTINGENCIES AND GUARANTEES**

**Claims and legal actions**

Thomson Learning is involved in ordinary and routine litigation incidental to its business. In the opinion of management, there are no pending legal proceedings that would have a material adverse effect on Thomson Learning's business, financial condition or results of operations.

**Guarantees**

Under Thomson Learning's standard terms and conditions of sale, Thomson Learning warrants ownership of its products and provides certain warranties and indemnifications in relation thereto. Thomson Learning is not aware of any instances that would result in payments being made as a result of these warranties and indemnifications, and therefore, no reserve has been recorded in the Combined Financial Statements in relation thereto.

**16. SEGMENT INFORMATION**

Thomson Learning operates in three reportable segments worldwide. Such segments are strategic business groups that offer products and services to target markets. The accounting policies applied by the segments are the same as those applied by Thomson Learning. All transactions between reportable segments are eliminated upon combination and reflected in the Corporate and other segment. Thomson Learning's segments are:

*Domestic Higher Education.* The Domestic Higher Education segment publishes higher-education textbooks and provides tailored learning solutions for students and professionals.

*Domestic Library Reference.* The Domestic Library Reference segment is a publisher for libraries, schools, and businesses. With its reference content, Thomson Learning creates and maintains databases that are published online, in print and in microform.

*International.* The International segment of Thomson Learning provides learning solutions in various formats to individuals and businesses located outside the United States of America.

Thomson Learning discloses information about its reportable segments based on the measures used by management in assessing the performance of those reportable segments. Thomson Learning uses "Segment operating profit", which is operating income before allocation of corporate management costs from TOC, amortization of identifiable intangible assets, and impairment of identifiable intangible assets, to measure the operating performance of its segments. Management uses this measure because the allocation of corporate management costs from TOC and the amortization and impairment of identifiable intangible assets are not considered to be controllable operating costs for purposes of assessing the current performance of the segments. Segment operating profit does not have any standardized meaning prescribed by GAAP. Total asset information by segment is not shown because it is not provided to or reviewed by the chief operating decision maker.

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Select financial information for Thomson Learning's segments is as follows:

	<b>Three months ended June 30,</b>			
	<b>2007</b>		<b>2006</b>	
	<b>Revenues</b>	<b>Segment operating (loss) profit</b>	<b>Revenues</b>	<b>Segment operating (loss) profit</b>
Domestic Higher Education	\$ 151,303	\$ 3,518	\$ 149,438	\$ 3,109
Domestic Library Reference	83,045	26,272	82,223	26,892
International	70,761	(13,028)	66,655	(1,523)
Segment totals	305,109	16,762	298,316	28,478
Corporate and other <sup>1</sup>	5,284	(39,426)	4,568	(19,236)
Total	<u>\$ 310,393</u>	<u>\$ (22,664)</u>	<u>\$ 302,884</u>	<u>\$ 9,242</u>

	<b>Six months ended June 30,</b>			
	<b>2007</b>		<b>2006</b>	
	<b>Revenues</b>	<b>Segment operating (loss) profit</b>	<b>Revenues</b>	<b>Segment operating (loss) profit</b>
Domestic Higher Education	\$ 279,122	\$ (7,492)	\$ 266,956	\$ (21,527)
Domestic Library Reference	148,542	41,219	148,038	40,906
International	138,644	(23,800)	125,922	(8,913)
Segment totals	566,308	9,927	540,916	10,466
Corporate and other <sup>1</sup>	10,573	(68,119)	9,243	(32,074)
Total	<u>\$ 576,881</u>	<u>\$ (58,192)</u>	<u>\$ 550,159</u>	<u>\$ (21,608)</u>

<sup>1</sup> Corporate and other includes shipping and handling revenue, revenue from administrative services and inter-segment eliminations and corporate costs.

The following table reconciles Segment operating loss per the business segment information to operating loss per the Combined Statement of Operations:

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Segment operating (loss) profit	\$ (22,664)	\$ 9,242	\$ (58,192)	\$ (21,608)
Less: Allocation of management costs from TOC	(13,677)	(10,443)	(25,274)	(21,804)
Less: Amortization of identifiable intangible assets	(10,432)	(10,183)	(20,729)	(20,099)
Less: Impairment of identifiable intangible assets	(1,744)	-	(1,744)	-
Operating loss	<u>\$ (48,517)</u>	<u>\$ (11,384)</u>	<u>\$ (105,939)</u>	<u>\$ (63,511)</u>

## 17. SUBSEQUENT EVENTS

On July 5, 2007, TL Holdings II L.P. acquired the stock and assets of Thomson Learning from TOC pursuant to the Acquisition Agreement in exchange for cash consideration of \$7,108.9 million. See Note 2, "Acquisition of Thomson Learning" for additional information related to this transaction.

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On July 24, 2007, Thomson Learning announced that it will change its name to Cengage Learning. Thomson Learning will introduce the Cengage Learning name throughout the business beginning on August 31, 2007 and in the interim, will continue to operate under the name, Thomson Learning.

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**MANAGEMENT DISCUSSION AND ANALYSIS OF**  
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The following discussion and analysis of our financial condition and results of operations cover the three and six month periods ending June 30, 2007 compared to the same periods in the preceding year, which is prior to the July 5, 2007 consummation of the acquisition of Thomson Learning (as defined in the Overview section below) by TL Holdings II L.P., and the related equity contribution and financing transactions discussed below, hereinafter referred to as the “Transactions”. Accordingly, unless otherwise indicated, the discussion and analysis of historical periods does not reflect the Transactions and the impact that the Transactions will have on us, including increased levels of indebtedness and the impact of purchase accounting. You should read the following discussion and analysis together with our Combined Financial Statements as of and for the years ended December 31, 2006, 2005 and 2004 and related notes thereto. This discussion contains 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 “*Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995.*”

### **The Acquisition and Related Financing Transactions**

On May 11, 2007, certain indirect wholly-owned subsidiaries of The Thomson Corporation (“TOC”) entered into a Stock and Asset Purchase Agreement (the “Acquisition Agreement”) with Apax/TL Holdings LLC, an affiliate of Apax Partners and OMERS Capital Partners and certain of their affiliates. Pursuant to the Acquisition Agreement, Apax/TL Holdings LLC assigned its rights and obligations among certain affiliates, including TL Holdings II L.P.

On July 5, 2007, TL Holdings II L.P. acquired the stock and assets of Thomson Learning from TOC in exchange for cash consideration of \$7,108.9 million (the “Acquisition”).

The Acquisition was financed through a common equity capital contribution of \$1,703.1 million and \$5,580.2 million in aggregate gross proceeds of debt financing as follows:

- \$1,215.6 million aggregate principal amount (\$1,200.1 million gross proceeds) of senior notes;
- \$519.0 million aggregate principal amount at maturity (\$400.1 million gross proceeds) of senior subordinated discount notes, for which no cash interest will accrue between the date of original issuance and July 15, 2009;
- \$3,440.0 million of borrowings under \$3,740.0 million of senior secured credit facilities; and
- \$540.0 million of borrowings under a senior unsecured Payment In Kind credit facility.

### **Transition Services Agreement**

Concurrent with the consummation of the Acquisition, we entered into a Transition Services Agreement with a subsidiary of TOC. Under the Transition Services Agreement, the TOC subsidiary will provide us, or cause to be provided to us, various services, including services relating to financial consolidation and reporting, payroll, technology infrastructure, real estate, treasury and cash management, telecommunications and information technology. Under the Transition Services Agreement, the cost of each transition service generally will be based on a flat fee.

Unless specifically indicated below, all services to be provided under the Transition Services Agreement will be provided for a specified period of time, and we can generally terminate those services in advance upon 30 days written notice without penalty and in certain circumstances, the TOC subsidiary can terminate some services. After the expiration of the arrangements contained in the Transition Services Agreement, we may not be able to replace these services in a timely manner or on terms and conditions, including cost, as favorable as those we have received from such TOC subsidiary. We have developed a plan to increase our own internal capabilities in the future to reduce our reliance on TOC for these services.

### **Human Resources Services Agreement**

Concurrent with the consummation of the Acquisition, we also entered into a Human Resources Services Agreement with a subsidiary of TOC. Under the Human Resources Services Agreement, the TOC subsidiary will provide to us, or cause to be provided to us, certain employee benefit plan, payroll, administration and other human resources services. Under the terms of the agreement, we are required to establish and maintain certain employee benefit plans pursuant to an administrative service contract, insurance or other arrangement entered into between us and a vendor approved by the TOC

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subsidiary and the third-party service provider to be used by the TOC subsidiary in providing the services under the agreement.

The cost of each service provided under the Human Resources Services Agreement is based on either a flat fee or an allocation (based on size or usage) of the cost incurred by Thomson Learning providing the service. All services to be provided under the Human Resources Services Agreement will be provided for a specified period of time, generally two years from the date of the Acquisition, and we do not have the ability to terminate those services or the Human Resources Services Agreement in advance. The TOC subsidiary can generally terminate the services upon six months prior notice.

## **Overview**

Prior to the Acquisition, we were comprised of wholly-owned indirect subsidiaries and divisions of TOC managed together by a single management team. The accompanying financial information reflects the assets, liabilities, revenues and expenses directly attributable to TOC's Domestic Higher Education and Domestic Library Reference businesses as well as certain international businesses (hereinafter referred to as "Thomson Learning"). The financial statements of Thomson Learning for the periods presented herein are combined on the basis of common control. Thomson Learning owns 50% of Universitas 21 Global ("U21"), a joint venture between Thomson Learning and a consortium of 19 universities from around the world, which it accounts for using the equity method.

We are a global print and electronic publisher of textbooks, reference materials and other educational resources for the higher education, professional training and library reference markets.

We operate in the following three reportable segments worldwide:

- *Domestic higher education segment* - publishes higher education textbooks and provides tailored learning solutions, including digital learning solutions, for students, faculty, institutions and professionals around the world.
- *Domestic library reference segment* - provider of authoritative reference and educational content, primarily for academic, public and K-12 libraries.
- *International segment* - sells our U.S. textbooks into international markets, adapts U.S. textbooks for various international markets and publishes and sells textbooks by non-U.S. authors.

We categorize shipping and handling revenue, revenue from administrative services and intersegment elimination and corporate costs under a segment reporting line item referred to as "Corporate and other" which represents approximately 1% of our annual combined revenues.

## **Sources of revenue**

*Products.* In our domestic higher education segment, the primary source of revenue is textbooks sold for use in two- and four-year colleges and universities, where professors drive the textbook "adoption" decision by selecting which textbooks will be used in their courses. We sell to the bookstores and other distribution channels and not directly to students. Students typically purchase textbooks through a college bookstore or online distribution channel. Some schools, like career and for-profit schools, make institutional purchases for all students in a course and charge for the textbooks as part of the course fee. Total revenue is gross textbook sales less the estimated value of returns. In the domestic library reference market, the primary decision makers for purchases are librarians. The sale is often direct, though some small libraries purchase from distributors. In addition, some states, municipalities, etc. have formed coalitions to drive uniformity of purchases and achieve scale in their buying. We generate revenue from academic, K-12 and public libraries.

*Services and other.* Services and other revenues include revenues from the delivery of content in electronic format and administrative services such as distribution, warehousing and payroll. In our domestic higher education segment, the adoption and purchase decisions for digital services are similar to print. However, digital products are more likely to be purchased via online channels and typically have a finite time frame (i.e., a semester) after which a user's access and support are terminated. In the domestic library reference market, providers attempt to encourage repurchase and up-sell by tracking online usage to demonstrate the product's utility to library end-users.

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*Operating expenses.* Our operating expenses are comprised principally of:

- products cost of revenues, which are costs directly related to publishing our textbooks and printed proprietary reference materials such as the cost of paper, printing and binding costs and royalty payments to our authors;
- services and other cost of revenues, which are costs directly related to our digital services for the domestic higher education segment and publishing our digital proprietary reference materials such as hosting and subscription services costs and royalty payments to our authors;
- amortization of pre-publication costs, which are costs related to the creation of a book, reference material, compact disc or other media and includes costs for the associated delivery method when such media is electronic;
- selling, general and administrative expenses, which are the salaries and related costs for our sales staff and our other employees and the marketing and administrative costs of operating our business; and
- depreciation and amortization, which represent the depreciation of our property, equipment and capitalized software for internal use as well as the amortization of our identifiable intangible assets.

### **Stand-alone company**

We have historically operated as divisions of TOC and not as a stand-alone company. The combined financial statements included in this quarterly report have been derived from the accounting records of TOC using the historical results of operations and the historical basis of assets and liabilities directly attributable to Thomson Learning. The historical financial information included in this quarterly report may not reflect what our results of operations, financial position and cash flows would have been had we operated as a separate, stand-alone company without the shared resources of TOC for the periods presented and may not be indicative of our future results of operations, financial position and cash flows.

Historically, we were allocated general corporate expenses from TOC for corporate-related functions based on our revenue in proportion to the total revenue of TOC. General corporate expense allocations include executive management, internal and external audit fees, treasury, investor relations, strategic sourcing and risk management. We were allocated general corporate expenses from TOC of \$13.7 million and \$10.4 million during the three months ended June 30, 2007 and 2006, respectively, and \$25.3 million and \$21.8 million during the six months ended June 30, 2007 and 2006, respectively. We believe the assumptions and methodologies underlying the allocations of general corporate expenses from TOC are reasonable. However, such expenses are not indicative of, nor is it practical or meaningful for us to estimate for all historical periods presented, the actual level of expenses that would have been incurred had we been operating as a separate, stand-alone public or private company.

### **Seasonality**

The academic calendar drives the purchasing behavior of our customers, with purchases for the fall semester in the third calendar quarter and purchases for the winter/spring semester in the fourth calendar quarter before the holiday break. We produce a significant amount of books in advance of these two order periods, and approximately 67% of our revenue is recorded in the third and fourth quarter of the calendar year.

The decreases in accounts receivable, accounts payable and accrued expenses as well as the increases in Notes payable to TOC and other current liabilities from December 31, 2006 to June 30, 2007 are a natural result of the seasonality of the business.

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**Results of Operations**

**The Three Months Ended June 30, 2007 Compared With The Three Months Ended June 30, 2006**

(Dollars in millions)	<b>Three months ended June 30,</b>		<b>Percentage</b>
	<b>2007</b>	<b>2006</b>	<b>Change</b>
<b>Statement of Operations</b>			
Revenues:			
Domestic higher education	\$ 151.3	\$ 149.4	1.3 %
Domestic library reference	83.0	82.2	1.0 %
International	70.8	66.7	6.1 %
Corporate	5.3	4.6	15.2 %
Total revenues	<u>310.4</u>	<u>302.9</u>	2.5 %
Cost of revenues, excluding depreciation and amortization stated below:			
Products	134.0	129.6	3.4 %
Services and other	25.3	24.0	5.4 %
Total cost of revenues, excluding depreciation and amortization	<u>159.3</u>	<u>153.6</u>	3.7 %
Amortization of pre-publication costs	25.0	24.8	0.8 %
Selling, general & administrative, excluding depreciation and amortization stated below	132.5	102.3	29.5 %
Allocation of management costs from TOC	13.7	10.4	31.7 %
Depreciation and impairment	16.3	13.0	25.4 %
Amortization of identifiable intangible assets	10.4	10.2	2.0 %
Impairment of identifiable intangible assets	1.7	-	NM
Total costs and expenses	<u>358.9</u>	<u>314.3</u>	14.2 %
Operating loss	(48.5)	(11.4)	325.4 %
Interest expense with TOC	4.9	6.0	(18.3)%
Interest expense	1.6	2.3	(30.4)%
Loss before taxes	<u>(55.0)</u>	<u>(19.7)</u>	179.2 %
Benefit from income taxes	19.7	7.6	159.2 %
Equity losses of investee, net of taxes	(3.2)	(1.9)	68.4 %
Net loss	<u>\$ (38.5)</u>	<u>\$ (14.0)</u>	175.0 %

**Revenues** increased by \$7.5 million, or approximately 2.5%, to \$310.4 million for the three months ended June 30, 2007 from \$302.9 million for the three months ended June 30, 2006, due to growth in domestic higher education revenue and the impact of foreign currency translation.

Our domestic higher education revenue increased by \$1.9 million, or approximately 1.3%, to \$151.3 million for the three months ended June 30, 2007 from \$149.4 million for the same period in the prior year. The increase was driven by higher sales in the humanities, social sciences, and business and economics disciplines as well as continued growth in custom products partially offset by fewer shipping days at the end of the quarter and lower school sales as a result of fewer adoption opportunities.

Our domestic library reference revenue increased by \$0.8 million, or approximately 1%, to \$83.0 million for the three months ended June 30, 2007 from \$82.2 million for the same period in the prior year. Results reflect the growth in digital products, partially offset by a decline in print reference material and microfilm.

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Our international revenue increased by \$4.1 million, or approximately 6.1%, to \$70.8 million for the three months ended June 30, 2007 from \$66.7 million for the same period in the prior year. This increase reflects the impact of foreign currency translation partially offset by timing of sales in Asia and Latin America.

*Cost of revenues, excluding depreciation and amortization* increased by \$5.7 million, or approximately 3.7%, to \$159.3 million for the three months ended June 30, 2007 from \$153.6 million for the three months ended June 30, 2006, primarily related to increased costs to support our higher revenues.

Our products cost of revenues increased by \$4.4 million, or approximately 3.4%, to \$134.0 million for the three months ended June 30, 2007 from \$129.6 million for the same period in the prior year. These costs predominantly include paper, printing and binding costs, as well as author royalties, all of which vary as revenues increase or decrease. The increase was directly a result of second quarter revenue growth and the impact of currency in our international operations.

Our services and other cost of revenues increased by \$1.3 million, or approximately 5.4%, to \$25.3 million for the three months ended June 30, 2007 from \$24.0 million for the same period in the prior year. These costs include the variable cost of royalties, hosting and subscription-related costs largely in our domestic library reference business. The increase was primarily due to an increase in digital revenues.

*Amortization of pre-publication costs* increased by \$0.2 million, or approximately 0.8%, to \$25.0 million for the three months ended June 30, 2007 from \$24.8 million for the same period in the prior year. This marginal increase was due primarily to higher sales and growth in the business.

*Selling, general & administrative expenses* increased by \$30.2 million, or approximately 29.5%, to \$132.5 million for the three months ended June 30, 2007 from \$102.3 million for the same period in the prior year. This increase largely resulted from retention and other bonus arrangements and professional service fees incurred in advance of the Transactions of \$18.9 million and the impact of foreign currency.

*Allocation of management costs from TOC* increased by \$3.3 million, or approximately 31.7%, to \$13.7 million for the three months ended June 30, 2007 from \$10.4 million for the same period in the prior year. This increase was due primarily to higher compensation costs and professional fees by TOC.

*Depreciation and impairment* increased by \$3.3 million, or approximately 25.4%, to \$16.3 million for the three months ended June 30, 2007 from \$13.0 million for the same period in the prior year. This increase is due primarily to a \$1.9 million impairment of internally developed software applications which no longer support our business operations.

*Amortization of identifiable intangible assets* increased by \$0.2 million, or approximately 2.0%, to \$10.4 million for the three months ended June 30, 2007 from \$10.2 million for the same period in the prior year. This marginal increase was due to having a full year of amortization for recently completed acquisitions.

*Impairment of identifiable intangible assets* of \$1.7 million reflects a charge relating to a reduction in forecasted revenue and cash flow in one of our international businesses, resulting from reduced government funding for one of the business unit's products.

*Interest expense with TOC* decreased by \$1.1 million, or approximately 18.3%, to \$4.9 million for the three months ended June 30, 2007 from \$6.0 million for the three months ended June 30, 2006, due principally to lower average net borrowings from TOC.

*Interest expense* decreased by \$0.7 million, or approximately 30.4%, to \$1.6 million for the three months ended June 30, 2007 from \$2.3 million for the three months ended June 30, 2006 primarily due to lower long-term debt reflecting the principal payments of \$35.0 million in 2006.

*Benefit from income taxes* increased by \$12.1 million, or approximately 159.2%, to \$19.7 million for the three months ended June 30, 2007 from \$7.6 million for the three months ended June 30, 2006, due principally to the increased loss before

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taxes. Our effective tax rate for the three months ended June 30, 2007 is 35.8% and for the three months ended June 30, 2006 is 38.6%.

Our effective tax rate is subject to change based on nonrecurring events as well as recurring factors including geographical mix of income or loss before taxes and the related tax rates in those jurisdictions. In addition, our effective tax rate will change based on discrete or other nonrecurring events (such as audit settlements) that may not be predictable.

*Equity losses of investee, net of taxes* increased by \$1.3 million, or approximately 68.4%, to \$3.2 million for the three months ended June 30, 2007 from \$1.9 million for the three months ended June 30, 2006, primarily as a result of our recognition of an impairment to the carrying value of U21, our equity investee, of \$1.7 million.

**The Six Months Ended June 30, 2007 Compared With The Six Months Ended June 30, 2006**

(Dollars in millions)	Six months ended June 30, 2007	Six months ended June 30, 2006	Percentage Change
<b>Statement of Operations</b>			
Revenues:			
Domestic higher education	\$ 279.1	\$ 267.0	4.5 %
Domestic library reference	148.5	148.0	0.3 %
International	138.6	125.9	10.1 %
Corporate	10.7	9.3	15.1 %
Total revenues	<u>576.9</u>	<u>550.2</u>	4.9 %
Cost of revenues, excluding depreciation and amortization stated below:			
Products	259.3	249.6	3.9 %
Services and other	47.7	44.1	8.2 %
Total cost of revenues, excluding depreciation and amortization	<u>307.0</u>	<u>293.7</u>	4.5 %
Amortization of pre-publication costs	47.0	45.5	3.3 %
Selling, general & administrative, excluding depreciation and amortization stated below	250.9	206.7	21.4 %
Allocation of management costs from TOC	25.3	21.8	16.1 %
Depreciation and impairment	30.2	25.9	16.6 %
Amortization of identifiable intangible assets	20.7	20.1	3.0 %
Impairment of identifiable intangible assets	1.7	-	NM
Total costs and expenses	<u>682.8</u>	<u>613.7</u>	11.3 %
Operating loss	(105.9)	(63.5)	66.8 %
Interest expense with TOC	9.4	20.1	(53.2)%
Interest expense	2.2	2.6	(15.4)%
Loss before taxes	<u>(117.5)</u>	<u>(86.2)</u>	36.3 %
Benefit from income taxes	42.8	33.1	29.3 %
Equity losses of investee, net of taxes	(4.8)	(4.0)	20.0 %
Net loss	<u>\$ (79.5)</u>	<u>\$ (57.1)</u>	39.2 %

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**Revenues** increased by \$26.7 million, or approximately 4.9%, to \$576.9 million for the six months ended June 30, 2007 from \$550.2 million for the six months ended June 30, 2006, due to growth in domestic higher education revenue and the impact of foreign currency translation.

Our domestic higher education revenue increased by \$12.1 million, or approximately 4.5%, to \$279.1 million for the six months ended June 30, 2007 from \$267.0 million for the same period in the prior year. The increase was driven by higher sales in the humanities, social sciences, and business and economics disciplines as well as continued growth in custom products partially offset by fewer shipping days at the end of the period and lower school sales as a result of fewer adoption opportunities.

Our domestic library reference revenue increased by \$0.5 million, or approximately 0.3%, to \$148.5 million for the six months ended June 30, 2007 from \$148.0 million for the same period in the prior year. Results reflect the growth in digital products, partially offset by a decline in print reference material and microfilm.

Our international revenue increased by \$12.7 million, or approximately 10.1%, to \$138.6 million for the six months ended June 30, 2007 from \$125.9 million for the same period in the prior year. This increase was driven by growth in Australia as well as the impact of foreign currency translation.

**Cost of revenues, excluding depreciation and amortization** increased by \$13.3 million, or approximately 4.5%, to \$307.0 million for the six months ended June 30, 2007 from \$293.7 million for the six months ended June 30, 2006, primarily related to increased costs to support our higher revenues.

Our products cost of revenues increased by \$9.7 million, or approximately 3.9%, to \$259.3 million for the six months ended June 30, 2007 from \$249.6 million for the same period in the prior year. These costs predominantly include paper, printing and binding costs, as well as author royalties, all of which vary as revenues increase or decrease. The increase was directly a result of revenue growth and the impact of currency in our international operations.

Our services and other cost of revenues increased by \$3.6 million, or approximately 8.2%, to \$47.7 million for the six months ended June 30, 2007 from \$44.1 million for the same period in the prior year. These costs include the variable cost of royalties, hosting and subscription-related costs largely in our domestic library reference business. The increase was primarily due to an increase in digital revenues.

**Amortization of pre-publication costs** increased by \$1.5 million, or approximately 3.3%, to \$47.0 million for the six months ended June 30, 2007 from \$45.5 million for the same period in the prior year. This marginal increase was due primarily to higher sales and growth in the business.

**Selling, general & administrative expenses** increased by \$44.2 million, or approximately 21.4%, to \$250.9 million for the six months ended June 30, 2007 from \$206.7 million for the same period in the prior year. This increase largely resulted from retention and other bonus arrangements and professional service fees incurred in advance of the Transactions of \$28.4 million and the impact of foreign currency.

**Allocation of management costs from TOC** increased by \$3.5 million, or approximately 16.1%, to \$25.3 million for the six months ended June 30, 2007 from \$21.8 million for the same period in the prior year. This increase was due primarily to higher compensation costs and professional fees by TOC.

**Depreciation and impairment** increased by \$4.3 million, or approximately 16.6%, to \$30.2 million for the six months ended June 30, 2007 from \$25.9 million for the same period in the prior year. This increase is due primarily to a \$1.9 million impairment of internally developed software applications which no longer support our business operations.

**Amortization of identifiable intangible assets** increased by \$0.6 million, or approximately 3.0%, to \$20.7 million for the six months ended June 30, 2007 from \$20.1 million for the same period in the prior year. This marginal increase was due primarily to having a full year of amortization for recently completed acquisitions.

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*Impairment of identifiable intangible assets* of \$1.7 million reflects a charge relating to a reduction in forecasted revenue and cash flow in one of our international businesses, resulting from reduced government funding for one of the business unit's products.

*Interest expense with TOC* decreased by \$10.7 million, or approximately 53.2%, to \$9.4 million for the six months ended June 30, 2007 from \$20.1 million for the six months ended June 30, 2006, due principally to lower average net borrowings from TOC.

*Interest expense* decreased by \$0.4 million, or approximately 15.4%, to \$2.2 million for the six months ended June 30, 2007 from \$2.6 million for the six months ended June 30, 2006. This decrease is attributed to lower long-term debt reflecting the principal payments of \$35.0 million in 2006.

*Benefit from income taxes* increased by \$9.7 million, or approximately 29.3%, to \$42.8 million for the six months ended June 30, 2007 from \$33.1 million for the six months ended June 30, 2006 due principally to the increased loss before taxes. Our effective tax rate for the six months ended June 30, 2007 is 36.4% and for the six months ended June 30, 2006 is 38.4%.

Our effective tax rate is subject to change based on nonrecurring events as well as recurring factors including geographical mix of income or loss before taxes and the related tax rates in those jurisdictions. In addition, our effective tax rate will change based on discrete or other nonrecurring events (such as audit settlements) that may not be predictable.

*Equity losses of investee, net of taxes* increased by \$0.8 million, or approximately 20.0%, to \$4.8 million for the six months ended June 30, 2007 from \$4.0 million for the six months ended June 30, 2006, primarily as a result of our recognition of an impairment to the carrying value of U21, our equity investee, of \$1.7 million.

### Liquidity and Capital Resources

The following table sets forth other financial data and our cash flows from operating, investing and financing activities for the three and six month periods ended June 30, 2007 and 2006:

(Dollars in millions)	Three months ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2007	2006	2007	2006
<b>Other Financial Data</b>				
Additions to property, equipment and capitalized software for internal use	\$ 20.0	\$ 11.1	\$ 26.8	\$ 16.9
Additions to pre-publication costs	35.5	29.3	61.3	56.2
<b>Statements of cash flows</b>				
Net cash used by operating activities	\$ (29.4)	\$ (14.4)	\$ (31.6)	\$ (42.2)
Net cash used by investing activities	(63.0)	(43.2)	(121.4)	(78.7)
Net cash provided by financing activities	72.1	57.5	134.9	115.0
Impact on cash and cash equivalents from change in foreign currency	0.6	0.4	0.8	0.1
Net (decrease) increase in cash and cash equivalents	\$ (19.7)	\$ 0.3	\$ (17.3)	\$ (5.8)

Our principal sources of liquidity are our existing cash, internally generated cash flow from operations and borrowings under our arrangements with TOC. The principal uses of cash are to fund planned operating expenditures and capital expenditures, including investments in products and technology offerings.

Our financing needs are supported by borrowings to and from TOC. We periodically lend to or borrow money from various subsidiaries of TOC as part of TOC's overall cash management and capitalization program. Certain of these

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arrangements are subject to written loan agreements specifying repayment terms and interest payments. These notes are reflected separately in the Combined Balance Sheet based on their legal form. Since these notes are part of TOC's overall capitalization of us, changes in the notes' balances are reflected as financing activities in the Combined Statement of Cash Flows.

We had a net working capital deficit of \$565.3 million as of June 30, 2007, which includes the following balances which were not acquired or assumed by TL Holdings II L.P as part of the Acquisition: (i) \$693.9 million of current liabilities payable TOC; (ii) \$35.0 million of current portion of long-term debt; and (iii) \$23.8 million of current notes receivables due from TOC.

### **Cash flows**

**Operating activities.** Net cash used by operating activities for the three months ended June 30, 2007 increased by \$15.0 million, or approximately 104.2%, to \$29.4 million from \$14.4 million for the same period in 2006. This increase was attributable primarily to increased losses in the current period.

Net cash used by operating activities for the six months ended June 30, 2007 decreased by \$10.6 million, or approximately 25.1%, to \$31.6 million from \$42.2 million for the six months ended June 30, 2006. This decrease was attributable to more favorable timing of payments of accounts payable and accruals in the current period, partially offset by increased losses during the period.

**Investing activities.** Net cash used by investing activities for the three months ended June 30, 2007 increased by \$19.8 million, or approximately 45.8%, to \$63.0 million from \$43.2 million for the same period in 2006. This increase resulted from a capital infusion into our equity investee of \$5.2 million, higher spending on pre-publication costs and increased additions to property, equipment and capitalized software for internal-use, primarily for the development of a disaster recovery center in Independence, Kentucky.

Net cash used by investing activities for the six months ended June 30, 2007 increased by \$42.7 million, or approximately 54.3%, to \$121.4 million from \$78.7 million for the same period in 2006. This increase resulted from acquisitions of businesses, a capital infusion into our equity investee of \$5.2 million, higher spending on pre-publication costs and increased additions to property, equipment and capitalized software for internal-use, primarily for the development of a disaster recovery center for our shared services center in Independence, Kentucky.

**Financing activities.** Net cash provided by financing activities for the three months ended June 30, 2007 increased by \$14.6 million, or approximately 25.4%, to \$72.1 million from \$57.5 million for the same period in 2006. This increase was the result of proceeds from notes payable/receivable to TOC and lower repayments of cash overdrafts, offset by a decrease in the net investment of TOC.

Net cash provided by financing activities for the six months ended June 30, 2007 increased by \$19.9 million, or approximately 17.3%, to \$134.9 million from \$115.0 million for the same period in 2006. This increase was the result of proceeds from notes payable/receivable to TOC, offset by a decrease in the net investment of TOC.

### **Cash position and indebtedness**

As of June 30, 2007, our total cash and cash equivalents were \$18.8 million and we had total indebtedness of approximately \$769.8 million, compared to total cash and cash equivalents and total indebtedness as of December 31, 2006 of \$36.1 million and \$562.7 million, respectively.

### **Off-balance sheet transactions**

As of June 30, 2007, we do not have any, nor are we party to, any off-balance sheet financial instruments.

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**Indebtedness and liquidity post-Transactions**

As a result of the completion of the Transactions, we are highly leveraged. On a pro forma basis as of June 30, 2007, our total indebtedness would have been \$5,606.2 million. We also have an additional \$300.0 million available for borrowing under our revolving credit facility and we may incur additional indebtedness pursuant to an uncommitted incremental term loan facility subject to certain limitations. Our liquidity requirements will be significant, primarily due to our debt service requirements. On a pro forma basis, after giving effect to the Transactions and excluding any cash interest associated with the senior subordinated discount notes, our cash interest expense for the three and six months ended June 30, 2007 would have been \$98.0 million and \$202.8 million, respectively. In addition, our liquidity and our ability to fund our capital requirements is also dependent on our future financial performance, which is subject to general economic, financial and other factors that are beyond our control. If those factors significantly change or other unexpected factors adversely affect us, our business may not generate sufficient cash flow from operations or we may not be able to obtain future financings to meet our liquidity needs. We anticipate that to the extent additional liquidity is necessary to fund our operations, it would be funded through borrowings under our revolving credit facility, the incurrence of other indebtedness, additional equity financings or a combination of these potential sources of liquidity. We may not be able to obtain this additional liquidity on terms acceptable to us or at all.

Management expects our cash flows from operations, combined with availability under our new revolving credit facility, to provide sufficient liquidity to fund our current obligations, projected working capital requirements, restructuring obligations and capital spending for the foreseeable future.

In assessing our liquidity, our management reviews and analyzes our current cash on-hand, the number of days our sales are outstanding, the contractual rates that we have established with our payors, inventory turns, foreign exchange rates, capital expenditure commitments and income tax rates. Our principal liquidity requirements will be to meet our working capital, capital expenditure needs and debt service requirements.

**Senior secured credit facilities**

In connection with the Transactions, we entered into senior secured credit facilities which provide senior secured financing of \$3,740.0 million, consisting of:

- a \$3,440.0 million term loan facility with a seven-year maturity; and
- a \$300.0 million revolving credit facility with a six-year maturity.

The revolving credit facility includes borrowing capacity available for letters of credit and for short-term borrowings referred to as swing line borrowings. In addition, the senior secured credit facilities also provide us with the option to raise, subject to certain limitations, incremental term loan facilities of up to \$750.0 million plus the amount of any voluntary prepayments of the term loans (and with the ability to raise additional incremental term facilities subject to certain secured leverage tests).

Borrowings under the term loan facility and the revolving credit facility bear interest, at our option, at a rate equal to a margin over either (a) a base rate determined by reference to the higher of (1) the rate of interest announced publicly by The Royal Bank of Scotland plc, from time to time, as its prime rate and (2) the federal funds effective rate plus 1/2 of 1% or (b) a LIBOR rate determined by reference to the costs of funds for deposits in the currency of such borrowing for the interest period relevant to such borrowing. For term loans, the margin is currently (i) 1.75%, in the case of base rate loans and (ii) 2.75%, in the case of LIBOR rate loans. For revolving credit loans, the margin is currently (i) 1.75%, in the case of base rate loans and (ii) 2.75%, in the case of LIBOR rate loans. The applicable margin for borrowings under both the term loan facility and the revolving credit facility may be reduced subject to attaining certain leverage ratios. In subsequent reports, we will report the actual interest rate as opposed to the method of calculation.

The senior secured credit facilities contain certain customary affirmative covenants and events of default.

**Senior notes and senior subordinated discount notes**

In connection with the Transactions, we issued \$1,215.6 million aggregate principal amount (\$1,200.1 million gross proceeds) of 10.50% senior notes due 2015 and \$519.0 million aggregate principal amount at maturity (\$400.1 million gross

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proceeds) of 13.25% senior subordinated discount notes due 2015. No cash interest will accrue on the senior subordinated discount notes between the date of original issuance and July 15, 2009.

The indentures that govern the senior notes and senior subordinated discount notes contain certain covenants, agreements and events of default which are customary with respect to non-investment grade debt securities.

**Unsecured payment in kind credit facility**

In connection with the Transactions, we also entered into a \$540.0 million senior unsecured floating rate Payment in Kind (“PIK”) credit facility with an eight-year maturity. Borrowings under the senior unsecured floating rate PIK credit facility bear interest at a rate of LIBOR plus 7.75% per annum, increasing to LIBOR plus 8.25% six months after the consummation of the Acquisition and to LIBOR plus 8.75% nine months after the consummation of the Acquisition, subject to a maximum interest limitation.

The senior unsecured floating rate PIK credit facility contains certain affirmative covenants and events of default which are customary with respect to financings of such type.

**Application of Critical Accounting Policies and Estimates**

In preparing our Combined Financial Statements and accounting for the underlying transactions and balances, we apply various accounting policies. We consider the policies disclosed as critical to understanding our Combined Financial Statements, as their application places the most significant demands on management’s judgment, since financial reporting results rely on estimates of matters that are inherently uncertain. These significant accounting policies should be read in conjunction with similar disclosures made in our Combined Financial Statements for the years ended December 31, 2006, 2005 and 2004. For a detailed discussion of the application of these accounting policies, refer to Note 4, “Critical Accounting Policies and Estimates” to these Combined Financial Statements, as well as our Combined Financial Statements for the years ended December 31, 2006, 2005 and 2004. There have been no changes in the application of critical accounting policies since December 31, 2006.

**Recent Accounting Pronouncements**

Please refer to Note 5, “Recent Accounting Pronouncements” to these Combined Financial Statements for a discussion of recent accounting standards that we have not yet been required to implement, but which may affect us in the future, as well as those accounting standards that have been adopted during 2007.

**TL HOLDINGS II L.P.**  
**(AS SUCCESSOR TO THOMSON LEARNING)**  
**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk from foreign currency exchange rates and interest rates, which could affect operating results, financial position and cash flows. We manage our exposure to these market risks through our regular operating and financing activities and, when appropriate, through the use of derivative financial instruments. These derivative financial instruments are utilized to hedge economic exposures as well as reduce earnings and cash flow volatility resulting from shifts in market rates. As permitted, certain of these derivative contracts may be designated for hedge accounting treatment under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. However, certain of these instruments may not qualify for hedge accounting treatment and, accordingly, our results of operations may be exposed to some level of volatility. Volatility to our results of operations will vary with the type and amount of derivative hedges outstanding, as well as fluctuations in the currency and interest rate market during the period.

We may periodically enter into limited types of derivative contracts, including interest rate and cross currency interest rate swap agreements and interest rate collars to manage interest rate exposures; foreign currency spot, forward, swap and option contracts to manage foreign currency exposures. The fair market values of all our derivative contracts change with fluctuations in interest rates and/or currency rates and are designed so that any changes in their values are offset by changes in the values of the underlying exposures. Derivative financial instruments are held solely as risk management tools and not for trading or speculative purposes.

By their nature, all derivative instruments involve, to varying degrees, elements of market and credit risk not recognized in our financial statements. The market risk associated with these instruments resulting from currency exchange and interest rate movements is expected to offset the market risk of the underlying transactions, assets and liabilities being hedged. We do not believe there is a significant risk of loss in the event of non-performance by derivative counterparties because these transactions are executed with a diversified group of major financial institutions. Further, our policy is to deal with counterparties having a minimum investment-grade or better credit rating. Credit risk is managed through the continuous monitoring of exposures to such counterparties.

At June 30, 2007, we did not have any outstanding derivative instruments.