Houghton Mifflin Harcourt

HMH Holdings (Delaware), Inc.

Annual Report for the year ended December 31, 2012

HMH Holdings (Delaware), Inc. ("Company") is not subject to the filing requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934. Consequently, this report has not and will not be filed with the Securities and Exchange Commission ("SEC"). The Company is preparing this Annual Report and posting this Annual Report on its website in accordance with the requirements of the investor rights agreement, dated as of June 22, 2012, by and among the Company and the holders party thereto from time to time.

Cautionary Statement Regarding Forward-Looking Statements

Certain statements contained in this report are "forward-looking statements" within the meaning of applicable federal securities laws. All statements contained herein that are not clearly historical in nature are forward-looking and the words "may," "will," "should," "anticipate," "believe," "could," "expect," "estimate," "forecast," "intend," "plan," "potential," "project," "target" and similar expressions are generally intended to identify forward-looking statements. All statements contained in this report, other than statements of historical fact, including without limitation, statements about our plans, strategies, prospects and expectations regarding future events and our financial performance, are forward-looking statements that involve certain risks and uncertainties. While these statements represent our current judgment on what the future may hold, and we believe these judgments are reasonable in the circumstances, these statements are not guarantees of any events or financial results, and our actual results may differ materially. You are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on these forward-looking statements. The forward-looking statements included in this report are made only as of the date of this report. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We undertake no obligation to update these forward-looking statements to reflect new information, future events or otherwise, except as required by law. All forward-looking statements involve risks and uncertainties, many of which are beyond our control, which may cause actual results, performance or achievements to differ materially from anticipated results, performance or achievements. We cannot assure you that projected results or events will be achieved. Factors that could cause our actual results to be materially different from our expectations include those factors described in this report and other reports under the caption "Risk factors," including, among others, the following:

- adverse or worsening economic trends or the continuation of current economic conditions;
- changes in state and local educational funding and/or related programs, legislation and procurement processes;
- changes in consumer demand for, and acceptance of, our products;
- changes in competitive factors;
- industry cycles and trends;
- conditions and/or changes in the publishing industry;
- restrictions under the credit agreement governing our existing Term Loan and Revolving Credit Facility;
- changes in laws or regulations governing our business and operations;
- changes or failures in the information technology systems we use;
- demographic trends;
- uncertainty surrounding our ability to enforce our intellectual property rights;
- inability to retain management or hire employees; and
- impact of potential impairment of goodwill and other intangibles in a challenging economy.

HMH Holdings (Delaware), Inc.
Annual Report
Year Ended December 31, 2012
Table of Contents

Page(s)

Item 1. Business ... 4

Item 1A. Risk Factors ... 15

Item 1B. Unresolved Staff Comments ... 22

Item 2. Properties ... 23

Item 3. Legal Proceedings ... 24

Item 4. Mine Safety Disclosures ... 24

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities ... 24

Item 6. Selected Financial Data ... 25

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations ... 26

Item 7A. Quantitative and Qualitative Disclosures about Market Risk ... 48

Item 8. Financial Statements and Supplementary Data ... 49

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure ... 105

Item 9A. Controls and Procedures ... 105

Item 9B. Other Information ... 105

Item 10. Directors, Executive Officers and Corporate Governance ... 105

Item 11. Executive Compensation ... 111

Item 12. Security Ownership of Certain Beneficial Owner’s and Management and Related Stockholders Matters ... 126

Item 13. Certain Relationships and Related Transactions, and Director Independence ... 129

Item 14. Principal Accounting Fees and Services ... 130

Item 15. Exhibits, Financial Statement Schedules ... 130

Item 1. Business

Company Overview

As used herein the terms "we", "us", "our" and "HMH" refer to HMH Holdings (Delaware), Inc. and its consolidated subsidiaries unless otherwise expressly stated or the context otherwise requires. Among the world's largest providers of pre-K-12 education solutions and one of the longest-established publishing houses, we are a global leader in supporting lifelong learning.

We are a leading provider of educational content, technology and professional services to the elementary and secondary school market in the United States, including a full range of comprehensive curriculum, supplemental products and service offerings. We have a long-standing expertise in teaching and instructional strategy and the design and creation of print and electronic learning materials across all grade levels. We distribute our solutions in multiple formats, including print and digital curriculum, technology platforms, assessment tools and services. We believe our solutions are a mission critical tool for school systems as they increasingly focus on outcomes-based learning and teaching solutions that reach students both in the classroom and at home. We believe we are a leader in the transformation of the traditional educational materials market and have the opportunity to increase net sales and profitability by selling our innovative solutions through a comprehensive and integrated approach to educating children. Furthermore, since 1832, we have published trade and reference materials including award-winning adult and children's books, fiction, and nonfiction.

Our mission is to change people's lives by fostering passionate, curious learners. We are experts in the learning process and continuously research, test, and improve what works, bringing to light new ideas and approaches that make learning more dynamic, engaging and effective. By combining cutting-edge research, editorial excellence and technological innovation, our goal is to improve teaching and learning environments and solve complex literacy and education challenges. Our interactive, results-driven education solutions are utilized by 60 million students in 120 countries.

We focus on two primary areas: pre-K-12 educational content and resources for institutions and consumers; and trade publishing.

As the leading educational publisher in the U.S. public school market, our pre-K-12 education business represented approximately 88% of our total revenue for the year ended December 31, 2012. Our revenue is diversified by geography and subject, with the highest revenue from a single state or subject representing approximately 7% and 20% of 2012 revenue, respectively, with less revenue derived from any other single state or subject.

Our education business delivers quality, effective content and services through a variety of mediums – including mobile learning applications, digital platforms, educational gaming, print materials, assessment tools and professional development resources – across multiple platforms and devices. Our K-12 portfolio includes widely recognized imprints such as Holt McDougal, Riverside and Heinemann.

Our Trade Publishing division is responsible for nearly two centuries worth of renowned and award-winning novels, non-fiction, children's books and reference titles. Our portfolio includes *The Best American* series; *The American Heritage* and *Webster's New World* dictionaries; *Betty Crocker*, *Better Homes and Gardens*, *How to Cook Everything*, *The Gourmet Cookbook*, and other leading culinary properties; the *Peterson Field Guides*; *CliffsNotes*; the works of J.R.R. Tolkien; and many iconic children's books and characters including *Curious George*, *The Little Prince* and *The Polar Express*.

Across both segments, we focus on the expansion of our digital content portfolio to include web and application-based social games and other products that build upon the skills and lessons taught in the classroom and at home. Recently released mobile apps such as *Curious George at the Zoo* demonstrate the opportunities to leverage our trusted consumer brands within our digital education offerings.

For the years ended December 31, 2012, 2011 and 2010, our net sales were $1,285.6 million, $1,295.3 million and $1,507.0 million (on a combined basis), respectively.

Corporate history

HMH Holdings (Delaware), Inc.

HMH Holdings (Delaware), Inc. ("HMH Holdings", "HMH", "Company", or "Houghton Mifflin Harcourt", "we", "us", "our", or the "Company") was incorporated as a Delaware corporation on March 5, 2010 and was established to be the holding company of the current operating group. HMH is a leading global education and learning company providing innovative solutions and approaches to the challenges facing education today. We are one of the world's largest providers of educational products and solutions for pre-K–12 learning and we also develop and deliver interactive, results-driven learning solutions that advance teacher effectiveness and student achievement in the Education market. Furthermore, since 1832, we have published trade and reference materials including award-winning adult and children's books, fiction, and nonfiction.

Restructuring and reorganization

On May 10, 2012, we entered into a Restructuring Support Agreement ("Plan Support Agreement") with consenting creditors holding greater than 74% of the principal amount of the outstanding senior secured indebtedness of the Company and with equity owners holding approximately 64% of the Company's outstanding common stock. The consenting creditors agreed to support the Company's Pre-Packaged Chapter 11 Plan of Reorganization ("Plan"). Pursuant to the Plan Support Agreement, the Company agreed to use its best efforts to (i) support and complete the restructuring and all transactions contemplated by the Plan, (ii) take any and all necessary and appropriate actions in furtherance of the restructuring contemplated under the Plan, (iii) complete the restructuring and all transactions contemplated under the Plan within set time-frames, (iv) obtain any and all required regulatory and/or third-party approvals for the restructuring, and (v) not directly or indirectly, seek, solicit, support, or engage in the negotiation or formulation of alternate plans of reorganization that were inconsistent with the reorganization as contemplated by the Plan Support Agreement.

On May 21, 2012 (the "Petition Date"), the U.S. based entities that borrowed or guaranteed the debt of the Company (collectively the "Debtors"), filed voluntary petitions for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Southern District of New York ("Court"). Concurrently therewith, the Debtors also filed the Plan, the Disclosure Statement in support of the Plan and filed various motions seeking relief to continue operations. Following the Petition Date, the Debtors operated their business as "debtors in possession" ("DIP") under the jurisdiction of the Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Court. Under Chapter 11 of the United States Bankruptcy Code ("Chapter 11"), certain claims against us in existence before the Petition Date were stayed while we operated our business as a DIP including any actions that might be commenced with regards to secured claims, although the holders of such claims had the right to move the Court for relief from the stay. Subsequent to the Petition Date, these claims were reflected in the balance sheet as liabilities subject to compromise. Secured claims were secured primarily by liens on the Company's accounts receivable. Additional claims (liabilities subject to compromise) could have potentially arisen after the filing date resulting from rejection of executory contracts or from the determination by the Court (or agreed to by parties in interest).

On June 22, 2012, the Company successfully emerged from bankruptcy as a reorganized company pursuant to the Plan. Ultimately, the Debtors did not reject any executory contracts during the bankruptcy case, and the Company continues to review and reconcile claims that were filed against it by creditors.

On March 9, 2010, we completed a restructuring of certain indebtedness and an upper-tier reorganization. As part of the reorganization, Riverdeep Interactive Learning, an Irish company and our previous parent company ("RIL"), entered into a series of transactions that ultimately resulted in HMH

Holdings and its subsidiaries no longer being subsidiaries of RIL. In the out-of-court restructuring, the then-existing first lien lenders received approximately 90% of the equity of HMH Holdings (pre-dilution from the associated rights offering) in exchange for converting $2 billion of debt and the then-existing mezzanine lenders received approximately 10% of the equity and warrants to purchase up to an additional 12.5% of the incremental value above a specified equity value (in each case, pre-dilution from the rights offering) in exchange for converting $2 billion of debt. In addition, we used the proceeds from the $650 million rights offering issued to certain then-existing first lien lenders and mezzanine lenders to pay transaction fees, accrued cash interest and fund cash on the balance sheet.

As a result, the financial information presented in this report for the years ended December 31, 2012, December 31, 2011 and the period from March 10, 2010 to December 31, 2010 represents the results of operations of HMH Holdings and its consolidated subsidiaries, and the financial information presented in this report for the period from January 1, 2010 to March 9, 2010 represents the results of operations of HMH Publishing, our predecessor, and its consolidated subsidiaries.

The historical financial information presented for 2010 has been derived from the financial statements and accounting records of HMH Holdings (Delaware), Inc. ("Successor") for the period March 10, 2010 to December 31, 2010 and from the financial statements and accounting records of HMH Publishing Company ("Predecessor") for the period January 1, 2008 through March 9, 2010. We have presented our 2010 results as the mathematical addition of the Predecessor and Successor periods (the "Combined Period"). We believe that this presentation provides meaningful information about our results of operations. This approach is not consistent with GAAP, may yield results that are not strictly comparable on a period-to-period basis and may not reflect the actual results we would have achieved. Prior to March 9, 2010, the financial information is for the Predecessor entity and following March 9, 2010 the financial information is for the Successor entity.

Strategic Priorities

To promote sustainable growth, product diversification and a strong global brand, we continue to focus on aligning our resources and efforts against the following priorities:

- *Reinforce the Core Business* **–** Maintain our market share of pre-K-12 by continuing to innovate from a product and marketing perspective.

- *Prudently Invest in Growth* **–** Broaden our market presence from a geographic, customer and product perspective through:
  - International expansion
  - Moving into the consumer (student, teacher, parent and lifelong learner) market
  - Continued focus on products and services with proven efficacy and deep pedagogical strength / market following
  - Building a comprehensive portfolio of offerings to include supplemental materials and services

- *Lead Digital Transition* **–** Reengineer our product development processes to allow for greater focus on digital innovation and on building quality, adaptive content that can be consumed across multiple platforms, devices and mediums.

- *Know the Customer* **–** Shift from a product-centric to a customer-focused approach in all aspects of our business, including product and service design and delivery.

- *Leverage Strategic Partnerships and Alliances* **–** Develop and expand relationships with strategic partners that already have a strong presence in HMH's targeted growth markets; and forge alliances with the world's leading technology companies to ensure that our quality, device-agnostic content is available to virtually any school district or household.

- *Drive Operational Excellence* **–** Continue to increase profit margins by refining organizational structure, investing in intelligence, process and tools, and attracting and retaining superior talent.

- *Harvest Non-Core Product Lines* **–** Evaluate divestment to ensure efficient use of capital and invest only at maintenance levels in profitable but declining product lines.

Business Segments

We are organized along two business segments: Education and Trade Publishing. The Education segment is our largest business, and represented on average approximately 90% of our total net sales for the years ended December 31, 2012, 2011 and 2010.

Education

Our Education business provides a comprehensive suite of educational products, technology platforms and services to meet the diverse needs of today's classrooms. These products and services include print and digital content in the form of textbooks, digital courseware, instructional aids, educational assessment and intervention solutions (which are aimed at improving achievement and supporting learning for students that are not keeping pace with peers), professional development and school reform services. With an in-house editorial staff supplemented by external specialists, we develop programs that can be aligned to state standards and customized for specific state requests. In addition, our Education segment offers a wide range of educational, cognitive and developmental standardized testing products in print, CD-ROM and online formats, targeting the educational and clinical assessment markets. The principal markets for our Education products are elementary and secondary school systems.

The Education business includes such trusted brands as Holt McDougal, Great Source, Rigby, Saxon, Steck-Vaughn, Math in Focus, Riverside and Heinemann. These brands offer solutions in reading, language arts, mathematics, intervention, social studies, science and world languages, as well as curriculum resources, professional development services and an array of highly regarded educational, cognitive and developmental assessment products. Each brand benefits from strong market share as well as strong relationships with its customers, most of which have been developed over many years through a service-based approach to designing, marketing and implementing its programs.

The Education segment net sales and Adjusted EBITDA were $1,128.6 million and $329.7 million, $1,169.6 million and $278.9 million and $1,383.1 million and $490.3 million, for the years ended December 31, 2012, 2011 and 2010, respectively.

Our Education products are divided into the following subgroups:

- *Comprehensive Curriculum.* The Comprehensive Curriculum subgroup develops comprehensive educational programs intended to provide a complete course of study in a subject, either at a single grade level or across multiple grade levels, and are the primary source of classroom instruction. We develop and market Comprehensive Curriculum programs for the Pre-K-12 market utilizing the Houghton Mifflin Harcourt brands in grades Pre-K-6 and the Holt McDougal brands in grades 6-12. This subgroup focuses its publishing portfolio on the subjects that have consistently received the highest priority from educators and educational policy makers, namely reading, literature/language arts, mathematics, science, world languages and social studies. In each subject, comprehensive learning programs are designed and then marketed with a variety of proprietary products to maximize teaching effectiveness, including textbooks, workbooks, teachers' guides and resources, audio/visual aids and technology-based products. Our Comprehensive Curriculum subgroup accounted for approximately 56.2%, 60.6% and 67.8% of our total Education segment net sales for the years ended December 31, 2012, 2011 and 2010, respectively.

- *Supplemental products.* We develop products targeted at addressing struggling learners through comprehensive intervention solutions, products targeted at assisting English language learners

and products providing incremental instruction in a particular subject area. Curriculum solutions are used both as alternatives and as supplements to Comprehensive Curriculum programs, enabling local educators to tailor their education programs in a cost-effective way that is irrespective of adoption schedules. As a result, the Supplemental Products subgroup creates net sales and earnings that do not vary greatly with the adoption cycle. In addition, the development of supplemental materials tends to require significantly less capital investment than the development of a Comprehensive Curriculum program. Our Supplemental Products subgroup accounted for approximately 13.0%, 12.5% and 10.1% of our total Education segment net sales for the years ended December 31, 2012, 2011 and 2010, respectively.

- *Heinemann.* Our Heinemann products include professional books and development resources to teachers of grades pre-K-12 and are known by educators for empowering teachers and giving them access to highly regarded and recognized experts in the education field. The author base includes some of the most prominent experts in teaching, who support the practice of other teachers through books, videos, workshops and classroom tools. Heinemann has also developed a market leading literacy intervention program with *Benchmarks/LLI*, which comprises roughly 50% of Heinemann product revenues. Our Heinemann subgroup accounted for approximately 10.9%, 8.8% and 6.8% of our total Education segment net sales for the years ended December 31, 2012, 2011 and 2010, respectively.
- *Professional Services.* To extend our value proposition beyond curriculum, assessment and technology solutions, we provide consulting services to assist school districts in increasing accountability for improvement and offering professional development training, comprehensive services and school turnaround solutions. We believe our professional services, led by The Leadership and Learning Center business, offer unique integrated solutions that combine the best learning resources available today with services that support deep implementation. These include learning resources that are supported with effective professional development in classroom assessment, teacher effectiveness and high impact leadership, which are all proven to have a measurable and sustainable impact on student achievement. Our Professional Services subgroup accounted for approximately 6.1%, 4.4% and 0.0% of our total Education business net sales for the years ended December 31, 2012, 2011 and 2010, respectively.
- *Riverside Assessment.* Riverside Assessment products provide district and state level solutions focused on clinical, group and formative assessment tools and platform solutions. Clinical solutions provide psychological and special needs testing to assess intellectual, cognitive and behavioral development. Our products include measurements relating to intellectual ability, academic achievement assessments around cognitive abilities and several diagnostic and assessment tools that assist in identifying the learning needs of students. Riverside Assessment products accounted for 8.2%, 9.0% and 8.0% of our total Education segment net sales for the years ended December 31, 2012, 2011 and 2010, respectively.
- *International.* Our International business primarily focuses on selling educational solutions and products into global education markets predominantly to large English language schools in high growth territories primarily in Asia, the Pacific, the Middle East, Latin America, the Caribbean and Africa. In addition to a dedicated sales and business development team, we have a global network of international partners and alliances, including distributors, in local markets around the world. International sales accounted for approximately 5.6%, 4.7% and 7.3% of our total Education segment net sales for the year ended December 31, 2012, 2011 and 2010, respectively.

Trade Publishing

Our Trade Publishing business, which dates back to 1832, primarily develops, markets and sells consumer books in print and digital formats and licenses book rights to other publishers and electronic businesses in the United States and abroad. The principal markets for Trade Publishing products are

retail stores, both physical and online, and wholesalers. Reference materials are also sold to schools, colleges, libraries, office supply distributors and other businesses.

Our Trade Publishing business offers a rich library of general interest, children's and reference works that include beloved characters and well-known brands. Our award-winning general interest titles encompass literary fiction, culinary, and non-fiction in hardcover, ebook and paperback formats, including the Mariner Books and Harvest Books paperback lines. Among the general interest properties are the popular J.R.R. Tolkien titles and the Best American series. The general interest group also publishes comprehensive culinary works and field guides, such as the Peterson Field Guides and Taylor's Gardening Guides. With the 2012 acquisition of certain culinary and reference assets, we became the #2 publisher in those respective market niches. Our vast catalog of books for young readers features numerous Newbery and Caldecott medal winners, including a 2012 Caldecott Honor winner. Our young readers list addresses a broad age group, spanning board books for the very young to novels for young adults, and includes recognized characters such as Curious George and Martha Speaks, both successful television programs featured on PBS, Five Little Monkeys, Gossie and Gertie, and many more. In the reference category, we are the publisher of the American Heritage and Webster dictionary, and related titles.

Even before ebooks gained prominence in the market, we had developed in-house experience in converting, structuring, storing and distributing dictionary and other reference content for digital platforms, and leveraged our knowledge and tools in the digital space to apply to consumer trade content including e-books and applications. As such, we have an established, innovative and flexible solution for converting, manipulating and distributing trade content to the many rapidly emerging digital consumer platforms such as e-readers and tablets. We have been able to move quickly to take advantage of the rapidly accelerating market for e-books, book or character based apps and other digital products with net sales from e-books reaching approximately $25.0 million for the year ended December 31, 2012, and now representing a meaningful piece of our Trade Publishing business. We continue to focus on the development of innovative new digital products which capitalize on our strong content, our digital expertise, and the growing consumer demand for these products.

For the years ended December 31, 2012, 2011 and 2010, Trade Publishing net sales and Adjusted EBITDA were approximately $157.1 million and $28.8 million,$125.7 million and $12.9 million, and $123.9 million and $12.7 million, respectively.

Our Industry

K-12 comprehensive curriculum (basal) market

The United States K-12 comprehensive curriculum (basal) market provides educational programs and assessments to approximately 56 million students across approximately 116,000 elementary and secondary schools. Basal programs cover curriculum standards in a particular subject and include a comprehensive offering of teacher and student materials required to conduct the class throughout the year. Products and services in basal programs include students' print and digital offerings and a variety of supporting materials such as teacher's editions, formative assessments, whole group instruction materials, practice aids, educational games and services.

Comprehensive curriculum programs are the primary source of classroom education for most K-12 academic subjects, and as a result, enrollment trends are a major driver of industry growth. Although economic cycles may affect short-term buying patterns, school enrollments, a driver of growth in the educational publishing industry, are highly predictable and are trending favorably over the longer term.

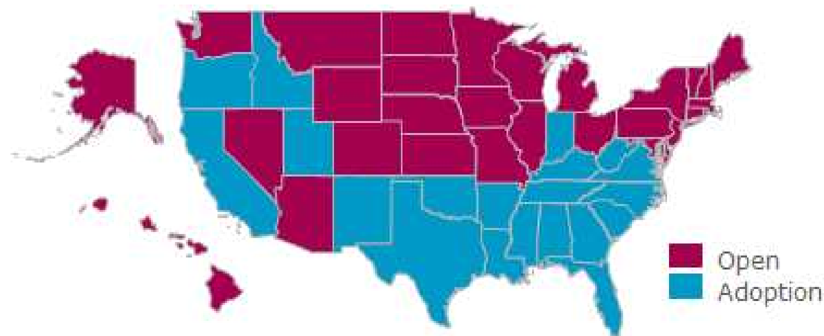
In addition, the market for comprehensive curriculum programs is affected by changes in state curriculum standards, which drive instruction, assessment, and accountability in each state. A significant change in state curriculum standards requires that assessments, teacher training programs, and instructional materials be revised or replaced to align to the new standards and historically has driven demand for new comprehensive curriculum programs.

Forty-five states have adopted a new, common set of curriculum standards in mathematics and English language arts, known as the Common Core State Standards. These standards are the product of a state-led effort to establish a single set of clear educational standards for grades K-12. States that have adopted the Common Core State Standards must base at least 85% of their state curricula on the standards. Most of these states also belong to one of two multistate testing consortia that are developing common state assessments in English language arts and mathematics, aligned to the new standards. The tests, which will be designed to replace existing statewide tests, are expected to be administered beginning in 2014-15. Schools in these states will need to augment and replace instructional materials, including comprehensive curriculum programs, to align to Common Core State Standards and to prepare students for the new state assessments.

Textbook adoption process

Twenty states approve and procure basal programs on a state-wide basis ("adoption states") before individual schools or school districts can purchase materials. In all remaining states, referred to as "open states" or "open territories," each individual school or school district can procure materials without state restrictions.

The following chart illustrates the current adoption and open states:



Adoption states represent over 50% of the U.S. elementary and secondary school-age population. Many adoption states provide "categorical funding" for instructional materials, which means that state funds cannot be used for any other purpose. A majority of adoption states provide categorical state funding for instructional materials, i.e., funds that typically cannot be used for any purpose other than to purchase instructional content or, is some cases, technology equipment used to deliver instruction. In some states, categorical instructional materials funds can be used only for the purchase of materials on the state-approved list.

In adoption states, the state education board's decision to approve a certain program developed by an educational publisher depends on recommendations that align to state's educational standards from instructional materials committees, which are often comprised of educators and curriculum specialists. These committees will recommend a program only if it aligns to the state's educational content standards. To ensure the approval and subsequent success of a new instructional materials program, extensive market research is conducted, including: discussions of the planned curriculum with the state level curriculum advisors to secure their support; development of prototype instructional materials that are focus-tested with educators, often against competing programs, to gather feedback on the program's content and design; and incorporation of qualitative input from existing customers in terms of classroom needs.

In open territories, sales teams present to instructional materials selection committees, which in turn make recommendations to district level school boards. Products are generally customized to meet the states' curriculum standards with similar research methods as in adoption states.

We believe that a publisher's ultimate success in a given state will depend on a variety of factors, including the quality of its programs and materials, the strength of its relationships with key decision-makers at the state and district level and the magnitude of its marketing and sales efforts. As a result, educational publishers often implement formal market research efforts that include educator focus groups, prototypes of student and ancillary materials and comparisons against competing products. At the same time, marketing and editorial staffs work closely together to incorporate the results of research into products and developing the most updated, research- and needs-based curricula.

Supplemental materials market

The supplemental materials market includes a wide range of product offerings targeted at addressing specific needs in a district generally not addressed through a comprehensive curriculum solution. These products come in the form of print, digital, service and blended product solutions. The development of supplemental materials tends to require significantly less capital investment than the development of a basal program. These materials enable local educators to tailor their education programs in a cost-effective way that is not tied to adoption schedules.

Supplemental products and services are funded through state and local resources as well as government funding allocations through Title 1 and the Individuals with Disabilities Education Act (IDEA). Title 1 distributes funding to schools and school districts with a high percentage of students from low income families. In addition, Title 1 appropriates money for the education system for the prevention of dropouts and the improvement of schools. IDEA governs how states and public agencies provide early intervention, special education and related services to children with disabilities. In recent years, the supplemental materials that schools have purchased have changed as the demands and expectations for educators and students have changed. Educational institutions have increasingly purchased digital solutions along with traditional supplemental materials and, with the growing emphasis on accountability, targeted intervention solutions, school reform and turnaround services are increasingly in demand.

Assessment market

The assessment market includes summative, formative/in-classroom, and diagnostic assessments. Summative assessments are concluding or "final" exams that measure students' proficiency in a particular subject or group of subjects on an aggregate level or against state standards. Formative assessments are on-going, in-classroom tests that occur throughout the school year and monitor progress in certain subjects or curriculum units. Diagnostic assessments are designed to pinpoint areas of need and are often administered by specialists to identify learning difficulties and qualify individuals for special services under the requirements of Individual Disabilities Education Act (IDEA).

As a result of RTTT (Race to the Top) funding, more states and districts are also placing greater emphasis on teacher evaluation systems that measure teacher performance based on standardized test scores and other elements required in formulas derived by the policymakers. Federal agencies are pushing the focus to children at even younger ages to provide intervention before significant achievement gaps are realized. This is leading to more opportunity in the early childhood market space from birth to eight.

The two assessment consortia —Smarter Balanced Assessment Consortia (SBAC) and Partnership Assessment of Readiness for College and Careers (PARCC)—continue to work towards operational tests for the 2014–2015 school year. There are 24 states in SBAC and 23 states in PARCC. Some states are still in both and will have to make a determination about which test to use over the next year or so.
As states plan for how they will deal with the upcoming consortia assessments, districts continue to transition to the Common Core State Standards as well as focus on their state standards being measured in the short term for accountability purposes. There is anticipation now for the Next Generation Science Standards, which are due to be final and released in March 2013. District demand for quality measures to help them prepare for the content coverage and item types anticipated on the common core assessment should continue to increase as the 2014–2015 requirement draws near.

International market

The global education market continues to demonstrate strong macro long-term growth characteristics. There are 1.4 billion students out of a 7.1 billion world population. Population growth is a leading indicator for pre-primary school enrollments, which subsequently impact on secondary and higher education enrolments. Globally, rapid population growth in the past 5 years has caused pre-primary enrolments to grow at 16% worldwide, this is expected to be 20% with new growth rates. The global population is expected to be 9.2 billion by 2050, as countries develop and improvements in medical conditions increase the birth rate.

In 2011, global education expenditure was $4,435 billion. K-12 education represents a total of 58.6% of global education expenditure. Global education expenditure is projected to grow at 7.4% through to 2017.

We predominantly export and sell K-12 books into the niche global market of high-end international private schools that follow the US curriculum. We sell to schools in this market across Asia, the Pacific, the Middle East, Latin America and the Caribbean. Our International sales team utilizes a global network of international partners and alliances, including distributors in local markets around the world. The size of the K-12 US Export market is estimated at $165 million, of which we have a strong market share.

Our immediate strategy is to expand our addressable market through working with local partners to localize our K-12 content for sale into public & private schools in targeted international markets and to sell digitized content through key partnerships / alliances into global school and consumer markets.

Trade Publishing market

The market for consumer books (Trade Publishing market) includes works of fiction and non-fiction for adults and children, dictionaries and other reference works. While print remains the primary format in which Trade books are produced and distributed, the market for Trade titles in digital format (primarily ebooks) has developed rapidly over the past several years, and the industry has quickly evolved to embrace new technologies for developing, producing, marketing and distributing Trade works.

Seasonality

In the K-12 market, we typically receive payments for products and services from individual school districts, and, to a lesser extent, individual schools and states. In the trade publishing market, payment is received for products and services from book distributors and retail booksellers. In the case of testing and assessment products and services, payment is received from the individually contracted parties.

Approximately 88% of our fiscal 2012 net sales was derived from educational publishing, which is a markedly seasonal business. Schools make most of their purchases in the second and third quarters of the calendar year in preparation for the beginning of the school year. Thus, over the past three years, approximately 69% of consolidated net sales have historically been realized in the second and third quarters. Sales of K-12 instructional materials and customized testing products are also cyclical, with some years offering more sales opportunities than others. The amount of funding available at the state level for educational materials also has a significant effect on year-to-year net sales.

Competition

We sell our products in competitive markets. In these markets, product quality, customer service and perceived stability and longevity are major factors in generating sales growth. Other factors affecting sales growth in the K-12 market include the level of student enrollment in subjects that are up for adoption and the level of spending per student appropriated in each state and/or school district. Profitability is affected by industry developments including: (i) competitive selling, sampling and implementation costs; (ii) development costs for customized instructional materials and assessment programs; and (iii) higher

technology costs due to the increased number of textbook program components being developed in digital formats. There are three primary traditional Comprehensive Curriculum publishers in the K-12 market, which also compete with a variety of specialized or regional publishers that focus on select disciplines and/or geographic regions. There are multiple competitors in the Trade Publishing, supplemental and assessment markets.

Printing and binding; raw materials

We outsource the printing and binding of our products, with approximately 81% of our printing currently handled by two vendors. We have a procurement agreement with each printer that provides volume and scheduling flexibility and price predictability. We have a longstanding relationship with each provider. Paper is one of our principal raw materials. We purchase our paper directly from suppliers and two paper merchants with whom we have various agreements that protect against price increases. We have not experienced and do not anticipate experiencing difficulty in obtaining adequate supplies of paper for our operations, as we have contracts with numerous suppliers that assure us of 100% availability on all main paper grades that we procure.

Distribution

We operate five distribution facilities from which we coordinate our own distribution process: one each in Indianapolis, Indiana; Geneva, Illinois; Lewisville, Texas; Troy, Missouri; and Kennesaw, Georgia. Additionally, some adoption states require us to use in-state textbook depositories for educational materials sold in that particular state. We utilize delivery firms including United Parcel Service Inc., CH Robinson Worldwide Inc., Roadrunner Transportation Services and DHL Worldwide Express Inc. to facilitate the principally ground transportation of products.

Employees

As of December 31, 2012, we had approximately 3,300 employees, none of which were covered by collective bargaining agreements. These employees are substantially located in the United States with approximately 200 employees located outside of the United States. We believe that relations with employees are generally good.

Intellectual property

Our principal intellectual property assets consist of our trademarks and copyrights in our content. Substantially all of our publications are protected by copyright, whether registered or unregistered, either in our name as the author of a work made for hire or the assignee of copyright, or in the name of an author who has licensed us to publish the work. Such copyrights secure the exclusive right to publish the work in the United States and in many countries abroad for specified periods: in the United States in most cases either 95 years from publication or for the author’s life plus 70 years, but in any event a minimum of 28 years for works published prior to 1978 and 35 years for works published thereafter.

We do not own any material patents, franchises or concessions, but we have registered certain trademarks and service marks in connection with our publishing businesses. We believe we have taken, and take in the ordinary course of business, all appropriate available legal steps to reasonably protect our intellectual property in all material jurisdictions.

Environmental matters

We generally contract with independent printers and binders for their services, and our operations are generally not otherwise affected by environmental laws and regulations. However, as the owner and lessee of real property, we are subject to environmental laws and regulations, including those relating to the discharge of hazardous materials into the environment, the remediation of contaminated sites and the

handling and disposal of wastes. It is possible that we could face liability, regardless of fault, and can be held jointly or severally liable, if contamination were to be discovered on the properties that we own or lease or on properties that we have formerly owned or leased. We are currently unaware of any material environmental liabilities or other material environmental issues relating to our properties or operations and anticipate no material expenditures for compliance with environmental laws or regulations.

Item 1A. Risk Factors

The following factors affect our business and the industry in which we operate. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known or that we currently consider immaterial may also have an adverse effect on our business. If any of the matters discussed in the following risk factors were to occur, our business, financial position, results of operations, cash flows, or prospects could be materially adversely affected.

Introduction of new products, services or technologies could impact our profitability.

We operate in highly competitive markets that continue to change to adapt to customer needs. In order to maintain a competitive position, we must continue to invest in new offerings and new ways to deliver our products and services. These investments may not be profitable or may be less profitable than what we have experienced historically. In particular, in the context of the Company's current focus on key digital opportunities, including e-books, the market is beginning to develop and the Company may be unsuccessful in establishing itself as a significant factor in any market which does develop. New distribution channels, such as digital platforms, the internet, online retailers and growing delivery platforms (e.g., e-readers), present both threats and opportunities to the Company's traditional publishing models, potentially impacting both sales volumes and pricing.

Our U.S. educational comprehensive curriculum, supplemental and assessment business may be adversely affected by changes in state and local educational funding resulting from either general economic conditions, changes in government educational funding, programs and legislation (both at the federal and state level), and/or changes in the state procurement process.

The results and growth of our U.S. educational comprehensive curriculum, supplemental and assessment businesses are dependent on the level of federal and state educational funding, which in turn is dependent on the robustness of state finances and the level of funding allocated to educational programs. Most public school districts, the primary customers for K-12 products and services, are largely dependent on state and local funding to purchase materials. In school districts in states that primarily rely on local tax proceeds, significant reductions in those proceeds for any reason can severely restrict district purchases of instructional materials. In districts and states that primarily rely on state funding for instructional materials, a reduction in state funds or loosening of restrictions on the use of those funds may reduce net sales. Additionally, many school districts receive substantial sums through Federal education programs, funding for which may be reduced as a result of the Federal sequester.

Federal and/or state legislative changes can also affect the funding available for educational expenditure, which include the impact of education reform such as the reauthorization of the Elementary and Secondary Education Act ("ESEA") and the implementation of Common Core State Standards. Existing programs and funding streams could be changed or eliminated in connection with legislation to reauthorize the ESEA and/or the federal appropriations process, in ways that could negatively affect demand and sources of funding for our products and services. Similarly, changes in the state procurement process for textbooks, supplemental material and student tests, particularly in adoption states, can also affect our markets and sales. For example, changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of our market in any given year.

There are multiple competing demands for educational funds and there is no guarantee that states will fund the purchase of new textbooks or testing programs, or that we will win this business.

Changes in educational funding could have a material and adverse impact on our business, results of operations, financial condition, liquidity and future prospects, and, as a result, could also cause us not to be in compliance with the financial covenants in our credit facilities.

A significant portion of net sales is derived from sales of K-12 instructional materials pursuant to cyclical adoption schedules, and if we are unable to maintain residual sales and continue to generate new business, net sales could be materially and adversely affected.

Due to the revolving and staggered nature of state adoption schedules, sales of K-12 instructional materials have traditionally been cyclical, with some years offering more sales opportunities than others. Furthermore, we cannot make assurances that states that have adopted our programs, or that schools and school districts that have purchased our products and services, will do so again in the future. A significant portion of net sales is dependent upon our ability to maintain residual sales and to continue to generate new business. For example, over the next couple of years, adoptions are scheduled in the primary subjects of reading, language arts and literature, social studies and mathematics in, among others, the states of Texas and Florida, two of the largest adoption states. The inability to succeed in these two states, or reductions in their anticipated funding levels, could materially and adversely affect net sales for subsequent years. Furthermore, allowing districts flexibility to use State funds previously dedicated exclusively to the purchase of instructional materials for things such as technology hardware and training, which could adversely affect district expenditures on state-adopted instructional materials in the future.

Our operating results fluctuate on a seasonal and quarterly basis and in the event we do not generate sufficient net sales in the third quarter, we may not be able to meet our obligations.

Our business is seasonal. For the year ended December 31, 2012, we derived approximately 88% of net sales from educational publishing in the Education business. For sales of educational products, purchases typically are made primarily in the second and third quarters of the calendar year, in preparation for the beginning of the school year, though testing net sales are primarily generated in the second and fourth quarters. We typically realize a significant portion of net sales during the third quarter, making third-quarter results material to full-year performance. This sales seasonality affects operating cash flow from quarter to quarter. We normally incur a net cash deficit from all of our activities through the middle of the third quarter of the year. We cannot make assurances that our third quarter net sales will continue to be sufficient to meet our obligations or that they will be higher than net sales for our other quarters.

Our business will be impacted by the rate of and state of technological change, including the digital evolution and other disruptive technologies.

A common trend in the publishing industry is the digitalization of content and proliferation of distribution channels, either over the internet, or via other electronic means, replacing traditional print formats. The digital migration brings the need for change in product distribution, consumers' perception of value and the publisher's position between retailers and authors.

Such digitalization increases competitive threats both from large media players and from smaller businesses, online and mobile portals. If we are unable to adapt and transition to the move to digitalization at the rate of our competitors, our ability to effectively compete in the marketplace will be affected.

We are a party to at-will contracts with significant customers and the termination of these contracts could harm our business.

We currently provide or have agreements to provide products and services to governmental agencies, school districts and educational facilities under contracts that are generally terminable at-will. The fact that these customers have at-will contracts with us gives rise to the possibility that we may have no recourse in the event of customer cancellation of a contract. In addition, contracts awarded by states

pursuant to a procurement process are subject to challenge by competitors and other parties during and after that process. We anticipate that we will continue to rely predominately upon customers under such at-will contractual arrangements. As a result of this reliance, the election by these customers to terminate any or all of their at-will contracts with us, or the loss of or decrease in business from several of our large customers, could materially and adversely affect our business, prospects, financial condition and results of operations.

We may not be able to identify successful business models for generating sales of technology based programs. Furthermore, customers' expectations for the number and sophistication of technology-based programs that are given to them at no additional charge may increase, as may development costs.

The core curriculum elementary school, core curriculum secondary school and educational testing customers have become accustomed to being given technology-based products at no additional charge from publishers, such as us, as incentives to adopt programs and other products. The sophistication and expense of technology-based products continues to grow. Our profitability may decrease materially if we are unable to realize sales of these products, customers continue to expect/insist on an increasing number of technology-based materials of increasing quality being given to them, or costs of these products continue to rise.

The presence and development of open-sourced content could continue to increase as foundations and other parties fund development of educational content to be offered to schools and the public at no cost, which could adversely affect our revenue.

In recent years there have been initiatives by non-profit organizations such as the Gates Foundation and the Hewlett Foundation to develop educational content that can be "open sourced" and made available to educational institutions for free or nominal cost. To the extent that such open sourced content is developed and made available to educational customers and is competitive with our instructional materials, our sales opportunities and net sales could be adversely affected.

Changes in product distribution channels and/or customer bankruptcy may restrict our ability to grow and affect our profitability in our Trade Publishing business.

New distribution channels such as digital formats, the internet, online retailers, growing delivery platforms (e.g. e-readers), combined with the concentration of retailer power, pose threats and provide opportunities to our traditional consumer publishing models in our Trade Publishing business, potentially impacting both sales volumes and pricing. The economic slowdown combined with the trend to e-books has created contraction in the consumer books retail market that has increased the risk of bankruptcy of major retail customers as evidenced by the 2010 bankruptcy filing of the Borders book chain, which resulted in the write-off of a receivable of $4.4 million. Additional bankruptcies of traditional "bricks and mortar" retailers of Trade Publishing could negatively affect our financial performance.

Expansion of our investments and business outside of our traditional core U.S. market may result in lower than expected returns and incremental risks.

To take advantage of international growth opportunities and to reduce our reliance on our core U.S. market, we are increasing our investments in a number of countries and emerging markets, including Asia and the Middle East, some of which are inherently more risky than our investments in the U.S. market. Political, economic, currency, reputational and corporate governance risks (including fraud) as well as unmanaged expansion are all factors which could limit our returns on investments made in these markets. For example, current political instability in the Middle East has caused uncertainty in the region, which could affect our results of operations in the region. Also, certain international customers require longer payment terms, increasing our credit risk. As we expand internationally, these risks will become more pertinent to us and could have a bigger impact on our business.

We operate in a highly competitive environment that is subject to rapid change and we must continue to invest and adapt to remain competitive.

Our businesses operate in highly competitive markets. These markets continue to change in response to technological innovations and other factors. Profitability is affected by developments in our markets beyond our control, including: changing U.S. federal and state standards for educational materials; rising development costs due to customers' requirements for more customized instructional materials and assessment programs; changes in prevailing educational and testing methods and philosophies; higher technology costs due to the trend toward delivering more educational content in both traditional print and electronic formats; market acceptance of new technology products, including online or computer-based testing; an increase in the amount of materials given away in the K-12 markets as part of a bundled pack; the impact of the expected increase in turnover of K-12 teachers and instructors on the market acceptance of our products; customer consolidation in the retail and wholesale trade book market and the increased dependence on fewer but stronger customers; rising advances for popular authors and market pressures to maintain competitive retail pricing; a material increase in product returns or in certain costs such as paper; and overall uncertain economic issues that affect all markets.

We cannot predict with certainty the changes that may occur and the effect of those changes on the competitiveness of our businesses, and the acceleration of any of these developments may materially and adversely affect our profitability.

The means of delivering our products may be subject to rapid technological change. Although we have undertaken several initiatives and invested significant amounts of capital to adapt to and benefit from these changes, we cannot predict whether technological innovations will, in the future, make some of our products, particularly those printed in traditional formats, wholly or partially obsolete. If this were to occur, we might be required to invest significant resources to further adapt to the changing competitive environment. In addition, we cannot predict whether end customers will have sufficient funding to purchase the equipment needed to use our new technology products.

In order to maintain a competitive position, we must continue to invest in new offerings and new ways to deliver our products and services. These investments may not be profitable or may be less profitable than what we have experienced historically. We could experience threats to our existing businesses from the rise of new competitors due to the rapidly changing environment within which we operate.

Our ability to enforce our intellectual property and proprietary rights may be limited, which may harm our competitive position and materially and adversely affect our business and results of operations.

Our products are largely comprised of intellectual property content delivered through a variety of media, including books and digital and web-based media. We rely on copyright, trademark and other intellectual property laws to establish and protect our proprietary rights in these products. However, we cannot make assurances that our proprietary rights will not be challenged, invalidated or circumvented. We conduct business in other countries where the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect future growth. Moreover, despite the existence of copyright and trademark protection under applicable laws, third parties may nonetheless violate our intellectual property rights, and our ability to remedy such violations, particularly in foreign countries, may be limited. In addition, the copying and distribution of content over the Internet creates additional challenges for us in protecting our proprietary rights. If we are unable to adequately protect and enforce our intellectual property and proprietary rights, our competitive position may be harmed and our business and financial results could be materially and adversely affected.

We operate in markets which are dependent on Information Technology ("IT") systems and technological change.

Our business is dependent on information technology. We either provide software and/or internet based services to our customers or we use complex IT systems and products to support our business activities,

particularly in infrastructure and as we move our products and services to an increasingly digital delivery platform.

We face several technological risks associated with software product development and service delivery in our educational businesses, information technology security (including virus and hacker attacks), e-commerce, enterprise resource planning, system implementations and upgrades. The failure to recruit and retain staff with relevant skills may constrain our ability to grow as we combine traditional publishing products with online service offerings.

We are reliant on third-party software development as part of our digital platform.

Some of the technologies and software that compose our instruction and assessment technologies are developed by third parties. We are reliant on those third parties for the development of future components and modules. Thus, we face risks associated with software product development and the ability of those third parties to meet our needs and their obligations under our contracts with them.

A major data privacy breach or unanticipated IT system failure may cause reputational damage to our brands and financial loss.

Across our businesses we hold large volumes of personal data, including that of employees, customers and students. Failure to adequately protect personal data could lead to penalties, significant remediation costs, reputational damage, potential cancellation of existing contracts and inability to compete for future business. We have policies, processes, internal controls and cybersecurity mechanisms to ensure the stability of our information technology, provide security from unauthorized access to our systems and maintain business continuity, but our operating results may be adversely impacted by unanticipated system failures, data corruption or breaches in security.

We may not be able to complete, or achieve the expected benefits from, any future acquisitions, which could materially and adversely affect our growth.

We have at times used acquisitions as a means of expanding our business and expect that we will continue to do so. If we do not successfully integrate acquisitions, anticipated operating advantages and cost savings may not be realized. The acquisition and integration of companies involve a number of risks, including: use of available cash, new borrowings or borrowings under our accounts receivable securitization facility to consummate the acquisition; demands on management related to the increase in our size after an acquisition; diversion of management's attention from existing operations to the integration of acquired companies; integration of companies existing systems into our systems; difficulties in the assimilation and retention of employees; and potential adverse effects on our operating results.

We may not be able to maintain the levels of operating efficiency that acquired companies achieved separately. Successful integration of acquired operations will depend upon our ability to manage those operations and to eliminate redundant and excess costs. We may not be able to achieve the cost savings and other benefits that we would hope to achieve from acquisitions, which could materially and adversely affect our financial condition and results.

We may not be able to retain or attract the key management, creative, editorial and sales personnel that we need to remain competitive and grow.

Our success depends, in part, on our ability to continue to retain key management and other personnel. We operate in a number of highly visible industry segments where there is intense competition for experienced and highly effective individuals, including authors. Our successful operations in these segments may increase the market visibility of members of key management, creative and editorial teams and result in their recruitment by other businesses. There can be no assurance that we can continue to attract and retain the necessary talented employees, including executive officers and other key members of management and, if we fail to do so, it could adversely affect our business.

In addition, our sales personnel make up about approximately 24% of our employees, and our business results depend largely upon the experience, knowledge of local market dynamics and long-standing customer relationships of such personnel. Our inability to retain or hire effective sales people at economically reasonable compensation levels could materially and adversely affect our ability to operate profitably and grow our business.

A significant increase in operating costs and expenses could have a material adverse effect on our profitability.

Our major expenses include employee compensation and printing, paper and distribution costs for product-related manufacturing. We offer competitive salary and benefit packages in order to attract and retain the quality employees required to grow and expand our businesses. Compensation costs are influenced by general economic factors, including those affecting the cost of health insurance and postretirement benefits, and any trends specific to the employee skill sets we require. We could experience changes in pension costs and funding requirements due to poor investment returns and/or changes in pension laws and regulations.

Paper prices fluctuate based on the worldwide demand and supply for paper in general and for the specific types of paper used by us. Paper is one of our principal raw materials and, for the year ended December 31, 2012, our paper purchases totaled approximately $47 million while our manufacturing costs totaled approximately $234 million. Our books and workbooks are printed by third parties and we typically have multi-year contracts for the production of books and workbooks in order to reduce price fluctuations over the contract term. Increases in any of our operating costs and expenses could materially and adversely affect our profitability and our results of operations.

We make significant investments in information technology data centers and other technology initiatives as well as significant investments in the development of programs for the K-12 marketplace. Although we believe we are prudent in our investment strategies and execution of our implementation plans, there is no assurance as to the ultimate recoverability of these investments.

Exposure to litigation could have a material effect on our financial position and results of operations.

We are involved in legal actions and claims arising from our business practices and face the risk that additional actions and claims will be filed in the future. Litigation alleging infringement of copyrights and other intellectual property rights has become extensive in the educational publishing industry. At present, there are various suits pending or threatened which claim that we exceeded the print run limitation or other restrictions in licenses granted to us to reproduce photographs in our textbooks. A number of similar claims against us have already been settled. While management does not expect any of these matters to have a material adverse effect on our results of operations, financial position or cash flows, due to the inherent uncertainty of the litigation process, the resolution of any particular legal proceeding or change in applicable legal standards could have a material effect on our financial position and results of operations.

We have insurance in such amounts and with such coverage and deductibles as management believes is reasonable. However, there can be no assurance that our liability insurance will cover all events or that the limits of coverage will be sufficient to fully cover all potential liabilities.

Operational disruption to our business caused by a major disaster and/or external threats could restrict our ability to supply products and services to our customers.

Across all our businesses, we manage complex operational and logistical arrangements including distribution centers, data centers and large office facilities as well as relationships with third party print vendors. We have also outsourced some support functions, including application maintenance support, to third party providers. Failure to recover from a major disaster (such as fire, flood or other natural disaster) at a key facility or the disruption of supply from a key third party vendor or partner (for example,

due to bankruptcy) could restrict our ability to service our customers. External threats, such as terrorist attacks, strikes, weather and political upheaval, could affect our business and employees, disrupting our daily business activities.

We are subject to contingent liabilities that may affect liquidity and our ability to meet our obligations.

In the ordinary course of business, we issue performance-related surety bonds and letters of credit posted as security for our operating activities, some of which obligate us to make payments if we fail to perform under certain contracts in connection with the sale of textbooks and assessment tests. The surety bonds are partially backstopped by letters of credit. As of December 31, 2012, our contingent liability for all letters of credit was approximately $26.2 million, of which $6.4 million were issued to backstop $11.7 million of surety bonds. The letters of credit reduce the borrowing availability on our Revolving Credit Facility, which could affect liquidity and, therefore, our ability to meet our obligations. We may increase the number and amount of contracts that require the use of letters of credit, which may further restrict liquidity and, therefore, our ability to meet our obligations in the future.

We may be adversely affected by significant changes in interest rates.

Our new financing indebtedness, including borrowings under a revolver, bears interest at variable rates. We have $248.1 million of aggregate principal amount indebtedness outstanding under our Term Loan that bears interest at a variable rate. An increase or decrease of 1% in the interest rate will change our interest expense by approximately $2.5 million on an annual basis. We also have up to $250.0 million of borrowing availability, subject to borrowing base availability, under our Revolving Credit Facility, and borrowings under the Revolving Credit Facility bear interest at a variable rate. Assuming that the Revolving Credit Facility is fully drawn, an increase or decrease of 1% in the interest rate will change our interest expense associated with the Revolving Credit Facility by $2.5 million on an annual basis. If market interest rates increase, variable-rate debt will create higher debt service requirements, which could adversely affect our cash flow. While we may enter into agreements limiting exposure to higher interest rates, these agreements may not offer complete protection from this risk.

We may not be able to generate sufficient cash to service all of our indebtedness and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments or to refinance our debt obligations and to fund planned capital expenditures and other growth initiatives depends on our financial and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We may not be able to maintain a level of cash flow from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness or to fund our other liquidity needs.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, sell assets, seek additional capital or seek to restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to sell material assets or operations to attempt to meet our debt service and other obligations. Our Term Loan and Revolving Credit Facility restrict our ability to use the proceeds from asset sales. We may not be able to consummate those asset sales to raise capital or sell assets at prices that we believe are fair and proceeds that we do receive may not be adequate to meet any debt service obligations then due.

Despite our current leverage, we may still be able to incur substantially more debt. This could further exacerbate the risks that we and our subsidiaries face.

We and our subsidiaries may be able to incur substantial additional indebtedness, including additional secured indebtedness, in the future. The terms of the credit agreements do and the agreements governing our existing and future indebtedness may restrict, but will not completely prohibit, us from doing so. As of December 31, 2012, we had approximately $185.9 million of borrowing availability under our Revolving Credit Facility. This may have the effect of reducing the amount of proceeds paid to you in the event of a liquidation. If new debt or other liabilities are added to our current debt levels, the related risks that we and our subsidiaries now face could intensify.

A small group of stockholders own a substantial percentage of our common stock, and their interests could conflict with yours.

As of December 31, 2012, a small group of stockholders and their affiliates, including Paulson & Co Inc., Anchorage Advisors L.L.C., Blackrock Financial Management, Inc., Avenue Investments, L.P., Q Investments L.P., Oak Hill Advisors L.P. and Lehman Commercial Paper, Inc., beneficially owned in the aggregate approximately 73% of the outstanding shares of our common stock. In addition, affiliates of Paulson & Co. Inc. currently have the right to nominate two directors to the board of directors so long as they own 25% or more of the Company's stock.

There can be no assurance as to the liquidity of the trading market for the common stock or that a trading market for such securities will develop.

Our common stock is not listed on any securities exchange. This may negatively affect the value and the pricing of the common stock in the secondary market, the transparency and availability of trading prices, and the liquidity of such securities. As a result, holders of such securities may be unable to resell such securities at an acceptable price or at all.

We may record future goodwill or indefinite-lived intangibles impairment charges related to one or more of our business units, which could materially adversely impact our results of operations.

We test our goodwill and indefinite-lived intangibles asset balances for impairment during the fourth quarter of each year, or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. We assess goodwill for impairment at the reporting unit level and, in evaluating the potential for impairment of goodwill, we make assumptions regarding estimated revenue projections, growth rates, cash flows and discount rates. Although we use consistent methodologies in developing the assumptions and estimates underlying the fair value calculations used in our impairment tests, these estimates are uncertain by nature and can vary from actual results. Declines in the future performance and cash flows of the reporting unit or small changes in other key assumptions may result future goodwill impairment charges, which could materially adversely impact our results of operations. We have goodwill and indefinite-lived intangible assets of approximately $520.1 million and $440.5 million, $520.1 million and $440.8 million as of December 31, 2012 and 2011, respectively. There was no goodwill impairment charge for the year ended December 31, 2012. For the year ended December 31, 2011, goodwill impairment charges were $1,442.5 million. For the years ended December 31, 2012 and 2011, impairment charges for indefinite-lived intangible assets were $5.0 million and $161.0 million, respectively.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our principal executive office is located at 222 Berkeley Street, Boston, Massachusetts 02116. The following table describes the approximate building areas in square feet, principal uses and the years of expiration on leased premises of our significant operating properties as of December 31, 2012. We believe that these properties are suitable and adequate for our present and anticipated business needs, satisfactory for the uses to which each is put, and, in general, fully utilized.

Location	Expiration year	Approximate area	Principal use of space	Segment used by
Owned Premises:				
Indianapolis, Indiana.	Owned	491,779	Warehouse	All segments
Troy, Missouri	Owned	575,000	Office and warehouse	Education
Bellmawr, New Jersey	Owned	380,000	Warehouse	Education
Leased Premises:				
Orlando, Florida	2019	250,842	Office	Education
Evanston, Illinois	2017	150,050	Office	Education
Rolling Meadows, Illinois . . .	2015	112,014	Office	Education
Geneva, Illinois	2019	485,989	Office and warehouse	Education
Wilmington, Massachusetts	2015	40,602	Office	All segments
Boston, Massachusetts . . . . (Corporate offices)	2017	328,686	Office	All segments
Portsmouth, New Hampshire	2017	20,645	Office	Education
New York, New York	2016	28,704	Office	Trade
Lewisville, Texas	2013	434,898	Office and warehouse	Education
Austin, Texas	2016	195,230	Office	Education
Dublin, Ireland	2025	39,944	Office	Education
Rancho Cucamonga, California	2015	13,346	Office	Education
Englewood, Colorado	2014	17,024	Office	Education
Orlando, Florida	2016	25,400	Warehouse	Corporate Records Ctr.
Kennesaw, Georgia	2015	59,450	Warehouse	Education
Itasca, Illinois	2016	46,823	Warehouse	Education

In addition, we lease several other offices that are not material to our operations and, in some instances, are either currently vacant due to consolidating our operations or are fully sublet.

Item 3. Legal Proceedings

We are involved in ordinary and routine litigation and matters incidental to our business. Specifically, there have been various settled, pending and threatened litigation that allege we exceeded the print run limitation or other restrictions in licenses granted to us to reproduce photographs in our textbooks. While management believes that there is a reasonable possibility we may incur a loss associated with the pending and threatened litigation, we are not able to estimate such amount, but we do not expect any of these matters to have a material adverse effect on our results of operations, financial position or cash flows. We have insurance in such amounts and with such coverage and deductibles as management believes is reasonable. There can be no assurance that our liability insurance will cover all events or that the limits of coverage will be sufficient to fully cover all liabilities.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Not applicable. There is no established trading market for our common stock.

Holders

There were approximately 190 holders of our common stock as of February 28, 2013.

Dividends

We paid no dividends to the holders of our common stock in the years ended December 31, 2012 and 2011, respectively. The credit agreement governing our revolving credit facility restricts our ability to pay dividends to the holders of our common stock.

Item 6. Selected Financial Data

(in $000s) Operating Data	2012	2011	For the Period March 10, 2010 to December 31, 2010	For the Period January 1, 2010 to March 9, 2010	2009	2008
Net sales	$ 1,285,641	$ 1,295,295	$ 1,397,142	$ 109,905	$ 1,562,415	$ 2,049,254
Gross profit	454,217	375,230	420,051	(21,624)	400,189	640,075
Impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets	8,003	1,674,164	103,933	4,028	953,587	824,009
Operating loss	(120,687)	(2,037,130)	(327,868)	(146,697)	(1,392,268)	(1,102,786)
Loss before reorganization items and taxes	(242,196)	(2,282,523)	(495,798)	(311,996)	(2,206,540)	(1,858,724)
Reorganization items, net	(149,114)	-	-	-	-	-
Net loss	(87,139)	(2,182,370)	(507,727)	(311,776)	(2,145,147)	(1,463,842)

Balance Sheet Data	2012	2011	2010		2009	2008
Working capital	$ 599,085	$ 440,844	$ 380,678		$ (570,115)	$ 274,643
Cash, cash equivalents and short-term investments	475,119	413,610	397,740		94,002	153,408
Total assets	3,029,584	3,263,903	5,257,155		5,295,149	7,013,611
Debt (short-term and long-term)	248,125	3,011,588	2,861,594		6,953,629	6,257,316
Stockholders' equity (deficit)	1,943,701	(674,552)	1,517,828		(2,614,736)	(856,060)

The financial information presented above for the years ended December 31, 2012, December 31, 2011 and the period from March 10, 2010 to December 31, 2010 represents the results of operations of HMH Holdings and its consolidated subsidiaries, and the financial information presented above for the period from January 1, 2010 to March 9, 2010 and for the years ended December 31, 2009 and December 31, 2008, represents the results of operations of HMH Publishing, our predecessor, and its consolidated subsidiaries.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis ("MD&A") is intended to facilitate an understanding of our results of operations and financial condition.

This MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying notes ("Financial Statements") for the years ended December 31, 2012, 2011 and 2010. The following discussion and analysis of our financial condition and results of operations 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. See "Cautionary Statement Regarding Forward-Looking Statements."

Overview

We are a leading provider of educational content, technology and professional services to the elementary and secondary school market in the United States, including a full range of comprehensive curriculum, supplemental products and service offerings. We have a long-standing expertise in teaching and instructional strategy and the design and creation of print and electronic learning materials across all grade levels. We distribute our solutions in multiple formats, including print and digital curriculum, technology platforms, assessment tools and services. We believe our solutions are a mission critical tool for school systems as they increasingly focus on outcomes-based learning and teaching solutions that reach students both in the classroom and at home. We believe we are a leader in the transformation of the traditional educational materials market and have the opportunity to increase net sales and profitability by selling our innovative solutions through a comprehensive and integrated approach to educating children. Furthermore, since 1832, we have published trade and reference materials including award-winning adult and children's books, fiction, and nonfiction.

Recent Developments

Chapter 11 Reorganization
On May 10, 2012, we entered into a Plan Support Agreement with consenting creditors holding greater than 74% of the principal amount of the outstanding senior secured indebtedness of the Company and with equity owners holding approximately 64% of the Company's outstanding common stock. The consenting creditors agreed to support the Company's Pre-Packaged Chapter 11 Plan of Reorganization ("Plan"). Pursuant to the Plan Support Agreement, the Company agreed to use its best efforts to (i) support and complete the restructuring and all transactions contemplated by the Plan, (ii) take any and all necessary and appropriate actions in furtherance of the restructuring contemplated under the Plan, (iii) complete the restructuring and all transactions contemplated under the Plan within set time-frames, (iv) obtain any and all required regulatory and/or third-party approvals for the restructuring, and (v) not directly or indirectly, seek, solicit, support, or engage in the negotiation or formulation of alternate plans of reorganization that were inconsistent with the reorganization as contemplated by the Plan Support Agreement.

On May 21, 2012 (the "Petition Date"), the U.S. based entities that borrowed or guaranteed the debt of the Company (collectively the "Debtors"), filed voluntary petitions for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Southern District of New York ("Court"). Concurrently therewith, the Debtors also filed the Plan, the Disclosure Statement in support of the Plan and filed various motions seeking relief to continue operations. Following the Petition Date, the Debtors operated their business as "debtors in possession" ("DIP") under the jurisdiction of the Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Court. Under Chapter 11 of the United States Bankruptcy Code ("Chapter 11"), certain claims against us in existence before the Petition Date were stayed while we operated our business as a DIP including any actions that might be commenced with regards to secured claims, although the holders of such claims had the right to move the Court for relief from the stay. Subsequent to the Petition Date, these claims were reflected in

the balance sheet as liabilities subject to compromise. Secured claims were secured primarily by liens on the Company's accounts receivable. Additional claims (liabilities subject to compromise) could have potentially arisen after the filing date resulting from rejection of executory contracts or from the determination by the Court (or agreed to by parties in interest).

On June 22, 2012, the Company successfully emerged from bankruptcy as a reorganized company pursuant to the Plan. Ultimately, the Debtors did not reject any executory contracts during the bankruptcy case, and the Company continues to review and reconcile claims that were filed against it by creditors.

Subsequent to the Petition Date, the provisions in U.S. Generally Accepted Accounting Principles guidance for reorganizations applied to the Company's financial statements while it operated under the provisions of Chapter 11. The accounting guidance did not change the application of generally accepted accounting principles in the preparation of financial statements. However, it does require that the financial statements, for periods including and subsequent to the filing of the Chapter 11 petition, distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business. Accordingly, all transactions (including, but not limited to, all professional fees, realized gains and losses and provisions for losses) directly associated with the reorganization and restructuring of our businesses are reported separately in the financial statements. All such expense or income amounts are reported in reorganization items in the accompanying consolidated statements of operations for the year ended December 31, 2012.

Summary of Emergence

On June 22, 2012, the Company successfully emerged from bankruptcy as a reorganized company pursuant to the Plan after voluntarily filing for bankruptcy on May 21, 2012. The financial restructuring realized by the confirmation of the Plan was accomplished through a debt-for-equity exchange. The Plan deleveraged the Company's balance sheet by eliminating the Company's secured indebtedness in exchange for new equity in the Company. Existing stockholders, in their capacity as stockholders, received warrants for the new equity in the Company in exchange for the existing equity.

Upon the Company's emergence from Chapter 11 bankruptcy proceedings on June 22, 2012, the Company was not required to apply fresh-start accounting based on U.S. Generally Accepted Accounting Principles guidance for reorganizations due to the fact that the pre-petition holders who owned more than 50% of the Company's outstanding common stock immediately before confirmation of the Plan received more than 50% of the Company's outstanding common stock upon emergence. Accordingly, a new reporting entity was not created for accounting purposes.

Below is a summary of the significant transactions affecting the Company's capital structure as a result of the effectiveness of the Plan.

Equity Transactions

On June 22, 2012, pursuant to the Plan, all of the issued and outstanding shares of common stock of the Company, including all options, warrants or any other agreements to acquire shares of common stock of the Company that existed prior to the Petition Date, were cancelled and in exchange, holders of such interests received distributions pursuant to the terms of the Plan. Following the emergence on June 22, 2012, the authorized capital stock of the Company consists of (i) 190,000,000 shares of common stock, of which 69,958,989 shares of common stock are issued and outstanding at December 31, 2012, 3,684,211 shares of common stock which are reserved for issuance upon exercise of warrants at December 31, 2012, and 8,187,135 shares of common stock which are reserved for issuance upon exercise of certain other warrants and awards to be issued by the Company at December 31, 2012 under the MIP (defined below) and (ii) 10,000,000 shares of preferred stock, $0.01 par value per share, of which no shares are issued and outstanding at December 31, 2012. There are no other outstanding obligations, warrants, options, or other rights to subscribe for or purchase from the Company any class of capital stock of the Company.

On June 22, 2012, the Company issued an aggregate of 70,000,000 post-emergence shares of new common stock pursuant to the final Plan on a pro rata basis to the holders of the then-existing first lien term loan (the “Term Loan”), of which 41,011 are treasury shares as of December 31, 2012, the then-existing first lien revolving loan facility (the “Revolving Loan”), and the 10.5% Senior Secured Notes due 2019 (the “10.5% Senior Notes”) as of the Petition Date. The Company relied on Section 1145(a)(1) of the Bankruptcy Code to exempt from the registration requirements of the Securities Act of 1933, the issuance of such new common stock.

A new Management Incentive Plan (“MIP”) became effective upon emergence. The MIP provides for grants of options and restricted stock at a strike price equal to or greater than the fair market value per share of common stock as of the date of the grant and reserved for management and employees up to 10% of the new common stock of the Company. During 2012, the Company granted to certain employees, including executive officers, stock options totaling 4,912,281 shares of the Company’s common stock. Each of the stock options granted have an exercise price equal to the fair market value on the date of grant and generally vest over a three or four year period. During 2012, the Company granted 22,200 restricted stock units to independent directors, which generally vest after one year. As of December 31, 2012, there are 3,252,654 shares remaining which are reserved for issuance under the MIP.

In accordance with the Plan, each existing common stockholder prior to bankruptcy received its pro rata share of warrants to purchase 5% of the common stock of the Company, subject to dilution for equity awards issued in connection with the MIP. The exercise price for the warrants is based upon a $3.1 billion enterprise valuation of the Company, and the warrants have a term of seven years. All of the then-existing common stock was extinguished on the effective date of the Plan. As of December 31, 2012, there are 3,684,211 shares reserved for issuance upon the exercise of such warrants. These warrants are referred to as the “New Warrants.”

Debt Transactions

On June 22, 2012, the Company’s creditors converted the First Lien Credit Agreement consisting of the Term Loan with an aggregate outstanding principal balance of $2.6 billion and the Revolving Loan with an aggregate outstanding principal balance of $235.8 million, and the outstanding $300.0 million principal amount of 10.5% Senior Notes to 100 percent pro rata ownership of the Company’s common stock, subject to dilution pursuant to the MIP and the exercise of the New Warrants, and received $30.3 million in cash.

In connection with the Chapter 11 filing on May 22, 2012, the Company entered into a new $500.0 million senior secured credit facility (DIP facility), which converted into an exit facility on the effective date of the emergence from Chapter 11. This exit facility consists of a $250.0 million revolving credit facility, which is secured by the Company’s accounts receivable and inventory, and a $250.0 million term loan credit facility. The proceeds of the exit facility were used to fund the costs of the reorganization and are providing working capital to the Company since its emergence from Chapter 11.

A summary of the transactions affecting the Company's debt balances is as follows:

Debt balance prior to emergence from bankruptcy (including accrued interest)	$	(3,142,234)
Exchange of debt for new common shares		1,750,000
Elimination of debt discount and deferred financing fees		98,352
Adequate protection payments		69,701
Conversion fees		30,299
Professional fees		21,726
(Gain) loss on extinguishment	$	(1,172,156)

Reorganization Items

Reorganization items represent expense or income amounts that were recorded in the consolidated financial statements as a result of the bankruptcy proceedings. Reorganization items were incurred starting with the date of the bankruptcy filing through the date of bankruptcy emergence. The gain from reorganization items for the year ended December 31, 2012 were as follows:

		Total		Adjusted to Capital in excess of par value		Reorganization items, net
Debt to equity conversion	$	(1,392,234)	$	(1,199,549)	$	(192,685)
Elimination of debt discount and deferred financing fees		98,352		84,740		13,612
Adequate protection payments		69,701		60,054		9,647
Conversion fees		30,299		26,106		4,193
Professional fees		21,726		18,381		3,345
(Gain) loss on extinguishment		(1,172,156)		(1,010,268)		(161,888)
Stock compensation		2,027		-		2,027
Issuance of warrants		10,747		-		10,747
Reorganization items, net	$	(1,159,382)	$	(1,010,268)	$	(149,114)

Liabilities Subject to Compromise

Certain pre-petition liabilities and indebtedness were subject to compromise under the Plan and were reported at amounts allowed or expected to be allowed by the Court. A summary of liabilities subject to compromise reflected in the consolidated balance sheet as of May 21, 2012 is as follows:

		May 21, 2012
$2,668,690 Term Loan due June 12, 2014	$	2,570,815
$235,751 Revolving Loan due December 12, 2013		235,751
$300,000 10.5% senior secured notes due June 1, 2019		300,000
Accrued interest		35,668
Total	$	3,142,234

As of December 31, 2012, there were no liabilities subject to compromise.

All pre-petition claims were considered liabilities subject to compromise at May 21, 2012. As discussed above, the Term Loan, the Revolving Loan, the 10.5% Senior Notes, and the associated accrued interest were exchanged for new common stock in the Company. There were no other liabilities subject to compromise as of May 21, 2012. We honored other prepetition obligations, including employee wages and trade payables in the ordinary course of business.

Seasonality and Comparability

Our net sales, operating profit and operating cash flow are impacted by the inherent seasonality of the academic calendar. Consequently, the performance of our 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 the K-12 market, we typically receive payments for products and services from individual school districts, and, to a lesser extent, individual schools and states. In the trade publishing markets, payment is received for products and services from book distributors and retail booksellers. In the case of testing and assessment products and services, payment is received from the individually contracted parties.

Approximately 88% of our fiscal 2012 net sales were derived from educational publishing, which is a markedly seasonal business. Schools make most of their purchases in the second and third quarters of the calendar year in preparation for the beginning of the school year. Thus, over the past three years, approximately 69% of consolidated net sales have historically been realized in the second and third quarters. Sales of K-12 instructional materials and customized testing products are also cyclical, with some years offering more sales opportunities than others. The amount of funding available at the state level for educational materials also has a significant effect on year-to-year net sales. Although the loss of a single customer would not have a material adverse effect on our business, schedules of school adoptions and market acceptance of our products can materially affect year-to-year net sales performance.

Financial Presentation

The historical financial information discussed in this annual report has been derived from the financial statements and accounting records of HMH Holdings (Delaware), Inc. ("Successor") for periods on and after March 10, 2010 and from the financial statements and accounting records of HMH Publishing Company ("Predecessor") for the period from January 1, 2010 through March 9, 2010. For purposes of presenting a comparison of our 2011 results to 2010, we have presented our 2010 results as the mathematical addition of the Predecessor and Successor periods (the "Combined Period"). We believe that this presentation provides meaningful information about our results of operations. This approach is not consistent with U.S. GAAP, may yield results that are not strictly comparable on a period-to-period basis and may not reflect the actual results we would have achieved. The table showing the combined 2010 results follows:

(in thousands)	Successor For the Period March 10 - December 31, 2010	Predecessor For the Period January 1, - March 9, 2010	Combined For the Period January 1, - December 31, 2010
Net sales	$ 1,397,142	$ 109,905	$ 1,507,047
Costs and expenses			
Cost of sales, excluding pre-publication and publishing rights amortization	559,593	45,270	604,863
Publishing rights amortization	235,977	48,336	284,313
Pre-publication amortization	181,521	37,923	219,444
Cost of sales	977,091	131,529	1,108,620
Selling and administrative	598,807	119,039	717,846
Other intangible asset amortization	57,601	2,006	59,607
Impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets	103,933	4,028	107,961
Severance and other charges	(11,243)	-	(11,243)
Gain on sale of assets	(1,179)	-	(1,179)
	1,725,010	256,602	1,981,612
Operating loss	(327,868)	(146,697)	(474,565)
Other income (expense)			
Interest expense	(258,174)	(157,947)	(416,121)
Other (loss) income, net	(6)	9	3
Change in fair value of derivative instruments	90,250	(7,361)	82,889
	(167,930)	(165,299)	(333,229)
Loss before taxes	(495,798)	(311,996)	(807,794)
Income tax expense (benefit)	11,929	(220)	11,709
Net loss	$ (507,727)	$ (311,776)	$ (819,503)

Consolidated Operating Results

(in thousands)

	Year Ended December 31, 2012	Year Ended December 31, 2011	Percent Change
Net sales	$ 1,285,641	$ 1,295,295	-0.7%
Costs and expenses			
Cost of sales, excluding pre-publication and publishing rights amortization	515,948	512,612	0.7%
Publishing rights amortization	177,747	230,624	-22.9%
Pre-publication amortization	137,729	176,829	-22.1%
Cost of sales	831,424	920,065	-9.6%
Selling and administrative	533,462	640,023	-16.6%
Other intangible asset amortization	54,815	67,372	-18.6%
Impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets	8,003	1,674,164	-99.5%
Severance and other charges	9,375	32,801	-71.4%
Gain on bargain purchase	(30,751)	-	NM
Gain on sale of assets	-	(2,000)	NM
Operating loss	(120,687)	(2,037,130)	-94.1%
Other income (expense)			
Interest expense	(123,197)	(244,582)	-49.6%
Change in fair value of derivative instruments	1,688	(811)	NM
Loss before reorganization items and taxes	(242,196)	(2,282,523)	-89.4%
Reorganization items, net	(149,114)	-	NM
Income tax expense (benefit)	(5,943)	(100,153)	-94.1%
Net loss	$ (87,139)	$ (2,182,370)	-96.0%

NM = not meaningful

Results of Operations – Comparing Years Ended December 31, 2012 and 2011

Net sales for the year ended December 31, 2012, decreased $9.7 million, or 0.7%, from $1,295.3 million for the same period in 2011 to $1,285.6 million. The decrease was due to a $47.0 million decline in the domestic education sales from the prior year. Our addressable new adoption and open territory sales were down from the prior year primarily due to known lower adoptions in 2012 coupled with a continuing decline in the open territory market. The addressable adoption market was down approximately 23% when compared to prior year and the open territory market was down approximately 8%. Offsetting a portion of the decline was a $31.4 million increase in our Trade sales primarily due to a number of best sellers and an increase in e-book sales.

Operating loss for the year ended December 31, 2012 decreased $1,916.4 million, or 94.1%, from a loss of $2,037.1 million for the same period in 2011 to a loss of $120.7 million, primarily due to a 2011 goodwill impairment charge of $1,442.5 million. The goodwill impairment was due to the carrying value of the Education reporting unit exceeding the implied fair value. Further, the increased loss in 2011 was also due to tradename and other impairments of $231.6 million. Other significant components of the decrease in operating loss were as follows:

- A $104.5 million decrease in amortization expense related to publishing rights, pre-publication and other intangible assets due to our use of accelerated amortization methods and lower plate spend over the past several years than earlier years;
- A $106.6 million decrease in selling and administrative expenses related primarily to a reduction in labor related costs of $32.0 million; a reduction in variable expenses such as commissions and depository fees of $11.0 million associated with lower revenue; lower travel and entertainment expenses of $11.0 million; with the remainder attributed to lower fixed and discretionary expenses such as rent, bad debt and professional fees;
- A $23.4 million decrease in severance and other charges as 2011 included a significant executive and workforce realignment; and
- A $30.8 million gain on bargain purchase associated with the acquisition of certain asset product lines for our Trade Publishing business.

Interest expense for the year ended December 31, 2012 decreased $121.4 million, or 49.6%, from $244.6 million for the same period in 2011 to $123.2 million, primarily as a result of the emergence from bankruptcy with substantially reduced debt. Going forward, we expect our full year interest expense to approximate $25.0 million annually.

Change in fair value of derivative instruments for the year ended December 31, 2012 increased $2.5 million from an unrealized loss of $0.8 million for the same period in 2011 to an unrealized gain of $1.7 million. The increase was due to favorable euro currency fluctuations on our foreign exchange forward contracts.

Reorganization items, net for the year ended December 31, 2012 was $149.1 million. The amount represents expense and income amounts that were recorded to the statement of operations as a result of the bankruptcy proceedings. Reorganization items were incurred starting with the date of the bankruptcy filing through the date of bankruptcy emergence.

Income tax benefit for the year ended December 31, 2012 decreased $94.2 million from a tax benefit of $100.2 million for the year ended December 31, 2011 to a tax benefit of $5.9 million. The full year effective tax rate for 2012 was 6.4% primarily due to a tax benefit allocated to continuing operations after considering the gain recorded in 2012 in equity as a result of the reorganization. Such gain serves as a source of income that enables realization of the tax benefit of the current year loss in continuing operations. This tax benefit in continuing operations is offset by the deferred tax liabilities associated with tax amortization on indefinite-lived intangibles as well as expected foreign, state and local taxes for 2012. The full year effective tax rate for 2011 was approximately 4.4% due to the deferred tax benefit resulting from the decrease in deferred tax liabilities associated with book impairments on indefinite-lived intangibles and goodwill.

Consolidated Operating Results

(in thousands)	Year Ended December 31, 2011	Combined Year Ended December 31, 2010	Percent Change
Net sales	$ 1,295,295	$ 1,507,047	-14.1%
Costs and expenses			
Cost of sales, excluding pre-publication and publishing rights amortization	512,612	604,863	-15.3%
Publishing rights amortization	230,624	284,313	-18.9%
Pre-publication amortization	176,829	219,444	-19.4%
Cost of sales	920,065	1,108,620	-17.0%
Selling and administrative	640,023	717,846	-10.8%
Other intangible asset amortization	67,372	59,607	13.0%
Impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets	1,674,164	107,961	NM
Severance and other charges	32,801	(11,243)	NM
Gain on sale of assets	(2,000)	(1,179)	69.6%
Operating loss	(2,037,130)	(474,565)	329.3%
Other income (expense)			
Interest expense	(244,582)	(416,121)	-41.2%
Other (loss) income, net	-	3	NM
Change in fair value of derivative instruments	(811)	82,889	NM
Loss before taxes	(2,282,523)	(807,794)	NM
Income tax expense (benefit)	(100,153)	11,709	NM
Net loss	$ (2,182,370)	$ (819,503)	NM

NM = not meaningful

Results of Operations – Comparing Years Ended December 31, 2011 and 2010

Net sales for the year ended December 31, 2011, decreased $211.8 million, or 14.1%, from $1,507.0 million for the same period in 2010 to $1,295.3 million. The decline was largely driven by a reduction in the Texas adoption market by over $250 million from 2010 coupled with a decline in sales to open territories along with a decline in international sales. Net sales for Texas for the year ended December 31, 2011 was $72.0 million, approximately $119.0 million less than the same period in 2010. Additionally, sales to open territories were approximately $61.0 million lower for the year ended 2011 compared to the same period in 2010 due primarily to the contraction of spending throughout most states. Lastly, our international sales were $33.0 million lower in 2011 than 2010 due to a tightening of credit terms with our middle east distribution partners.

Operating loss for the year ended December 31, 2011 increased $1,562.6 million, or 329.3%, from a loss of $474.6 million for the same period in 2010 to a loss of $2,037.1 million, primarily due to a goodwill impairment charge of $1,442.5 million. The goodwill impairment was due to the carrying value of the Education reporting unit exceeding the implied fair value. Further, the increased loss was also due to

tradename and other impairments of $231.6 million and $44.0 million increase in severance and other expenses and lower annual net sales partially offset by:

- A $88.5 million decrease in amortization expense related to publishing rights, pre-publication and other intangible assets due to our use of accelerated amortization methods and lower plate spend over the past several years than earlier years;
- A $77.8 million decrease in selling and administrative expenses related primarily to a reduction in variable expenses such as commissions and depository fees associated with lower revenue; and
- A $92.3 million decrease in cost of sales (excluding pre-publication and publishing rights amortization) due to a reduction of the inventory step up amortization of $41.7 million, which was included in 2010, along with lower net sales.

Interest expense for the year ended December 31, 2011 decreased $171.5 million, or 41.2%, from $416.1 million for the same period in 2010 to $244.6 million, primarily a result of the expiration of legacy swap agreements with unfavorable fixed interest rates and the conversion of $4.0 billion of debt to equity in March 2010 as part of the restructuring. The components for the decline were:

- In 2010, we paid $93.1 million related to the interest rate swap agreements in place at the time. The swap agreements, which were mandatory under our Credit Agreement, expired at December 31, 2010;
- The Mezzanine debt, which bore interest at 17.5% through March 9, 2010, incurred $67.0 million in interest in 2010 that did not exist in 2011;
- A reduction of $5.1 million of deferred financing costs as a substantial amount of deferred financing fees that existed at March 9, 2010 were written off; and
- A reduction of $8.1 million related to the accounts receivable securitization facility as we had $140.0 million outstanding on the securitization facility from February 2010 through August 3, 2010 and an average outstanding balance of $30.1 million for only two months during 2011.

Change in fair value of derivative instruments for the year ended December 31, 2011 decreased $83.7 million from a gain of $82.9 million for the same period in 2010 to an unrealized loss of $0.8 million. The decrease was due to interest rate swap payments made during 2010, which effectively reduced the unrealized liability established on the balance sheet. No interest rate swap agreements were in place during 2011. The $0.8 million unrealized loss on change in fair value of derivative instruments related to unfavorable foreign exchange forward contracts in place during 2011.

Income tax expense for the year ended December 31, 2011 decreased $111.9 million from an expense of $11.7 million for the year ended December 31, 2010 to a benefit of $100.2 million. The full year effective tax rate for 2011 was approximately 4.4% due to the deferred tax benefit resulting from the decrease in deferred tax liabilities associated with book impairments on indefinite-lived intangibles and goodwill. An income tax benefit was recorded in the fourth quarter of 2011 and was due primarily to the book impairment on indefinite-lived intangible assets and goodwill, which reduced the related deferred tax liabilities.

Non-GAAP Financial Measures

To supplement our Financial Statements presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"), we have presented certain financial measures in addition to our GAAP results. We believe that these non-GAAP financial measures provide useful information for evaluating our business performance. This information should be considered as supplemental in nature and should not be considered in isolation or as a substitute for the related financial information prepared in accordance with GAAP. In addition, these non-GAAP financial measures may not be the same as similarly entitled measures reported by other companies.

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

Adjusted EBITDA

Management believes that the presentation of Adjusted EBITDA provides useful information to investors regarding our results of operations because it assists both investors and management in analyzing and benchmarking the performance and value of our business. Adjusted EBITDA provides an indicator of general economic performance that is not affected by debt restructurings, fluctuations in interest rates or effective tax rates, or levels of depreciation or amortization. Accordingly, our management believes that this measurement is useful for comparing general operating performance from period to period. Furthermore, the agreements governing our indebtedness contain covenants and other tests based on Adjusted EBITDA. In addition, targets and positive trends in Adjusted EBITDA are used as performance measures and to determine certain compensation of management. Other companies may define Adjusted EBITDA differently and, as a result, our measure of Adjusted EBITDA may not be directly comparable to Adjusted EBITDA of other companies. Although we use Adjusted EBITDA as a financial measure to assess the performance of our business, the use of Adjusted EBITDA is limited because it does not include certain material costs, such as interest and taxes, necessary to operate our business. Adjusted EBITDA should be considered in addition to, and not as a substitute for, net earnings in accordance with GAAP as a measure of performance. You are cautioned not to place undue reliance on Adjusted EBITDA.

Below is a reconciliation of our net loss to this non-GAAP measure:

(in thousands)	Successor			Predecessor
	Year Ended, December 31,	Year Ended, December 31,	For the Period March 10, 2010 to December 31,	For the Period January 1, 2010 to March 9,
	2012	2011	2010	2010
Net loss	$ (87,139)	$ (2,182,370)	$ (507,727)	$ (311,776)
Consolidated interest expense	123,197	244,582	258,174	157,947
Provision (benefit) for income taxes	(5,943)	(100,153)	11,929	(220)
Depreciation expenses	58,131	58,392	48,649	10,900
Amortization expenses (including capitalized permission settlements)	370,291	474,825	475,099	88,265
Non-cash charges - stock compensation	4,227	8,558	4,274	925
Non-cash charges - gain (loss) on foreign currency and interest hedge	(1,688)	811	(90,250)	7,361
Non-cash charges - asset impairment charges	8,003	1,674,164	103,933	4,028
Purchase accounting adjustments (a)	(16,511)	22,732	113,182	-
Fees, expenses or charges for equity offerings, debt or acquisitions	267	3,839	1,513	-
Non-recurring debt restructuring (b)	-	-	30,000	9,564
Non-recurring restructuring (c)	6,716	-	-	-
Severance, separation costs and facility closures (d)	9,375	32,818	23,975	992
Reorganziation items, net (e)	(149,114)	-	-	-
ADJUSTED EBITDA	$ 319,812	$ 238,198	$ 472,751	$ (32,014)

(a) Represents certain non-cash accounting adjustments, most significantly relating to deferred revenue, and inventory costs , that we were required to record as a direct result of the March 9, 2010 Restructuring and the acquisitions for the years ended 2012, 2011 and 2010.
(b) Represents fees paid and charged to operations relating to the March 9, 2010 Restructuring.
(c) Represents non-recurring restructuring costs (other than severance and real estate) such as consulting and realignment.
(d) Represents costs associated with the restructuring. Included in such costs are severance, facility integration and vacancy of excess facilities. 2010 costs also includes program integration and related inventory obsolescence and consulting costs.
(e) Represents net gain associated with the Chapter 11 Reorganization.

Unlevered Free Cash Flow

Free cash flow is a measure generally used by investors, analysts and management to gauge a company's ability to generate cash from operations in excess of that necessary to be reinvested to sustain and grow the business and fund its obligations. We calculate unlevered free cash flow as net cash provided by operating activities excluding cash paid for interest and reorganization items, reduced for cash expenditures relating to additions to pre-publication costs and additions to property, plant and equipment. We believe that our unlevered free cash flow calculation provides a relevant measure of liquidity and a useful basis for assessing our ability to fund operations. Unlevered free cash flow is not a financial measure under GAAP and should be used in conjunction with GAAP cash measures provided in our Consolidated Statement of Cash Flows.

Below is a reconciliation of our net cash provided by operating activities to this non-GAAP measure:

	Year Ended December 31,		
	2012	2011	2010
Net cash provided by operating activities	$ 104,802	$ 132,796	$ 141,670
Add back:			
Cash paid for interest	92,481	180,647	273,772
Reorganization items included in operating activities	16,705	-	-
Less: Additions to pre-publication costs	(114,522)	(122,592)	(118,670)
Less: Additions to property, plant and equipment	(50,943)	(71,817)	(67,698)
Unlevered Free Cash Flow	$ 48,523	$ 119,034	$ 229,074

Business Operating Results

We are organized along two business segments: Education and Trade Publishing. The Education business is the largest division, and represented approximately 88% and 90% of our total net sales for the years ended December 31, 2012 and 2011, respectively. Our Trade Publishing represented approximately 12% and 10% our total net sales for the year ended December 31, 2012 and 2011, respectively. The Corporate/Other category represents non-allocated corporate expenses. The majority of our non-GAAP reconciling items for Adjusted EBITDA reflected herein impact the Education business and Corporate/Other category. We changed our corporate cost allocation policy in the fourth quarter of 2012; thus the 2011 amounts have been adjusted to conform with the 2012 presentation.

Results of Operations – Comparing Years Ended December 31, 2012 and 2011

	Year Ended		Percentage
	2012	2011	Change
Net sales:			
Education	$ 1,128,591	$ 1,169,645	-3.5%
Trade Publishing	157,050	125,650	25.0%
Corporate/Other	-	-	-
Total	$ 1,285,641	$ 1,295,295	
Adjusted EBITDA:			
Education	$ 329,723	$ 278,930	18.2%
Trade Publishing	28,774	12,888	123.3%
Corporate/Other	(38,685)	(53,620)	-27.9%
Total	$ 319,812	$ 238,198	

Net Sales

Education

The Education business net sales for the year ended December 31, 2012, decreased $41.1 million, or 3.5% from $1,169.6 million for the same period in 2011 to $1,128.6 million. The decrease was primarily due to a $47.0 million decline in domestic education sales from the prior year. This is a result of our addressable new adoption and open territory sales being down from the prior year largely due to known lower adoptions in 2012 coupled with a continuing decline in the open territory market. The addressable adoption market is down approximately 23% when compared to the prior year and the open territory market is down approximately 8% from the prior year. While our Singapore Math product continues to outperform, certain other supplemental product sales are down due to aging products. The decrease was partially offset by the strength of our professional development and reading intervention sales which increased $20.5 million.

Trade Publishing

Net sales for the Trade Publishing business for the year ended December 31, 2012 increased $31.4 million, or 25.0% to $157.1 million from $125.7 million for the same period in 2011. The increase is primarily attributed to the theatrical releases of “The Hobbit”, “Life of Pi” and “Extremely Loud and Incredibly Close” which drove increased book sales. Further, there was a continued increase in e-Book sales driven by an overall growth in digital devices.

Adjusted EBITDA

Education

Our Education business Adjusted EBITDA for the year ended December 31, 2012 increased $50.8 million, or 18.2%, from $278.9 million for the same period in 2011 to $329.7 million. The increase was attributed to a reduction in labor related costs due to the head count reduction associated with the restructuring activity and a reduction in travel expense and other fixed and discretionary costs realized as part of cost control measures. The increase was offset by the effect of the $41.1 million decrease in net sales for the year.

Trade Publishing

Adjusted EBITDA for the Trade Publishing business for the year ended December 31, 2012 increased $15.9 million, or 123.3%, to $28.8 million from $12.9 million for the same period in 2011. The increase was primarily attributed to the effect of the $31.4 million increase in net sales offset by slightly higher royalties.

Corporate/Other

Corporate/Other represents certain general overhead costs not fully allocated to the business units such as Legal, Accounting, Treasury, Human Resources and C-suite functions. Additionally, 2011 included headcount associated with certain incubator initiatives which were terminated in the latter half of 2011 resulting in labor savings in 2012. Adjusted EBITDA for Corporate/Other for the year ended December 31, 2012 increased $14.9 million, to a loss of $38.7 million from a loss of $53.6 million for the same period in 2011. The increase was due to lower headcount and administrative expenses associated with cost control measures.

Results of Operations – Comparing Years Ended December 31, 2011 and 2010

	Year Ended		Percentage
	2011	2010	Change
Net sales:			
Education	$ 1,169,645	$ 1,383,147	-15.4%
Trade Publishing	125,650	123,900	1.4%
Corporate/Other	-	-	-
Total	$ 1,295,295	$ 1,507,047	
Adjusted EBITDA:			
Education	$ 278,930	$ 490,262	-43.1%
Trade Publishing	12,888	12,730	1.2%
Corporate/Other	(53,619)	(62,255)	-13.9%
Total	$ 238,199	$ 440,737	

Net Sales

Education

The Education business net sales for the year ended December 31, 2011, decreased $213.5 million, or 15.4%, from $1,383.1 million for the same period in 2010 to $1,169.6 million. The decline was largely driven by a reduction in the Texas adoption market by over $250 million from 2010 coupled with a decline in sales to open territories along with a decline in international sales. Net sales for Texas for the year ended December 31, 2011 was $72.0 million, approximately $119.0 million less than the same period in 2010. Additionally, sales to open territories were approximately $61.0 million lower for the year ended 2011 compared to the same period in 2010 due primarily to the contraction of spending throughout most

states. Lastly, our international sales were $33.0 million lower in 2011 than 2010 due to a tightening of credit terms with our middle east distribution partners.

Trade Publishing
Net sales for the Trade Publishing business for the year ended December 31, 2011 increased $1.8 million, or 1.4%, to $125.7 million from $123.9 million for the same period in 2010. The increase was primarily attributed to favorable returns compared to the prior year due to a shift to e-book sales from print sales partially offset by a decline in sub-rights income.

Adjusted EBITDA

Education
Our Education business Adjusted EBITDA for the year ended December 31, 2011 decreased $211.3 million, or 43.1%, from $490.3 million for the same period in 2010 to $278.9 million. The decline was largely driven by the 2011 decline in net sales attributed to the smaller markets in Texas and open territories. Additionally, our cost of sales rate increased as we shifted to more development and consulting services from the more profitable print products. Additionally, we incurred higher bad debt expense and returns expense attributed to a tightening of credit terms with middle east distribution partners.

Trade Publishing
Adjusted EBITDA for the Trade Publishing business for the year ended December 31, 2011 increased $0.2 million, or 1.2%, to $12.9 million from $12.7 million for the same period in 2010. The increase was primarily attributed to cost management.

Corporate/Other
Corporate/Other represents certain general overhead costs not fully allocated to the business units along with incubator initiatives focusing on consumer and emerging markets and research and development. Adjusted EBITDA for Corporate/Other for the year ended December 31, 2011 decreased $8.6 million, to a loss of $53.6 million from a loss of $62.2 million for the same period in 2010. The increase was due to the elimination of our corporate office in Dublin.

Liquidity and Capital Resources

	Year Ended December 31,		
(in thousands)	2012	2011	2010
Cash and cash equivalents	$ 329,078	$ 413,610	$ 380,073
Short-term investments	146,041	-	17,667
Current portion of long-term debt	2,500	43,500	193,064
Long-term debt	245,625	2,968,088	2,668,530
Operating cash flow	104,802	132,796	141,670
Unlevered free cash flow	48,523	119,034	229,074

As discussed in Note 2 to the Financial Statements, on June 22, 2012, our creditors converted the First Lien Credit Agreement consisting of the Term Loan with an aggregate outstanding principal balance of $2.6 billion and the Revolving Loan with an aggregate outstanding principal balance of $235.8 million, and the outstanding $300.0 million principal amount of 10.5% Senior Notes to 100 percent pro rata ownership of the Company's common stock.

On May 22, 2012, we entered into a new $500.0 million senior secured credit facility (DIP facility) which was converted into an exit facility on the effective date of the emergence from Chapter 11. This exit facility consists of a $250.0 million revolving credit facility, which is secured by the Company's accounts receivable and inventory, and a $250.0 million term loan credit facility. The proceeds of the exit facility were used to fund the costs of the reorganization and provide post-closing working capital to the Company. As of December 31, 2012, we had approximately $248.1 million outstanding under our term loan credit facility and no amounts outstanding under our revolving credit facility. We had approximately $185.9 million of borrowing availability under our revolving credit facility and approximately $26.2 million of outstanding letters of credit as of December 31, 2012. We had approximately $329.1 million of cash and cash equivalents and $146.0 million of short-term investments at December 31, 2012.

We expect our cash flows from operations combined with our cash on hand and borrowings under our revolving credit facility to provide sufficient liquidity to fund our current obligations, capital spending, debt service requirements and working capital requirements over at least the next twelve months.

Operating activities

Net cash provided by operating activities was $104.8 million for the year ended December 31, 2012, a $28.0 million decrease from the $132.8 million provided by operating activities for the year ended December 31, 2011. The decrease in cash provided by operating activities from 2011 to 2012 was primarily due to decreases in working capital, primarily consisting of lower deferred revenue and a decrease in accounts payable partially offset by stronger operating performance.

Net cash provided by operating activities was $132.8 million for the year ended December 31, 2011, a $8.9 million decrease from the $141.7 million provided by operating activities for the year ended December 31, 2010. The decrease in cash provided by operating activities from 2010 to 2011 was driven by an unfavorable change in receivables as a substantial amount of prior year adoption sales were collected by the end of the fourth quarter of 2010, along with lower inventory levels and decreased interest payable. These changes were partially offset by favorable changes in accounts payable and severance and other charges.

Investing activities

Net cash used in investing activities was $296.0 million for the year ended December 31, 2012, a increase of $100.7 million from the $195.3 million used in investing activities for the year ended December 31, 2011. The increase in cash expenditures for 2012 is primarily attributable to purchases of $165.6 million of short-term investments offset by reductions in capital expenditures of $28.9 million for property, plant, and equipment and pre-publication costs, and reductions in cash outlays over the prior year for acquisitions of $24.6 million.

Net cash used in investing activities was $195.3 million for the year ended December 31, 2011, a decrease of $62.4 million from the $257.7 million used in investing activities for the year ended December 31, 2010. The decrease reflects $17.8 million in proceeds from the sale of short term investments and $16.8 million in proceeds from restricted cash accounts related to cash collateralized letter of credit which were released in 2011. In the year ended December 31, 2010, $18.0 million had been used for the purchase of short term investments and $42.7 million had been deposited to restricted cash accounts. Partially offsetting the source of cash from investing activities was $30.0 million of additional capital expenditure over the prior period for an acquisition of an intangible asset.

Financing activities

Net cash provided by financing activities was $106.7 million for the year ended December 31, 2012, which was $10.7 million higher than the net cash provided by financing activities for the year ended December 31, 2011. During 2012, in connection with our emergence from bankruptcy, we issued new term debt with proceeds of $250.0 million and we paid $104.0 million in restructuring costs and $26.6 million in deferred financing fees relating to the bankruptcy and new term debt. We also paid $10.9

million of principal payments on the debt existing prior to bankruptcy and three quarters of principal payments related to the new term debt totaling $1.9 million. During 2011, we issued secured notes with proceeds of $300.0 million and we paid $150.0 million to retire the 7.2% secured notes that matured on March 15, 2011. We also made principal payments on our long term debt totaling $43.5 million and paid approximately $10.5 million of fees in connection with the issuance of the $300.0 million 10.5% Senior Notes.

Net cash provided by financing activities was $96.0 million for the year ended December 31, 2011, which was $306.1 million lower than the net cash provided by financing activities for the year ended December 31, 2010. During 2011, we received $300.0 million through a 10.5% Senior Notes offering and paid $8.8 million for fees associated with that offering. We also paid $1.6 million of deferred financing fees related to the amendments to our accounts receivable securitization facility. We paid $150.0 million to retire the 7.2% secured notes that matured on March 15, 2011. During the year ended December 31, 2010, we raised $649.6 million, net of fees, from our rights offering. Offsetting this inflow was a payment of $43.7 million of related restructuring costs.

Unlevered Free Cash Flow

Unlevered Free Cash Flow was $48.5 million for the year ended December 31, 2012, which was $70.5 million lower than the $119.0 million unlevered free cash flow for the year ended December 31, 2011. The decrease was primarily due to a negative impact of changes in our operating assets and liabilities partially offset by decreases in capital expenditures and stronger operating results.

Unlevered Free Cash Flow was $119.0 million for the year ended December 31, 2011, which was $110.1 million lower than the $229.1 million unlevered free cash flow for the year ended December 31, 2010. The decrease was primarily due to lower operating results and a negative impact of changes in our operating assets and liabilities.

Critical Accounting Policies

The preparation of financial statements in conformity with U.S. GAAP requires the use of estimates, assumptions and judgments by management that affect the reported amounts of assets, liabilities, net sales, expenses and related disclosure of contingent assets and liabilities in the amounts reported in the financial statements and accompanying notes. On an on-going basis, we evaluate our estimates and assumptions, including, but not limited to, book returns, allowance for bad debts, recoverability of advances to authors, valuation of inventory, financial instruments, depreciation and amortization periods, recoverability of long-term assets such as property, plant and equipment, capitalized pre-publication costs, other identified intangibles, goodwill, deferred revenue, income taxes, pensions and other postretirement benefits, contingencies, litigation and purchase accounting. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates. For more information regarding our critical accounting policies, see Note 3 to our Financial Statements.

Revenue Recognition

We derive revenue primarily from the sale of print and digital textbooks and instructional materials, trade books, reference materials, multimedia instructional programs, license fees for book rights, content, software and services that include test development, test scoring, consulting and training. Revenue from print and digital textbooks and instructional materials, trade books, reference materials, assessment materials and multimedia instructional programs is recognized in the period when persuasive evidence of an arrangement with the customer exists, the products are shipped, title and risk of loss have transferred to the customer, all significant obligations have been performed and collection is reasonably assured.

We enter into certain contractual arrangements that have multiple elements, one or more of which may be delivered subsequent to the initial sale. These multiple deliverable arrangements may include print and digital media, professional development, training services, software, software as a service (SaaS), and various services related to the software including but not limited to hosting, maintenance and support, and implementation. At the inception of these arrangements, consideration is allocated using the Relative Sales Value (RSV) method. For each element, we determine whether the element falls under the accounting guidance within multiple element arrangements or software revenue recognition. For elements which fall under the accounting guidance for multiple element arrangements, we apply the highest applicable relative selling price guidance available, Vendor Specific Objective Evidence (VSOE), Third Party Evidence (TPE), or Best Estimate of Selling Price (BESP). For elements which fall under the accounting guidance for software revenue recognition, we apply VSOE and the residual method. If we are not able to establish VSOE, we estimate relative selling price based on TPE or BESP for purposes of allocation of total project discount, and defer until all such elements are fulfilled assuming all other revenue recognition criteria have been met. For multiple deliverable arrangements, fair value is determined for all elements and the relative sales value of revenue for items to be delivered after the initial sale is deferred until such time as the items are delivered. A significant component of revenue that is deferred relates to gratis items delivered in connection with sales to customers within adoption states. As our business model shifts to more digital and on-line learning components, additional revenue could be deferred. As products are shipped with right of return, a provision for estimated returns on these sales is made at the time of sale based on historical experience.

License fees for software products without future obligations are recognized upon delivery. Certain contracts include software and on-going fees for maintenance and other support. If VSOE of the fair value of each element of the arrangement exists, the elements of the contract are unbundled and the revenue is recognized for each element when or as delivered. Revenue for test delivery, test scoring and training are recognized when the services have been completed, the fee is fixed or determinable and collection is reasonably assured. Revenue for test development is recognized as the services are provided. Differences between what has been billed and what has been recognized as revenue is recorded as deferred revenue. We enter into agreements to license certain book publishing rights and content. We recognize revenue on such arrangements when all materials have been delivered to the customer and collection is reasonably assured.

Accounts Receivable

Accounts receivable are recorded net of allowances for doubtful accounts and reserves for book returns. In the normal course of business, we extend credit to customers that satisfy predefined criteria. We estimate the collectability of our receivables. Allowances for doubtful accounts are established through the evaluation of accounts receivable aging and prior collection experience to estimate the ultimate collectability of these receivables. Reserves for book returns are based on historical return rates and sales patterns.

Inventories

Inventories are stated at the lower of weighted average cost or net realizable value. The level of obsolete and excess inventory is estimated on a program or title level-basis by comparing the number of units in stock with the expected future demand. The expected future demand of a program or title is determined by the copyright year, the previous years' sales history, the subsequent year's sales forecast, known forward-looking trends including our development cycle to replace the title or program and competing titles or programs.

Pre-publication costs

We capitalize the art, prepress, manuscript and other costs incurred in the creation of the master copy of a book or other media (the "pre-publication costs"). Pre-publication costs are primarily amortized from the year of copyright, or sale if earlier, over five years using the sum-of-the-years-digits method. This policy is used throughout the Company, except for the Trade Publishing consumer books, which expenses such

costs as incurred, and the assessment products, which uses the straight-line amortization method. The amortization methods and periods chosen best reflect the pattern of expected sales generated from individual titles or programs. We periodically evaluate the remaining lives and recoverability of capitalized pre-publication costs, which are often dependent upon program acceptance by state adoption authorities.

Amortization expense related to pre-publication costs for the years ended December 31, 2012 and 2011 were $137.7 million and $176.8 million, respectively. For the period January 1, 2010 to March 9, 2010 amortization expense related to pre-publication costs was $37.9 million and for the period March 10, 2010 to December 31, 2010 amortization expense related to pre-publication costs was $181.5 million Pre-publication costs recorded on the balance sheet are periodically reviewed for impairment by comparing the unamortized capitalized costs of the assets to the fair value of those assets.

For the years ended December 31, 2012 and 2011, the period January 1, 2010 to March 9, 2010, and the period March 10, 2010 to December 31, 2010, pre-publication costs of $0.4 million, $33.5 million, zero and $16.9 million, respectively, were deemed to be impaired. The impairment was included as a charge to the statement of operations in the impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets caption.

Goodwill and indefinite-lived intangible assets

Goodwill is the excess of the purchase price paid over the fair value of the net assets of the business acquired. Other intangible assets principally consist of branded trademarks and trade names, acquired publishing rights and customer relationships. Goodwill and indefinite-lived intangible assets (certain trade names) are not amortized but are reviewed at least annually for impairment or earlier, if an indication of impairment exists. Recoverability of goodwill and indefinite lived intangibles is evaluated using a two-step process. In the first step, the fair value of a reporting unit is compared to its carrying value. If the fair value of a reporting unit exceeds the carrying value of the net assets assigned to a reporting unit, goodwill is considered not impaired and no further testing is required. If the carrying value of the net assets assigned to a reporting unit exceeds the fair value of a reporting unit, the second step of the impairment test is performed in order to determine the implied fair value of a reporting unit's goodwill. Determining the implied fair value of goodwill requires valuation of a reporting unit's tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to the extent of the difference. We estimate total fair value of each reporting unit using discounted cash flow analysis, and make assumptions regarding future revenue, gross margins, working capital levels, investments in new products, capital spending, tax, cash flows and the terminal value of the reporting unit. With regard to other intangibles with indefinite lives, we determine the fair value by asset, which is then compared to its carrying value to determine if the assets are impaired.

Goodwill is allocated entirely to our Education reporting unit. Determining the fair value of a reporting unit is judgmental in nature, and involves the use of significant estimates and assumptions. These estimates and assumptions may include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, the determination of appropriate market comparables as well as the fair value of individual assets and liabilities. Consistent with prior years, we used an income approach to establish the fair value of the reporting unit as of October 1, 2012. As in prior years, we used the most recent five year strategic plan as the initial basis of our analysis.

We completed our annual goodwill and indefinite-lived intangible asset impairment tests as of October 1, 2012, 2011, and 2010 and recorded a noncash impairment charge of $5.0 million for the year ended December 31, 2012, $1,635.1 million for the year ended December 31, 2011 and $87.0 million for the period March 10, 2010 to December 31, 2010. There was no impairment for the period January 1, 2010 to March 9, 2010. The impairments principally related to one specific tradename within the Education

segment in 2012, goodwill and tradenames within the Education segment in 2011, and related to tradenames within the Education segment and Trade Publishing segment in 2010. The impairment charges resulted primarily from a decline in revenue from previously projected amounts as a result of the economic downturn and reduced educational spending by states and school districts. All impairment charges are included in operating income.

Publishing Rights
A publishing right is an acquired right which allows us to publish and republish existing and future works as well as create new works based on previously published materials. We determine the fair market value of the publishing rights arising from business combinations by discounting the after-tax cash flows projected to be derived from the publishing rights and titles to their net present value using a rate of return that accounts for the time value of money and the appropriate degree of risk. The useful life of the publishing rights is based on the lives of the various copyrights involved. We calculate amortization using the percentage of the projected operating income before taxes derived from the titles in the current year as a percentage of the total estimated operating income before taxes over the remaining useful life. Acquired publication rights, as well as customer-related intangibles with definitive lives, are primarily amortized on an accelerated basis over periods ranging from three to 20 years.

Royalty advances
Royalty advances to authors are capitalized and represent amounts paid in advance of the sale of an author's product and are recovered as earned. As advances are recorded, a partial reserve may be recorded immediately based primarily upon historical sales experience. Advances are evaluated periodically to determine if they are expected to be recovered. Any portion of a royalty advance that is not expected to be recovered is fully reserved.

Impact of inflation and changing prices

Although inflation is currently well below levels in prior years and has, therefore, benefited recent results, particularly in the area of manufacturing costs, there are offsetting costs. Our ability to adjust selling prices has always been limited by competitive factors and long-term contractual arrangements which either prohibit price increases or limit the amount by which prices may be increased. Further, a weak domestic economy at a time of low inflation could cause lower tax receipts at the state and local level, and the funding and buying patterns for textbooks and other educational materials could be adversely affected. Prices for paper moderated during the last three years

The most significant investments affected by inflation include pre-publication, other property, plant and equipment and inventories. We use the weighted average cost method to value substantially all inventory. We have negotiated favorable pricing through contractual agreements with our two top print and sourcing vendors, and from our other major vendors, which has helped to stabilize our unit costs, and therefore our cost of inventories sold. Our publishing business requires a high level of investment in pre-publication for our educational and reference works, and in other property, plant and equipment. We expect to continue to commit funds to the publishing areas through both internal growth and acquisitions. We believe that by continuing to emphasize cost controls, technological improvements and quality control, we can continue to moderate the impact of inflation on our operating results and financial position.

Covenant Compliance

As of December 31, 2012, we were in compliance with all of our debt covenants.

We are currently required to meet certain restrictive financial covenants as defined under our Term Loan and Revolving Credit Facility. We have financial covenants primarily pertaining to interest coverage and maximum leverage ratios. A breach of any of these covenants, ratios, tests or restrictions, as applicable, for which a waiver is not obtained could result in an event of default, in which case our lenders could elect

to declare all amounts outstanding to be immediately due and payable and result in a cross-default under other arrangements containing such provisions. A default would permit lenders to accelerate the maturity for the debt under these agreements and to foreclose upon any collateral securing the debt owed to these lenders and to terminate any commitments of these lenders to lend to us. If the lenders accelerate the payment of the indebtedness, our assets may not be sufficient to repay in full the indebtedness and any other indebtedness that would become due as a result of any acceleration. Further, in such an event, the lenders would not be required to make further loans to us, and assuming similar facilities were not established and we are unable to obtain replacement financing, it would materially affect our liquidity and results of operations.

Contractual Obligations

The following table provides information with respect to our estimated commitments and obligations as of December 31, 2012:

(in thousands)

Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
			(dollars)		
Term loan due May 2018 (1)	$ 248,125	$ 2,500	$ 5,000	$ 5,000	$ 235,625
Capital Leases	5,925	1,689	4,236	-	-
Operating leases (2)	192,930	43,818	82,642	48,388	18,082
Purchase obligations (3)	407,535	187,628	210,329	9,513	65
Total cash contractual obligations	$ 854,515	$ 235,635	$ 302,207	$ 62,901	$ 253,772

(1) The Term loan due May 2018 amortizes at a rate of 1% per annum of the original $250.0 million amount. Amounts in the table above exclude interest payable on the Term loan.

(2) Represents minimum lease payments under non-cancelable operating leases.

(3) Purchase obligations are agreements to purchase goods or services that are enforceable and legally binding. These goods and services consist primarily of author advances, subcontractor expenses, information technology licenses, and outsourcing arrangements.

In addition to the payments described above, we have employee benefit obligations that require future payments. For example, we have made $19.8 million in cash contributions to our pension and postretirement benefit plans in 2012 and expect to make another $13.5 million of contributions in 2013 relating to our pension and postretirement benefit plans although we are not obligated to do so. We expect to periodically draw and repay borrowings under the accounts receivable securitization facility. We believe that we will be able to meet our cash interest obligations on our outstanding debt when they are due and payable.

Off-Balance Sheet Arrangement

We have no off-balance sheet arrangements**.**

Item 7A. 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 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 our earnings and cash flow volatility resulting from shifts in market rates. As permitted, we may designate certain of these derivative contracts for hedge accounting treatment in accordance with authoritative guidance regarding accounting for derivative instruments and hedging activities. However, certain of these instruments may not qualify for, or we may choose not to elect, hedge accounting treatment and, accordingly, the results of our operations may be exposed to some level of volatility. Volatility in 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. Periodically we may enter into derivative contracts, including interest rate swap agreements and interest rate caps and collars to manage interest rate exposures, and foreign currency spot, forward, swap and option contracts to manage foreign currency exposures. The fair market values of all these 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. Our policy is to deal with counterparties having a single A or better credit rating at the time of the execution. We manage credit risk through the continuous monitoring of exposures to such counterparties.

We continue to review liquidity sufficiency by performing various stress test scenarios, such as cash flow forecasting which considers hypothetical interest rate movements. Furthermore, we continue to closely monitor current events and the financial institutions that support our credit facility, including monitoring their credit ratings and outlooks, credit default swap levels, capital raising and merger activity.

We have $248.1 million of aggregate principal amount indebtedness outstanding under our Term Loan that bears interest at a variable rate. An increase or decrease of 1% in the interest rate will change our interest expense by approximately $2.5 million on an annual basis. We also have up to $250.0 million of borrowing availability, subject to borrowing base availability, under our Revolving Credit Facility, and borrowings under the Revolving Credit Facility bear interest at a variable rate. We have no borrowings outstanding under the Revolving Credit Facility at December 31, 2012. Assuming that the Revolving Credit Facility is fully drawn, an increase or decrease of 1% in the interest rate will change our interest expense associated with the Revolving Credit Facility by $2.5 million on an annual basis.

We conduct various digital development activities in Ireland, and as such, our cash flows and costs are subject to fluctuations from changes in foreign currency exchange rates. We manage our exposures to this market risk through the use of short-term forward exchange contracts, when deemed appropriate, which were not significant as of December 31, 2012. We do not enter into derivative transactions or use other financial instruments for trading or speculative purposes.

Item 8. Financial Statements and Supplementary Data
HMH Holdings (Delaware), Inc.
Financial Statements
Table of Contents

Page(s)

Reports of Independent Auditors……………………………………………………….…………………..50-51

Consolidated Balance Sheets 52

Consolidated Statements of Operations 53

Consolidated Statements of Comprehensive Income (Loss)..54

Consolidated Statements of Cash Flows 55

Consolidated Statements of Stockholders’ Equity (Deficit)...56

Notes to Consolidated Financial Statements 57-104

Independent Auditor's Report

To the Board of Directors and Stockholders of
HMH Holdings (Delaware), Inc.

We have audited the accompanying consolidated financial statements of HMH Holdings (Delaware), Inc. and its subsidiaries (Successor), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity (deficit), and cash flows for the years ended December 31, 2012 and 2011 and for the period March 10, 2010 to December 31, 2010 (Successor Periods).

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HMH Holdings (Delaware), Inc. and its subsidiaries at December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for the years ended December 31, 2012 and 2011 and for the period March 10, 2010 to December 31, 2010 in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Schedule II Valuation and Qualifying Accounts for the years ended December 31, 2012 and 2011 and for the period March 10, 2010 to December 31, 2010 (Successor Periods) is presented for purposes of additional analysis and is not a required part of the financial statements. The information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

/s/ PricewaterhouseCoopers LLP
Boston, Massachusetts
March 29, 2013

Report of Independent Auditors

To the Board of Directors and Stockholders of
HMH Holdings (Delaware), Inc.

In our opinion, the accompanying consolidated statements of operations, comprehensive income (loss), stockholders' equity (deficit), and cash flows for the period January 1, 2010 to March 9, 2010 present fairly, in all material respects, the results of operations and cash flows of HMH Publishing Company and its subsidiaries (Predecessor) for the period January 1, 2010 to March 9, 2010 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedule II Valuation and Qualifying Accounts for the period January 1, 2010 to March 9, 2010 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ PricewaterhouseCoopers LLP
Boston, Massachusetts
March 30, 2011

HMH Holdings (Delaware), Inc.
Consolidated Balance Sheets
December 31, 2012

(in thousands of dollars, except share information)	December 31, 2012	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	$ 329,078	$ 413,610
Restricted cash	-	26,495
Short-term investments	146,041	-
Accounts receivable, net of allowance for bad debts and book returns of $36.4 million and $43.8 million, respectively	229,118	256,271
Inventories	197,613	242,162
Deferred income taxes	42,858	14,152
Prepaid expenses and other assets	13,731	13,811
Total current assets	958,439	966,501
Property, plant, and equipment, net	149,227	152,212
Pre-publication costs, net	256,202	289,125
Royalty advances to authors, net of allowance of $20.5 million and $12.3 million, respectively	48,247	42,700
Goodwill	520,088	520,088
Other intangible assets, net	1,067,052	1,274,213
Other assets	30,329	19,064
Total assets	$ 3,029,584	$ 3,263,903
Liabilities and Stockholders' Equity (Deficit)		
Current liabilities		
Current portion of long-term debt	$ 2,500	$ 43,500
Accounts payable	86,416	130,128
Royalties payable	60,352	52,294
Salaries, wages, and commissions payable	34,730	43,515
Deferred revenue	124,216	141,763
Interest payable	87	30,843
Severance and other charges	18,290	35,750
Accrued postretirement benefits	2,342	2,252
Other liabilities	30,421	45,612
Total current liabilities	359,354	525,657
Long-term debt	245,625	2,968,088
Royalties payable	2,070	1,313
Long-term deferred revenue	171,105	208,173
Accrued pension benefits	48,714	64,490
Accrued postretirement benefits	27,231	33,718
Deferred income taxes	124,588	32,072
Other liabilities	107,196	104,944
Total liabilities	1,085,883	3,938,455
Commitments and contingencies (Note 14)		
Stockholders' equity (deficit)		
Preferred stock, $0.01 par value: 10,000,000 shares authorized; no shares issued and outstanding at December 31, 2012	-	-
Common stock, $0.01 par value: 190,000,000 shares authorized; 69,958,989 shares issued and outstanding at December 31, 2012 and $0.001 par value: 600,000,000 shares authorized; 283,636,235 shares issued and outstanding at December 31, 2011	700	284
Treasury stock, 41,011 shares as of December 31, 2012	-	-
Capital in excess of par value	4,741,765	2,038,714
Accumulated deficit	(2,777,236)	(2,690,097)
Accumulated other comprehensive income (loss)	(21,528)	(23,453)
Total stockholders' equity (deficit)	1,943,701	(674,552)
Total liabilities and stockholders' equity (deficit)	$ 3,029,584	$ 3,263,903

The accompanying notes are an integral part of these consolidated financial statements.

HMH Holdings (Delaware), Inc.
Consolidated Statements of Operations

(in thousands of dollars)	Successor			Predecessor
	For the Year Ended December 31, 2012	**For the Year Ended December 31, 2011**	**For the Period March 10, 2010 to December 31, 2010**	**For the Period January 1, 2010 to March 9, 2010**
Net sales	$ 1,285,641	$ 1,295,295	$ 1,397,142	$ 109,905
Costs and expenses				
Cost of sales, excluding pre-publication and publishing rights amortization	515,948	512,612	559,593	45,270
Publishing rights amortization	177,747	230,624	235,977	48,336
Pre-publication amortization	137,729	176,829	181,521	37,923
Cost of sales	831,424	920,065	977,091	131,529
Selling and administrative	533,462	640,023	598,807	119,039
Other intangible asset amortization	54,815	67,372	57,601	2,006
Impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets	8,003	1,674,164	103,933	4,028
Severance and other charges	9,375	32,801	(11,243)	-
Gain on bargain purchase	(30,751)	-	-	-
Gain on sale of assets	-	(2,000)	(1,179)	-
Operating loss	(120,687)	(2,037,130)	(327,868)	(146,697)
Other income (expense)				
Interest expense	(123,197)	(244,582)	(258,174)	(157,947)
Other (loss) income, net	-	-	(6)	9
Change in fair value of derivative instruments	1,688	(811)	90,250	(7,361)
Loss before reorganization items and taxes	(242,196)	(2,282,523)	(495,798)	(311,996)
Reorganization items, net	(149,114)	-	-	-
Income tax expense (benefit)	(5,943)	(100,153)	11,929	(220)
Net loss	$ (87,139)	$ (2,182,370)	$ (507,727)	$ (311,776)

The accompanying notes are an integral part of these consolidated financial statements.

HMH Holdings (Delaware), Inc.
Consolidated Statements of Comprehensive Income (Loss)

(in thousands of dollars)	Successor			Predecessor
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10, 2010 to December 31, 2010	For the Period January 1, 2010 to March 9, 2010
Net loss	$ (87,139)	$ (2,182,370)	$ (507,727)	$ (311,776)
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustments	(465)	(4,241)	1,829	392
Change in pension and benefit plan liability, net of tax expense of $85 for 2012	2,378	(14,509)	(6,533)	(1,313)
Unrealized gain on short-term investments	12	181	(180)	-
Other comprehensive income (loss), net of taxes	1,925	(18,569)	(4,884)	(921)
Comprehensive loss	$ (85,214)	$ (2,200,939)	$ (512,611)	$ (312,697)

The accompanying notes are an integral part of these consolidated financial statements.

HMH Holdings (Delaware), Inc.

Consolidated Statements of Cash Flows

(in thousands of dollars)	Successor			Predecessor
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10, 2010 to December 31, 2010	For the Period January 1, 2010 to March 9, 2010
Cash flows from operating activities				
Net loss	$ (87,139)	$ (2,182,370)	$ (507,727)	$ (311,776)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities				
Noncash interest expense	-	-	-	20,737
Gain on bargain purchase	(30,751)	-	-	-
Gain on sale of assets	-	(2,000)	(1,179)	-
Depreciation and amortization expense	428,422	532,996	523,651	99,260
Amortization of debt discount and deferred financing costs	24,584	46,249	37,040	13,680
Deferred income taxes (benefit)	(10,076)	(117,616)	11,708	(220)
Noncash stock-based compensation expense	6,254	8,559	4,274	925
Noncash issuance of warrants	10,747	-	-	-
Reorganization items	(179,024)	-	-	-
Impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets	8,003	1,674,164	103,933	4,028
Allowance for loan receivable from officer	-	-	18,875	-
Change in fair value of derivative instruments	(1,688)	811	(90,250)	7,361
Changes in operating assets and liabilities, net of acquisitions				
Accounts receivable	25,826	(2,356)	(27,996)	86,787
Inventories	44,549	39,825	98,329	(22,741)
Accounts payable and accrued expenses	(44,594)	18,488	(13,145)	(30,990)
Royalties, net	9,478	5,778	11,653	(9,867)
Deferred revenue	(54,615)	110,993	130,683	(9,539)
Interest payable	4,912	18,013	(49,328)	118,423
Severance and other charges	(17,460)	4,570	(30,977)	(4,257)
Accrued pension and postretirement benefits	(19,710)	(10,568)	(19,003)	1,297
Other, net	(12,916)	(12,740)	(17,575)	(4,404)
Net cash provided by (used in) operating activities	104,802	132,796	182,966	(41,296)
Cash flows from investing activities				
Proceeds from (deposits into) restricted cash accounts	26,495	16,751	(42,745)	-
Proceeds from sale of short-term investments	19,575	17,800	-	-
Purchases of short-term investments	(165,603)	-	(17,978)	-
Additions to pre-publication costs	(114,522)	(122,592)	(96,613)	(22,057)
Additions to property, plant, and equipment	(50,943)	(71,817)	(64,139)	(3,559)
Proceeds from sale of assets	-	150	2,177	-
Acquisition of intangible asset	-	(30,000)	-	-
Acquisition of business, net of cash acquired	(11,000)	(5,592)	(12,824)	-
Net cash (used in) provided by investing activities	(295,998)	(195,300)	(232,122)	(25,616)
Cash flows from financing activities				
(Payments) borrowings under receivables funding agreement	-	-	(140,000)	2,350
Proceeds from term loan	250,000	-	-	-
Payments of long-term debt	(12,750)	(43,500)	(43,640)	-
Payments of short-term debt	-	(150,000)	-	-
Proceeds from secured notes offering	-	300,000	-	-
Payments of deferred financing fees	(26,586)	(10,459)	-	-
Dividend to affiliate	-	-	-	(2,500)
Proceeds from issuance of common stock, net	-	-	649,600	-
Loan advances to officer	-	-	(20,000)	-
Payment of capital restructuring costs	(104,000)	-	(43,671)	-
Net cash provided by (used in) financing activities	106,664	96,041	402,289	(150)
Net increase (decrease) in cash and cash equivalents	(84,532)	33,537	353,133	(67,062)
Cash and cash equivalents				
Beginning of period	413,610	380,073	26,940	94,002
Net increase (decrease) in cash and cash equivalents	(84,532)	33,537	353,133	(67,062)
End of period	$ 329,078	$ 413,610	$ 380,073	$ 26,940
Supplementary disclosure of cash flow information				
Income taxes paid (refunded)	$ 7,699	$ 2,825	$ (2,210)	$ 855
Interest paid	92,481	180,647	268,925	4,847
Deferred/contingent consideration for acquisitions, net (non cash)	-	4,695	(15,626)	-
Pre-publication costs included in accounts payable (non cash)	(10,630)	-	-	-
Property, plant, and equipment included in accounts payable (non cash)	1,438	-	-	-
Property, plant, and equipment acquired under capital leases (non cash)	4,799	-	-	-
Chapter 11 Reorganization (See Note 2)				
March 2010 Restructuring (See Note 1)				

HMH Holdings (Delaware), Inc.
Consolidated Statements of Stockholders' Equity (Deficit)

Predecessor Company

(in thousands of dollars, except share information)	Common Stock Shares	Common Stock Par Value	Treasury Stock	Capital in excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2009	3,100	$ -	$ -	$ 2,135,798	$ (4,734,442)	$ (16,092)	$ (2,614,736)
Net loss	-	-	-	-	(311,776)	-	(311,776)
Other comprehensive income (loss)	-	-	-	-	-	(921)	(921)
Stock compensation	-	-	-	925	-	-	925
Dividend to affiliate	-	-	-	(2,500)	-	-	(2,500)
Recapitalization of amounts due from Parent	-	-	-	(1,154)	-	-	(1,154)
Balance at March 9, 2010	3,100	$ -	$ -	$ 2,133,069	$ (5,046,218)	$ (17,013)	$ (2,930,162)

Successor Company

(in thousands of dollars, except share information)	Common Stock Shares	Common Stock Par Value	Treasury Stock	Capital in excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance at March 10, 2010	129,999,970	$ 130	$ -	$ 1,376,435	$ -	$ -	$ 1,376,565
Net loss	-	-	-	-	(507,727)	-	(507,727)
Other comprehensive income (loss)	-	-	-	-	-	(4,884)	(4,884)
Issuance of common stock, net	153,636,265	154	-	649,446	-	-	649,600
Stock compensation	-	-	-	4,274	-	-	4,274
Balance at December 31, 2010	283,636,235	284	-	2,030,155	(507,727)	(4,884)	1,517,828
Net loss	-	-	-	-	(2,182,370)	-	(2,182,370)
Other comprehensive income (loss)	-	-	-	-	-	(18,569)	(18,569)
Stock compensation	-	-	-	8,559	-	-	8,559
Balance at December 31, 2011	283,636,235	$ 284	$ -	$ 2,038,714	$ (2,690,097)	$ (23,453)	$ (674,552)
Net loss	-	-	-	-	(87,139)	-	(87,139)
Other comprehensive income (loss), net of tax expense of $85	-	-	-	-	-	1,925	1,925
Issuance of common stock	69,958,989	700	-	1,749,300	-	-	1,750,000
Gain on debt-for-equity exchange, net of tax expense of $73,801	(283,636,235)	(284)	-	936,750	-	-	936,466
Issuance of w arrants	-	-	-	10,747	-	-	10,747
Stock compensation	-	-	-	6,254	-	-	6,254
Addition of treasury stock, 41,011 shares	-	-	-	-	-	-	-
Balance at December 31, 2012	69,958,989	$ 700	$ -	$ 4,741,765	$ (2,777,236)	$ (21,528)	$ 1,943,701

The accompanying notes are an integral part of these consolidated financial statements.

1. Basis of Presentation

HMH Holdings (Delaware), Inc., ("HMH", "Houghton Mifflin Harcourt", "we", "us", "our", or the "Company"), is a leading global education and learning company providing innovative solutions and approaches to the challenges facing education today. We are one of the world's largest providers of educational products and solutions for pre-K–12 learning and we also develop and deliver interactive, results-driven learning solutions that advance teacher effectiveness and student achievement in the Education market. Furthermore, since 1832, we have published trade and reference materials including award-winning adult and children's books, fiction, and nonfiction.

The consolidated December 31, 2012 and 2011 financial statements of HMH include the accounts of all of our wholly-owned subsidiaries as of and for the periods ended December 31, 2012, December 31, 2011, December 31, 2010 and March 9, 2010. Prior to the March 2010 Restructuring noted below, our operations were held by HMH Publishing Company ("HMH Publishing" or "Predecessor"), a wholly-owned subsidiary of Education Media and Publishing Group Limited ("EMPG" or "Former Parent") formed through the combination of Houghton Mifflin and Harcourt Education (both education learning companies) and Riverdeep Group Limited, a digital publishing business. Throughout the notes to the consolidated financial statements, both HMH and HMH Publishing are referred to collectively as the "Company".

The accompanying consolidated financial statements have been prepared in accordance with principles generally accepted in the United States of America ("GAAP"). All intercompany accounts and transactions have been eliminated.

Seasonality and Comparability

Our net sales, operating profit and operating cash flows are impacted by the inherent seasonality of the academic calendar. Consequently, the performance of our 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.

Schools make most of their purchases in the second and third quarters of the calendar year in preparation for the beginning of the school year. Thus, over the past three years, approximately 69% of consolidated net sales have historically been realized in the second and third quarters. Sales of K-12 instructional materials and customized testing products are also cyclical, with some years offering more sales opportunities than others. The amount of funding available at the state level for educational materials also has a significant effect on year-to-year revenue. Although the loss of a single customer would not have a material adverse effect on our business, schedules of school adoptions and market acceptance of our products can materially affect year-to-year revenue performance.

Chapter 11 Reorganization

On May 10, 2012, we entered into a Restructuring Support Agreement ("Plan Support Agreement") with consenting creditors holding greater than 74% of the principal amount of the outstanding senior secured indebtedness of the Company and with equity owners holding approximately 64% of the Company's outstanding common stock. The consenting creditors agreed to support the Company's Pre-Packaged Chapter 11 Plan of Reorganization ("Plan"). Pursuant to the Plan Support Agreement, the Company agreed to use its best efforts to (i) support and complete the restructuring and all transactions contemplated by the Plan (as defined below), (ii) take any and all necessary and appropriate actions in furtherance of the restructuring contemplated under the Plan, (iii) complete the restructuring and all transactions contemplated under the Plan within set time-frames, (iv) obtain any and all required regulatory and/or third-party approvals for the restructuring, and (v) not directly or indirectly, seek, solicit, support, or engage in the negotiation or formulation of alternate plans of reorganization that were inconsistent with the reorganization as contemplated by the Plan Support Agreement.

On May 21, 2012 (the "Petition Date"), the U.S. based entities that borrowed or guaranteed the debt of the Company (collectively the "Debtors"), filed voluntary petitions for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court for the Southern District of New York ("Court"). Concurrently therewith, the Debtors also filed the Plan, the Disclosure Statement in support of the Plan and filed various motions seeking relief to continue operations. Following the Petition Date, the Debtors operated their business as "debtors in possession" ("DIP") under the jurisdiction of the Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Court. Under Chapter 11 of the United States Bankruptcy Code ("Chapter 11"), certain claims against us in existence before the Petition Date were stayed while we operated our business as a DIP including any actions that might be commenced with regards to secured claims, although the holders of such claims had the right to move the Court for relief from the stay. Subsequent to the Petition Date, these claims were reflected in the balance sheet as liabilities subject to compromise. Secured claims were secured primarily by liens on the Company's accounts receivable. Additional claims (liabilities subject to compromise) could have potentially arisen after the filing date resulting from rejection of executory contracts or from the determination by the Court (or agreed to by parties in interest).

On June 22, 2012, the Company successfully emerged from bankruptcy as a reorganized company pursuant to the Plan. Ultimately, the Debtors did not reject any executory contracts during the bankruptcy case, and the Company continues to review and reconcile claims that were filed against it by creditors.

March 2010 Restructuring

As a result of lower than expected operating results beginning in the latter half of 2008 and continuing through 2009, primarily due to a downturn in the economy and state budget deficits adversely affecting many of our customers, we failed several of our debt covenants and faced liquidity constraints. Waivers were obtained from our first lien lenders and mezzanine lenders for the covenant violations through March 9, 2010.

On March 9, 2010, the Company and its first lien and mezzanine lenders and its shareholders consummated a restructuring of the Company (the "Restructuring"). As part of the Restructuring, a new legal entity was formed, HMH Holdings (Delaware), Inc., to hold all of the assets of the operating companies. On March 9, 2010, the then-existing senior secured lenders in the first lien credit facility received 90% (pre-dilution from the rights offering noted below) of the equity in HMH, in exchange for converting $1,983.7 million of their senior secured position in the first lien credit agreement to equity in HMH. The then-existing mezzanine lenders received 10% of the equity of HMH (pre-dilution from the rights offering) and 40,519,431 warrants at a strike price of $12.26, in exchange for converting all of their $2,124.8 million subordinated secured position in the mezzanine credit agreement to equity. The former shareholder, EMPG, cancelled its equity ownership in the Company in exchange for 18,956,473 warrants with a strike price of $22.32.

Additionally, on March 9, 2010, HMH raised $650.0 million of new equity capital through a rights offering from the then-existing senior secured and mezzanine lenders who agreed to convert a portion of their first lien and mezzanine positions to equity. The proceeds were used to pay transaction fees, accrued interest and fund working capital needs.

As a result of this change in control, we applied the acquisition method of accounting, as required by authoritative literature. Accordingly, the consolidated financial statements prior to the closing of the Restructuring reflect the historical accounting basis in the assets and liabilities and are labeled Predecessor Company, while such records subsequent to the Restructuring are labeled Successor Company and reflect the fair values determined as part of applying the acquisition method. This is presented in the consolidated financial statements by a vertical black line division which appears between the columns labeled Predecessor and Successor in the financial statements and the

relevant notes. The black line signifies that the periods prior to the Restructuring are not comparable.

A valuation was performed to determine the acquisition price using the Income Approach employing a Discounted Cash Flow ("DCF") methodology. The DCF method explicitly recognizes that the value of a business enterprise is equal to the present value of the cash flows that are expected to be available for distribution to the equity and/or debt holders of a company. In the valuation of a business enterprise, indications of value are developed by discounting future net cash flows available for distribution to their present worth at a rate that reflects both the current return requirements of the market and the risk inherent in the specific investment.

We used a multi-year DCF model to derive a Total Invested Capital value which was adjusted for cash, non-operating assets, debt and any negative net working capital to calculate a Business Enterprise Value of approximately $5.0 billion which was then used to value our equity. In connection with the Income Approach portion of this exercise, we made the following assumptions: (1) the discount rate was based on an average of a range of scenarios with rates between 8.6% and 11.4%; (2) management's estimates of future performance of our operations; and (3) a terminal growth rate of 3.5%. The discount rate and market growth rate reflect the risks associated with the general economic pressure impacting both the economy in general and more specifically the publishing industry. Costs and professional fees incurred as part of the refinancing totaled $43.7 million and were recorded in other assets and long-term receivables in the Predecessor Company and were treated as a reduction to the equity value in the Successor Company.

We finalized the valuation and completed the allocation of the business enterprise value. The allocation of the business enterprise value at March 10, 2010 was as follows:

Cash and cash equivalents	$	22,995
Accounts receivable		222,213
Inventories		380,243
Note receivable - related party		73
Prepaid expenses and other assets		12,191
Property, plant, and equipment		128,282
Pre-publication costs		463,459
Royalty advances to authors		44,415
Goodwill		1,935,965
Other intangible assets		2,108,538
Other assets		9,123
Accounts payable		(105,688)
Royalties payable		(34,621)
Salaries, wages, and commissions payable		(46,872)
Deferred revenue		(107,609)
Interest payable		(30,517)
Interest rate swap liability		(121,891)
Severance and other charges		(62,157)
Accrued postretirement benefits		(2,443)
Other liabilities		(124,761)
Debt		(3,009,212)
Royalties payable		(3,243)
Accrued pension benefits		(80,026)
Accrued postretirement benefits		(31,526)
Deferred income taxes		(153,003)
Other liabilities		(37,363)
Total net assets	$	1,376,565

Subsequent Events

The Company has performed an evaluation of subsequent events through March 29, 2013, which is the date the financial statements were issued.

2. Chapter 11 Reorganization Disclosures

As discussed in Note 1, the Company filed voluntary petitions for relief under Chapter 11. On June 21, 2012, the Bankruptcy Court entered an order confirming and approving the Plan for the Debtors and the Plan became effective and the transactions contemplated under the Plan were consummated on June 22, 2012.

Subsequent to the Petition Date, the provisions in U.S. Generally Accepted Accounting Principles guidance for reorganizations applied to the Company's financial statements while it operated under the provisions of Chapter 11. The accounting guidance did not change the application of generally accepted accounting principles in the preparation of financial statements. However, it does require that the financial statements, for periods including and subsequent to the filing of the Chapter 11 petition, distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business. Accordingly, all transactions (including, but not limited to, all professional fees, realized gains and losses and provisions for losses) directly associated with the reorganization and restructuring of our businesses are reported separately in the financial

statements. All such expense or income amounts are reported in reorganization items in the accompanying consolidated statements of operations for the year ended December 31, 2012.

Summary of Emergence
On June 22, 2012, the Company successfully emerged from bankruptcy as a reorganized company pursuant to the Plan after voluntarily filing for bankruptcy on May 21, 2012. The financial restructuring realized by the confirmation of the Plan was accomplished through a debt-for-equity exchange. The Plan deleveraged the Company's balance sheet by eliminating the Company's secured indebtedness in exchange for new equity in the Company. Existing stockholders, in their capacity as stockholders, received warrants for the new equity in the Company in exchange for the existing equity.

Upon the Company's emergence from Chapter 11 bankruptcy proceedings on June 22, 2012, the Company was not required to apply fresh-start accounting based on U.S. Generally Accepted Accounting Principles guidance for reorganizations due to the fact that the pre-petition holders who owned more than 50% of the Company's outstanding common shares immediately before confirmation of the Plan received more than 50% of the Company's outstanding common stock upon emergence. Accordingly, a new reporting entity was not created for accounting purposes.

Below is a summary of the significant transactions affecting the Company's capital structure as a result of the effectiveness of the Plan.

Equity Transactions
On June 22, 2012, pursuant to the Plan, all of the issued and outstanding shares of common stock of the Company, including all options, warrants or any other agreements to acquire shares of common stock of the Company that existed prior to the Petition Date, were cancelled and in exchange, holders of such interests received distributions pursuant to the terms of the Plan. As of June 22, 2012, the authorized capital stock of the Company consists of (i) 190,000,000 shares of common stock, of which 69,958,989 shares of common stock are issued and outstanding at December 31, 2012, 3,684,211 shares of common stock which are reserved for issuance upon exercise of warrants, and 8,187,135 shares of common stock which are reserved for issuance upon exercise of certain other warrants and awards to be issued by the Company under the MIP (defined below) and (ii) 10,000,000 shares of preferred stock, $0.01 par value per share, of which no shares are issued and outstanding. There are no other outstanding obligations, warrants, options, or other rights to subscribe for or purchase from the Company any class of capital stock of the Company.

On June 22, 2012, the Company issued an aggregate of 70,000,000 post-emergence shares of new common stock pursuant to the final Plan on a pro rata basis to the holders of the then-existing first lien term loan (the "Term Loan"), of which 41,011 are treasury shares as of December 31, 2012, the then-existing first lien revolving loan facility (the "Revolving Loan"), and 10.5% Senior Notes as of the Petition Date. The Company relied on Section 1145(a)(1) of the Bankruptcy Code to exempt from the registration requirements of the Securities Act of 1933, the issuance of such new common stock.

A new Management Incentive Plan ("MIP") became effective upon emergence. The MIP provides for grants of options and restricted stock at a strike price equal to or greater than the fair market value per share of common stock as of the date of the grant and reserved for management and employees up to 10% of the new common stock of the Company. During 2012, the Company granted to certain employees, including executive officers, stock options totaling 4,912,281 shares of the Company's common stock. Each of the stock options granted have an exercise price equal to the fair market value and generally vest over a three or four year period. During 2012, the Company granted 22,200 restricted stock units to independent directors which generally vest over a

one year period. As of December 31, 2012, there are 3,252,654 shares reserved for issuance under the MIP.

In accordance with the Plan, each existing common stockholder received its pro rata share of warrants to purchase 5% of the common stock of the Company, subject to dilution for equity awards issued in connection with the MIP. The exercise price for the warrants is based upon a $3.1 billion enterprise valuation of the Company, and the warrants have a term of seven years. All of the then-existing common stock was extinguished on the effective date of the Plan. As of December 31, 2012, there are 3,684,211 shares reserved for issuance upon the exercise of such warrants. These warrants are referred to as the “New Warrants.”

Debt Transactions
On June 22, 2012, the Company’s creditors converted the First Lien Credit Agreement consisting of the Term Loan with an aggregate outstanding principal balance of $2.6 billion and the Revolving Loan with an aggregate outstanding principal balance of $235.8 million, and the outstanding $300.0 million principal amount of 10.5% Senior Notes to 100 percent pro rata ownership of the Company’s common stock, subject to dilution pursuant to the MIP and the exercise of the New Warrants (described previously), and received $30.3 million in cash.

In connection with the Chapter 11 filing on May 22, 2012, the Company entered into a new $500.0 million senior secured credit facility (DIP facility), which converted into an exit facility on the effective date of the emergence from Chapter 11. This exit facility consists of a $250.0 million revolving credit facility, which is secured by the Company’s accounts receivable and inventory, and a $250.0 million term loan credit facility. The proceeds of the exit facility were used to fund the costs of the reorganization and are providing working capital to the Company since its emergence from Chapter 11.

A summary of the transactions affecting the Company’s debt balances is as follows:

Debt balance prior to emergence from bankruptcy (including accrued interest)	$	(3,142,234)
Exchange of debt for new common shares		1,750,000
Elimination of debt discount and deferred financing fees		98,352
Adequate protection payments		69,701
Conversion fees		30,299
Professional fees		21,726
(Gain) loss on extinguishment	$	(1,172,156)

Reorganization Items
Reorganization items represent expense or income amounts that were recorded in the consolidated financial statements as a result of the bankruptcy proceedings. Reorganization items were incurred starting with the date of the bankruptcy filing through the date of bankruptcy emergence. The gain from reorganization items for the year ended December 31, 2012 were as follows:

	Total	Adjusted to Capital in excess of par value	Reorganization items, net
Debt to equity conversion	$ (1,392,234)	$ (1,199,549)	$ (192,685)
Elimination of debt discount and deferred financing fees	98,352	84,740	13,612
Adequate protection payments	69,701	60,054	9,647
Conversion fees	30,299	26,106	4,193
Professional fees	21,726	18,381	3,345
(Gain) loss on extinguishment	(1,172,156)	(1,010,268)	(161,888)
Stock compensation	2,027	-	2,027
Issuance of warrants	10,747	-	10,747
Reorganization items, net	$ (1,159,382)	$ (1,010,268)	$ (149,114)

Liabilities Subject to Compromise

Certain pre-petition liabilities and indebtedness were subject to compromise under the Plan and were reported at amounts allowed or expected to be allowed by the Court. A summary of liabilities subject to compromise reflected in the consolidated balance sheet as of May 21, 2012 is as follows:

	May 21, 2012
$2,668,690 Term Loan due June 12, 2014	$ 2,570,815
$235,751 Revolving Loan due December 12, 2013	235,751
$300,000 10.5% senior secured notes due June 1, 2019	300,000
Accrued interest	35,668
Total	$ 3,142,234

As of December 31, 2012, there were no liabilities subject to compromise.

All pre-petition claims were considered liabilities subject to compromise at May 21, 2012. As discussed above, the Term Loan, the Revolving Loan, the 10.5% Senior Notes, and the associated accrued interest were exchanged for new common stock in the Company. There were no other liabilities subject to compromise as of May 21, 2012. We honored other prepetition obligations, including employee wages and trade payables in the ordinary course of business.

3. Significant Accounting Policies

Principles of Consolidation

Our accompanying consolidated financial statements include the results of operations of the Company and our wholly-owned subsidiaries. All material intercompany accounts and transactions are eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates, assumptions and judgments by management that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosure of contingent assets and liabilities in the amounts reported in the financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates and assumptions including, but not limited to, book returns, allowance for bad debts, recoverability of advances to authors, valuation of inventory, depreciation and amortization periods, recoverability of

long-term assets such as property, plant, and equipment, capitalized pre-publication costs, other identified intangibles, goodwill, deferred revenue, income taxes, pensions and other postretirement benefits, contingencies, and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

Revenue Recognition

We derive revenue primarily from the sale of print and digital textbooks and instructional materials, trade books, reference materials, multimedia instructional programs, license fees for book rights, content, software and services that include test development, test scoring, consulting and training. Revenue from print and digital textbooks and instructional materials, trade books, reference materials, assessment materials and multimedia instructional programs is recognized in the period when persuasive evidence of an arrangement with the customer exists, the products are shipped, title and risk of loss have transferred to the customer, all significant obligations have been performed and collection is reasonably assured.

We enter into certain contractual arrangements that have multiple elements, one or more of which may be delivered subsequent to the initial sale. These multiple deliverable arrangements may include print and digital media, professional development, training services, software, software as a service (SaaS), and various services related to the software including but not limited to hosting, maintenance and support, and implementation. At the inception of these arrangements, consideration is allocated using the Relative Sales Value (RSV) method. For each element, we determine whether the element falls under the accounting guidance within multiple element arrangements or software revenue recognition. For elements which fall under the accounting guidance for multiple element arrangements, we apply the highest applicable relative selling price guidance available, Vendor Specific Objective Evidence (VSOE), Third Party Evidence (TPE), or Best Estimate of Selling Price (BESP). For elements which fall under the accounting guidance for software revenue recognition, we apply VSOE and the residual method. If we are not able to establish VSOE, we estimate relative selling price based on TPE or BESP for purposes of allocation of total project discount, and defer until all such elements are fulfilled assuming all other revenue recognition criteria have been met. For multiple deliverable arrangements, fair value is determined for all elements and the relative sales value of revenue for items to be delivered after the initial sale is deferred until such time as the items are delivered. A significant component of revenue that is deferred relates to gratis items delivered in connection with sales to customers within adoption states. As our business model shifts to more digital and on-line learning components, additional revenue could be deferred. As products are shipped with right of return, a provision for estimated returns on these sales is made at the time of sale based on historical experience.

License fees for software products without future obligations are recognized upon delivery. Certain contracts include software and on-going fees for maintenance and other support. If VSOE of the fair value of each element of the arrangement exists, the elements of the contract are unbundled and the revenue is recognized for each element when or as delivered. Revenue for test delivery, test scoring and training are recognized when the services have been completed, the fee is fixed or determinable and collection is reasonably assured. Revenue for test development is recognized as the services are provided. Differences between what has been billed and what has been recognized as revenue is recorded as deferred revenue. We enter into agreements to license certain book publishing rights and content. We recognize revenue on such arrangements when all materials have been delivered to the customer and collection is reasonably assured.

Advertising Costs and Sample Expenses

Advertising costs are charged to selling and administrative expenses as incurred. Advertising costs were $6.7 million and $7.4 million for the years ended December 31, 2012 and 2011, respectively. For the period January 1, 2010 to March 9, 2010, advertising costs were $1.1 million

and for the period March 10, 2010 to December 31, 2010 advertising costs were $5.1 million. Sample expenses are charged to selling and administrative expenses when the samples are shipped.

Cash and Cash Equivalents
Cash and cash equivalents consist primarily of cash in banks and highly liquid investment securities that have maturities of three months or less when purchased. The carrying amount of cash equivalents approximates fair value because of the short term maturity of these investments.

Restricted Cash
Restricted cash consists primarily of cash collateral for irrevocable standby letters of credit in connection with property that we currently lease and performance and surety bonds.

Short-term Investments
Short-term investments typically consist of marketable securities with maturities between three and twelve months at the balance sheet date. We have classified all of our short-term investments as available-for-sale at December 31, 2012. The investments are reported at fair value, with any unrealized gains or losses excluded from earnings and reported as a separate component of stockholders' equity as other comprehensive income (loss).

Accounts Receivable
Accounts receivable are recorded net of allowances for doubtful accounts and reserves for book returns. In the normal course of business, we extend credit to customers that satisfy predefined criteria. We estimate the collectability of our receivables. Allowances for doubtful accounts are established through the evaluation of accounts receivable aging and prior collection experience to estimate the ultimate collectability of these receivables. Reserves for book returns are based on historical return rates and sales patterns.

Inventories
Inventories are stated at the lower of weighted average cost or net realizable value. The level of obsolete and excess inventory is estimated on a program or title level-basis by comparing the number of units in stock with the expected future demand. The expected future demand of a program or title is determined by the copyright year, the previous years' sales history, the subsequent year's sales forecast, known forward-looking trends including our development cycle to replace the title or program and competing titles or programs.

Property, Plant, and Equipment
Property, plant, and equipment are stated at cost, or in the case of assets acquired in business combinations, at fair value as of the acquisition date, less accumulated depreciation. Equipment under capital lease is stated at fair value at inception of the lease, less accumulated depreciation. Maintenance and repair costs are charged to expense as incurred, and renewals and improvements that extend the useful life of the assets are capitalized.

Depreciation on property, plant, and equipment is calculated using the straight-line method over the estimated useful lives of the assets or, in the case of assets acquired in business combinations, over their remaining lives. Equipment held under capital leases and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset. Estimated useful lives of property, plant, and equipment are as follows:

	Estimated Useful Life
Building and building equipment	10 to 35 years
Machinery and equipment	2 to 15 years
Capitalized software	3 to 5 years
Leasehold improvements	Lesser of useful life or lease term

Capitalized Internal-Use and External-Use Software

Capitalized internal-use and external-use software is included in property, plant and equipment on the consolidated balance sheets.

We capitalize certain costs related to obtaining or developing computer software for internal use. Costs incurred during the application development stage, including external direct costs of materials and services, and payroll and payroll related costs for employees who are directly associated with the internal-use software project, are capitalized and amortized on a straight-line basis over the expected useful life of the related software. The application development stage includes design, software configuration and integration, coding, hardware installation and testing. Costs incurred during the preliminary stage, as well as maintenance, training and upgrades that do not result in additional functionality are expensed as incurred.

Certain computer software development costs for software that is to be sold or marketed are capitalized in the consolidated balance sheets. Capitalization of computer software development costs begins upon the establishment of technological feasibility. We define the establishment of technological feasibility as a working model. Amortization of capitalized computer software development costs is provided on a product-by-product basis using the straight-line method, beginning upon commercial release of the product, and continuing over the remaining estimated economic life of the product. The carrying amounts of computer software development costs are periodically compared to net realizable value and impairment charges are recorded, as appropriate, when amounts expected to be realized are lower.

We review internal and external software development costs for impairment. For the year ended December 31, 2012 and 2011, software development costs of $2.6 million and $5.6 million, respectively, were impaired. For the period January 1, 2010 to March 9, 2010 software development costs of $4.0 million were impaired. There were no software development cost impairments for the period March 10, 2010 to December 31, 2010. All impairments were included as a charge to the statement of operations in the impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets caption.

Pre-publication costs

We capitalize the art, prepress, manuscript and other costs incurred in the creation of the master copy of a book or other media (the "pre-publication costs"). Pre-publication costs are primarily amortized from the year of copyright, or sale if earlier, over five years using the sum-of-the-years-digits method. This policy is used throughout the Company, except for the Trade Publishing consumer books, which expenses such costs as incurred, and the assessment products, which uses the straight-line amortization method. The amortization methods and periods chosen best reflect the pattern of expected sales generated from individual titles or programs. We periodically evaluate the remaining lives and recoverability of capitalized pre-publication costs, which are often dependent upon program acceptance by state adoption authorities.

Amortization expense related to pre-publication costs for the years ended December 31, 2012 and 2011 were $137.7 million and $176.8 million, respectively. For the period January 1, 2010 to March 9, 2010 amortization expense related to pre-publication costs was $37.9 million and for the period March 10, 2010 to December 31, 2010 amortization expense related to pre-publication costs was $181.5 million

Pre-publication costs recorded on the balance sheet are periodically reviewed for impairment by comparing the unamortized capitalized costs of the assets to the fair value of those assets. For the years ended December 31, 2012 and 2011, the period January 1, 2010 to March 9, 2010, and the period March 10, 2010 to December 31, 2010, pre-publication costs of $0.4 million, $33.5 million, zero and $16.9 million, respectively, were deemed to be impaired. The impairment was included as a charge to the statement of operations in the impairment charge for goodwill, intangible assets, pre-publication costs and fixed assets caption.

Goodwill and indefinite-lived intangible assets

Goodwill is the excess of the purchase price paid over the fair value of the net assets of the business acquired. Other intangible assets principally consist of branded trademarks and trade names, acquired publishing rights and customer relationships. Goodwill and indefinite-lived intangible assets (certain trade names) are not amortized but are reviewed at least annually for impairment or earlier, if an indication of impairment exists. Recoverability of goodwill and indefinite lived intangibles is evaluated using a two-step process. In the first step, the fair value of a reporting unit is compared to its carrying value. If the fair value of a reporting unit exceeds the carrying value of the net assets assigned to a reporting unit, goodwill is considered not impaired and no further testing is required. If the carrying value of the net assets assigned to a reporting unit exceeds the fair value of a reporting unit, the second step of the impairment test is performed in order to determine the implied fair value of a reporting unit's goodwill. Determining the implied fair value of goodwill requires valuation of a reporting unit's tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to the extent of the difference. We estimate total fair value of each reporting unit using discounted cash flow analysis, and make assumptions regarding future revenue, gross margins, working capital levels, investments in new products, capital spending, tax, cash flows and the terminal value of the reporting unit. With regard to other intangibles with indefinite lives, we

determine the fair value by asset, which is then compared to its carrying value to determine if the assets are impaired.

Goodwill is allocated entirely to our Education reporting unit. Determining the fair value of a reporting unit is judgmental in nature, and involves the use of significant estimates and assumptions. These estimates and assumptions may include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, the determination of appropriate market comparables as well as the fair value of individual assets and liabilities. Consistent with prior years, we used an income approach to establish the fair value of the reporting unit as of October 1, 2012. As in prior years, we used the most recent five year strategic plan as the initial basis of our analysis.

We completed our annual goodwill and indefinite-lived intangible asset impairment tests as of October 1, 2012, 2011, and 2010 and recorded a noncash impairment charge of $5.0 million for the year ended December 31, 2012, $1,635.1 million for the year ended December 31, 2011 and $87.0 million for the period March 10, 2010 to December 31, 2010. There was no impairment for the period January 1, 2010 to March 9, 2010. The impairments principally related to one specific tradename within the Education business in 2012, goodwill and tradenames within the Education business in 2011, and related to tradenames within the Education business and Trade Division in 2010. The impairment charges resulted primarily from a decline in revenue from previously projected amounts as a result of the economic downturn and reduced educational spending by states and school districts.

Publishing Rights
A publishing right is an acquired right that allows us to publish and republish existing and future works as well as create new works based on previously published materials. We determine the fair market value of the publishing rights arising from business combinations by discounting the after-tax cash flows projected to be derived from the publishing rights and titles to their net present value using a rate of return that accounts for the time value of money and the appropriate degree of risk. The useful life of the publishing rights is based on the lives of the various copyrights involved. We calculate amortization using the percentage of the projected operating income before taxes derived from the titles in the current year as a percentage of the total estimated operating income before taxes over the remaining useful life. Acquired publication rights, as well as customer-related intangibles with definitive lives, are primarily amortized on an accelerated basis over periods ranging from three to 20 years.

Impairment of other long-lived assets
We review our other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If the future undiscounted cash flows are less than their book value, impairment exists. The impairment is measured as the difference between the book value and the fair value of the underlying asset. Fair value is normally determined using a discounted cash flow model.

Severance
We accrue postemployment benefits if the obligation is attributable to services already rendered, rights to those benefits accumulate, payment of benefits is probable, and amount of benefit is reasonably estimated. Postemployment benefits include severance benefits.

Subsequent to recording such accrued severance liabilities, changes in market or other conditions may result in changes to assumptions upon which the original liabilities were recorded that could result in an adjustment to the liabilities.

Royalty advances

Royalty advances to authors are capitalized and represent amounts paid in advance of the sale of an author's product and are recovered as earned. As advances are recorded, a partial reserve may be recorded immediately based primarily upon historical sales experience. Advances are evaluated periodically to determine if they are expected to be recovered. Any portion of a royalty advance that is not expected to be recovered is fully reserved.

Income taxes

We record income taxes using the asset and liability method. Deferred income tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax basis, and operating loss and tax credit carryforwards. Our consolidated financial statements contain certain deferred tax assets which have arisen primarily as a result of interest expense limitations, as well as other temporary differences between financial and tax accounting. We establish a valuation allowance if the likelihood of realization of the deferred tax assets is reduced based on an evaluation of objective verifiable evidence. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against those deferred tax assets. We evaluate the weight of all available evidence to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized.

We also evaluate any uncertain tax positions and only recognize the tax benefit from an uncertain tax position if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon settlement. We record a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. Any change in judgment related to the expected ultimate resolution of uncertain tax positions is recognized in earnings in the period in which such change occurs. Interest and penalties, if any, related to unrecognized tax benefits are recorded in income tax expense.

Share-Based Compensation

Certain employees and or directors have been granted stock options and restricted stock awards in both the predecessor and successor companys' common stock. Stock based compensation expense reflects the fair value of stock-based awards measured at the grant date and recognized over the relevant service period. We estimate the fair value of each stock-based award on the measurement date using either the current market price or the Black-Scholes option valuation model. The Black-Scholes option valuation model incorporates assumptions as to stock volatility, the expected life of the options, risk-free interest rate and dividend yield for time-vested stock options and restricted stock. We recognize compensation cost on a straight-line basis over the awards' vesting periods.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as changes in the equity of an enterprise except those resulting from stockholder transactions. The amounts shown on the consolidated statements of stockholders' equity (deficit) and comprehensive income (loss) relate to the cumulative effect of changes in pension liabilities, foreign currency translation gain and loss adjustments, and unrealized gains and losses on short-term investments.

Foreign Currency Translation

The functional currency for each of our subsidiaries is the currency of the primary economic environment in which the subsidiary operates, generally defined as the currency in which the entity generates and expends cash. Foreign currency denominated assets and liabilities are translated

into United States dollars at current rates as of the balance sheet date and the revenue, costs and expenses are translated at the average rates established during each reporting period. Cumulative translation gains or losses are recorded in equity as an element of accumulated other comprehensive income.

Financial instruments
Derivative financial instruments are employed to manage risks associated with interest rate exposures and are not used for trading or speculative purposes. We recognize all derivative instruments, such as interest rate swap agreements, in our consolidated balance sheets at fair value. Changes in the fair value of derivatives are recognized periodically either in earnings or in stockholders' equity (deficit) as a component of accumulated other comprehensive income (loss), depending on whether the derivative financial instrument qualifies for hedge accounting and, if so, whether it qualifies as a fair value hedge or a cash flow hedge. Gains and losses on derivatives designated as hedges, to the extent they are effective, are recorded in other comprehensive income, and subsequently reclassified to earnings to offset the impact of the hedged items when they occur. Changes in the fair value of derivatives not qualifying as hedges are reported in earnings. Our interest rate swap agreements that existed during 2010 and terminated upon expiration did not qualify for hedge accounting because we did not contemporaneously document our hedging strategy upon entering into the hedging arrangements. The net interest paid or received on interest rate swaps is recognized within net interest expense in the consolidated statement of operations. There were no derivative instruments that qualified for hedge accounting during 2011 and 2012.

Treasury Stock
We account for treasury stock under the cost method. When shares are reissued or retired from treasury stock they are accounted for at an average price. Upon retirement the excess over par value is charged against capital in excess of par value.

Recent Accounting Pronouncements
Recent accounting pronouncements, not included below, are not expected to have a material impact on our consolidated financial position and results of operations.

In May 2011, the FASB issued new guidance for fair value measurements intended to achieve common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards. The amended guidance provides a consistent definition of fair value to ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. The amended guidance changes certain fair value measurement principles and enhances the disclosure requirements, particularly for Level 3 fair value measurements. On January 1, 2012, we adopted the amended guidance for fair value measurements. The changes did not have a significant impact on our financial position, results of operations or cash flows.

In June 2011, the FASB issued guidance that modified how comprehensive income is presented in an entity's financial statements. The guidance issued requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of equity. On January 1, 2012, we adopted the comprehensive income guidance and disclosed the components of comprehensive income in a separate statement.

In September 2011, the FASB issued new guidance to simplify how entities test goodwill for impairment. The amended guidance permits an entity to first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the

fair value of a reporting unit is less than its carrying amount. If this is the case, companies will need to perform a more detailed two-step goodwill impairment test which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. The amended guidance was effective for us beginning January 1, 2012. The adoption of this update did not have a material impact on our financial statements.

In July 2012, the FASB issued an accounting standard update that amends the accounting guidance on testing indefinite-lived intangible assets for impairment. The amendments in this accounting standard update are intended to reduce complexity and costs by allowing an entity the option to make a qualitative evaluation about the likelihood that an indefinite-lived intangible asset is impaired to determine whether it should perform a quantitative impairment test. The amendments also enhance the consistency of impairment testing guidance among long-lived asset categories by permitting an entity to assess qualitative factors to determine whether it is necessary to calculate the asset's fair value when testing an indefinite-lived intangible asset for impairment, which is equivalent to the impairment testing requirements for other long-lived assets. The amendments in this accounting standard update are effective for interim and annual impairment tests performed for fiscal years beginning after September 15, 2012. We test indefinite-lived intangible assets for impairment annually on October 1 or more frequently when events or changes in circumstances indicate that impairment may have occurred. The accounting standard update will be effective for us beginning in 2013. We believe the adoption of this update will not have a material impact on our financial statements.

4. Acquisitions

On November 5, 2012, we acquired certain asset product lines from a third party for a total purchase price of approximately $11.0 million, which was paid in cash at closing. The acquisition provides us with the copyrights, trademarks and intellectual property of the acquired product lines for our Trade Publishing business. In connection with the acquisition, we entered into a transition services agreement whereby the third party will provide certain transitional services to us for the acquired product lines. Since the fair value assigned to the net assets acquired exceeded the consideration paid, we recorded a $30.8 million gain on bargain purchase on the transaction in 2012. Intangible assets, author advances, and other assets recorded as part of the acquisition totaled approximately $30.4 million, $6.2 million, and $5.1 million, respectively.

Prior Year Acquisitions

During 2011, we reduced the accrued contingent consideration recorded for one of our 2010 acquisitions by $6.3 million, as we determined we would not able to achieve certain EBITDA growth targets and the projections for future growth were much lower than originally anticipated. In accordance with the accounting guidance relating to the subsequent remeasurement of contingent consideration, the amount was recorded as a decrease to the selling and administrative expenses caption in our statement of operations for the year ended December 31, 2011.

During 2011, we completed two acquisitions for a total purchase price of approximately $6.5 million, which is net of cash acquired. The purchase price consisted of approximately $5.6 million of cash at closing and $0.9 million of accrued contingent consideration. The acquisitions provide us with English as a second language course material for the international markets.

During 2010, we completed two acquisitions for a total purchase price of approximately $28.3 million, which is net of cash acquired. The purchase price consisted of approximately $12.9 million of cash at closing, installment payments due over 5 years with a net present value of approximately $4.1 million, and approximately $11.6 million of accrued contingent consideration. The acquisitions provided us with a suite of educational technology software for students along with consulting services to school districts throughout the United States.

The 2011 and 2010 transactions were accounted for under the acquisition method of accounting. We allocated the purchase price to each company's assets and liabilities assumed at estimated fair values as of the acquisition dates. The excess of the purchase price over the net amounts assigned to the fair value of the assets acquired and liabilities assumed was recorded as goodwill. Goodwill and intangible assets recorded as part of the acquisitions totaled approximately $6.5 million and $0 in 2011 and $20.1 million and $6.9 million in 2010, respectively. The financial results of each company acquired were included within our financial statements from their respective dates of acquisition. The acquisitions were not considered to be material for purposes of additional disclosure.

5. Balance Sheet Information

Short-term Investments

The estimated fair value of our short-term investments classified as available for sale, is as follows:

	December 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Short-term investments:				
U.S. Government and agency securities	$ 146,029	$ 12	$ -	$ 146,041
	$ 146,029	$ 12	$ -	$ 146,041

The contractual maturities of our short-term investments are one year or less.

Account Receivable

Accounts receivable at December 31, 2012 and 2011 consisted of the following:

	2012	2011
Accounts receivable	$ 265,477	$ 300,181
Allowance for bad debt	(10,575)	(18,296)
Reserve for returns	(25,784)	(25,614)
	$ 229,118	$ 256,271

Inventories

Inventories at December 31, 2012 and 2011 consisted of the following:

	2012	2011
Finished goods	$ 192,382	$ 236,350
Raw materials	5,231	5,812
Inventory	$ 197,613	$ 242,162

Property, Plant, and Equipment

Balances of major classes of assets and accumulated depreciation and amortization at December 31, 2012 and 2011 were as follows:

	2012	2011
Land and land improvements	$ 6,629	$ 6,629
Building and building equipment	16,512	16,322
Machinery and equipment	44,384	37,452
Capitalized software	222,799	176,276
Leasehold improvements	23,831	22,131
	314,155	258,810
Less: Accumulated depreciation and amortization	(164,928)	(106,598)
Property, plant, and equipment, net	$ 149,227	$ 152,212

For the year ended December 31, 2012 and 2011, depreciation and amortization expense related to property, plant, and equipment were $58.1 million and $58.4 million, respectively. Depreciation and amortization expense for the period January 1, 2010 to March 9, 2010 was $10.9 million and for the period March 10, 2010 to December 31, 2010 was $48.6 million.

Property, plant, and equipment at December 31, 2012 include approximately $5.3 million acquired under capital lease agreements of which the majority is included in machinery and equipment. The future minimum lease payments required under non-cancelable capital leases as of December 31, 2012 is as follows: $1.7 million in 2013, $1.7 million in 2014, $1.6 million in 2015, and $0.9 million in 2016.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consisted of the following at December 31, 2012 and 2011:

	2012	2011
Net change in pension and benefit plan liability	$ (18,664)	$ (21,042)
Foreign currency translation adjustments	(2,877)	(2,412)
Unrealized gain on short-term investments	13	1
	$ (21,528)	$ (23,453)

6. Goodwill and Other Intangible Assets

Goodwill and other intangible assets consisted of the following:

	December 31, 2012		December 31, 2011	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Goodwill	$ 520,088	$ -	$ 520,088	$ -
Trademarks and tradenames	440,505	-	440,805	-
Publishing rights	1,180,000	(644,348)	1,180,000	(466,601)
Customer related and other	271,150	(180,255)	245,470	(125,461)
	$ 2,411,743	$ (824,603)	$ 2,386,363	$ (592,062)

The changes in the carrying amount of goodwill for the years ended December 31, 2012 and 2011 are as follows:

Balance at December 31, 2010	$ 1,956,071
Acquisitions	6,517
Impairment losses	(1,442,500)
Balance at December 31, 2011	520,088
Goodwill	1,962,588
Accumulated impairment losses	(1,442,500)
Balance at December 31, 2011	520,088
Goodwill	1,962,588
Accumulated impairment losses	(1,442,500)
Balance at December 31, 2012	$ 520,088

We had goodwill of $520.1 million at December 31, 2012 and 2011. The additions to goodwill relate to our acquisitions described in Note 4 of approximately $6.5 million for the year ended December 31, 2011. The decrease in goodwill of $1,442.5 million for the year ended December 31, 2011 was due to goodwill impairment charges. There was no goodwill impairment charge for the year ended December 31, 2012, for the period January 1, 2010 to March 9, 2010, or for the period March 10, 2010 to December 31, 2010.

In accordance with the provisions of the accounting standard for goodwill and other intangible assets, goodwill and certain indefinite-lived tradenames are not amortized. We recorded an impairment charge of approximately $5.0 million, $192.6 million, and $87.0 million for certain of our intangible assets at October 1, 2012, 2011, and 2010, respectively. Amortization expense for publishing rights and customer related and other intangibles were $232.6 and $298.0 million for the year ended December 31, 2012 and 2011, respectively. Amortization expense for publishing rights and customer related and other intangibles were $50.3 million for the period January 1, 2010 to March 9, 2010, and $293.6 million for the period March 10, 2010 to December 31, 2010.

On October 5, 2011, we entered into an agreement with EMPG International Limited (“EMPGI”), a former related party, to terminate the 2008 license agreement between us and EMPGI. The license agreement had provided EMPGI the rights to translate and prepare localized versions of substantially all of our products, as well as change or create derivative versions and redistribute such products in territories outside of our current presence. As a result of entering into the agreement, certain international intellectual property rights were obtained for consideration of a one-time payment of $30.0 million. This amount has been capitalized within other intangible assets and is being amortized over a 20 year life.

Estimated aggregate amortization expense expected for each of the next five years related to intangibles subject to amortization is as follows:

	Publishing Rights	Other Intangible Assets
2013	$ 139,588	$ 18,421
2014	105,624	10,044
2015	81,007	10,267
2016	61,350	9,372
2017	46,238	8,765
Thereafter	101,845	34,026

7. Debt

As described in Note 2, pursuant to the Plan, the holders of the Company's debt converted the First Lien Credit Agreement consisting of the Term Loan with an aggregate outstanding principal balance of $2.6 billion and the Revolving Loan with an aggregate outstanding principal balance of $235.8 million, and the outstanding $300.0 million principal amount of 10.5% Senior Notes to 100 percent pro rata ownership of the Company's common stock. As described in Note 1, we completed a Restructuring on March 9, 2010 converting $1,983.7 million of our then-existing Term Loan and the entire balance of our then-existing Mezzanine Loan to equity.

Long-term debt at December 31, 2012 and 2011 consisted of the following:

	2012	2011
$250,000 Term Loan due May 21, 2018 interest payable monthly	$ 248,125	$ -
$2,668,690 Term Loan due June 12, 2014	-	2,475,837
$235,751 Revolving Loan due December 12, 2013	-	235,751
$300,000 10.5% Secured Notes due June 1, 2019, interest payable semiannually	-	300,000
	248,125	3,011,588
Less: Current portion of long-term debt	2,500	43,500
Total long-term debt, net of discount	$ 245,625	$ 2,968,088

Long-term debt repayments due (at face value) in each of the next five years and thereafter is as follows:

Year		
2013	$	2,500
2014		2,500
2015		2,500
2016		2,500
2017		2,500
Thereafter		235,625
	$	248,125

On May 26, 2011, we issued $300.0 million aggregate principal amount of our 10.5% Senior Notes, which matured on June 1, 2019. The 10.5% Senior Notes accrued interest at 10.5% and interest was paid semi-annually on June 1 and December 1. The 10.5% Senior Notes were pari passu to our existing Term Loan. The proceeds from the 10.5% Senior Notes were used to provide for working capital needs and to repay borrowings under the accounts receivable securitization facility. We incurred approximately $8.2 million of professional fees to issue the 10.5% Senior Notes which were capitalized in accordance with the applicable accounting guidance for debt issuance costs, and were being amortized over the term of the debt.

On May 22, 2012, we entered into a new $500.0 million DIP facility which was converted into an exit facility upon emergence from Chapter 11. This exit facility consists of a $250.0 million revolving credit facility ("Revolving Credit Facility"), which is secured by the Company's accounts receivable and inventory, and a $250.0 million term loan credit facility ("Term Loan"). The Revolving Credit Facility has a term of five years and the interest rate is determined by a combination of LIBOR rate and average daily availability. No funds have been drawn on the Revolving Credit Facility as of December 31, 2012. The Term Loan has a term of six years and the interest rate is based on the LIBOR plus 6.0%. The actual LIBOR is subject to a minimum "floor" of 1.25%. As of December 31, 2012, the interest rate of the Term Loan is 7.25%. The proceeds of the Term Loan were used to fund the costs of the reorganization and provide post-closing working capital to the Company.

On June 11, 2012 and June 20, 2012, respectively, we entered into Amendment No. 1 and Amendment No. 2 to the Term Loan. Amendment No. 1 modified definitions by reducing LIBOR from 1.50% to 1.25% along with a reduction in the interest rate from 6.25% to 6.0%. Amendment No. 2 related to administrative matters modifying the notice requirement, which enabled the Company to move from a DIP facility to an exit facility upon emergence from bankruptcy.

On June 20, 2012, we entered into Amendment No. 1 and Amendment No. 2 to our Revolving Credit Facility. Amendment No. 1 modified definitions relating to administrative matters releasing our restricted cash of $26.5 million, which was collateralizing our letters of credit. Amendment No. 2 modified certain provisions of the agreement with regard to same day borrowing.

The $2.6 billion Term Loan and $235.8 million Revolving Loan were all issued with a discount equal to 4% of the borrowing commitment of each instrument. As of December 31, 2011, the effective interest rates were 8.1% and 6.4% for the $2.6 billion Term Loan and $235.8 million Revolving Loan, respectively. We have written off the remaining balance of deferred financing fees as of March 10, 2010 relating to the issuance of the $2.6 billion Term Loan, then-existing Mezzanine Loan and $235.8 million Revolving Loan. The discounts were being amortized over the life of each debt arrangement as additional interest expense.

Loan Covenants

We are required to meet certain restrictive financial covenants as defined under our Term Loan and Revolving Credit Facility. We have financial covenants pertaining to interest coverage, maximum leverage, and fixed charge ratios. The interest coverage ratios are set forth as follows: 7.0 to 1.0 for fiscal quarters ending during 2012, 8.0 to 1.0 for fiscal quarters ending during 2013, and 9.0 to 1.0 for fiscal quarters ending thereafter. The maximum leverage ratios are set forth as follows: 2.25 to 1.0 for fiscal quarters ending through September 30, 2013 and 2.0 to 1.0 for fiscal quarters ending December 31, 2013 and thereafter. The fixed charge ratio, which only pertains to the revolving credit facility and is only tested in limited situations, is 1.0 to 1.0 through the end of the facility. As of December 31, 2012, we were in compliance with all of our debt covenants.

Receivables Funding Agreement

On August 4, 2010, HM Receivables Co. II, LLC ("HMRC II"), a subsidiary of us, entered into a Receivables Funding and Administration Agreement (the "New Funding Agreement'), which established a $250.0 million revolving credit facility, with a maturity date of August 4, 2013. The interest rate was LIBOR based. All accounts receivables were held in a subsidiary of HMH, HMRC II, which had entered into the aforementioned New Funding Agreement and amendments thereto. Total HMRCII receivables on December 31, 2011 were $302.1 million. As of December 31, 2011, $156.3 million of eligible receivables were pledged as collateral on the revolving credit facility, and the receivables have been sold by originating subsidiaries to HMRC II. The assets of HMRC II were not available to satisfy the obligations of our other subsidiaries. No LIBOR based rate was elected as of December 31, 2011 insofar as the HMRCII facility had no borrowings. In connection with the 2012 Chapter 11 Reorganization, HMRC II was terminated.

8. Interest Swap Arrangements

We entered into interest rate swap agreements to manage our exposure to interest rate changes as required under our First Lien Credit Agreement which had required, prior to the March 9, 2010 amendment, that at least 50% of the aggregate principal amount of our debt being effectively subject to a fixed or maximum interest. The swaps effectively converted a portion of our variable rate debt to a fixed rate, without exchanging the notional principal amounts.

We had entered into the following interest rate swap agreements with various financial institutions.

Effective date of swap	Expiration Date	Notional Amount	Interest Rates
3/30/2007	3/31/2010	$ 814,370	4.999%–5.12%
12/31/2007	12/31/2010	1,875,000	3.00%–4.715%

Our interest rate swaps were not designated as hedges and therefore did not qualify for hedge accounting under the accounting standards for derivative instruments and hedging activities. Our interest rate swaps expired in 2010. We had no other interest rate swaps outstanding as of December 31, 2012 and 2011. We recorded an unrealized loss of $7.4 million for the period January 1, 2010 to March 9, 2010, and a gain of $90.3 million for the period March 10, 2010 to December 31, 2010 in our statement of operations to account for the changes in fair value of the derivatives. Interest rate swap arrangements expensed and recorded in interest expense for the period January 1, 2010 to March 9, 2010 were $23.3 million and for the period March 10, 2010 to December 31, 2010 were $69.8 million.

9. Severance and Other Charges

2012

During the year ended December 31, 2012, $19.2 million of severance payments were made to employees whose employment ended in 2012 and prior years and $7.6 million of net payments for office space no longer utilized by the Company. Further, we recorded an expense in the amount of $9.4 million to reflect additional costs for severance and revised estimates for office space no longer utilized in connection to our continuing strategic alignment of the business.

2011

On November 8, 2011, our Board of Directors approved a restructuring plan that was substantially implemented in the fourth quarter of 2011. The plan included workforce reductions of up to approximately 10% of the current workforce as part of an organizational realignment and a reduction of operating costs. Accordingly, a severance charge of $28.8 million was recorded in 2011 to reflect the workforce reductions due to our organizational realignment. For the year ended December 31, 2011, $18.3 million of severance payments were made to employees whose employment ended in 2011 and prior years.

In the year ended December 31, 2011, the vacant space accrual was increased $4.0 million primarily as a result of our exiting certain space. Additionally, during 2011, we paid $9.9 million of payments for excess space where our committed payment obligations exceeded the sublease income received.

2010

We recorded a reduction in severance expense for the period March 10, 2010 to December 31, 2010 of approximately $0.3 million in connection with revised cost estimates in relation to workforce reductions of employees. These reductions were part of our continuing strategic integration of the former Houghton and Harcourt businesses. During 2010, approximately $11.1 million of severance payments were made to employees whose employment ended in 2010 and prior years.

As part of purchase accounting, we established a $48.0 million accrual for ongoing obligations to pay rent for vacant space that could not be sublet or space that is expected to be sublet at rates lower than the committed lease arrangements. The length of these obligations varies by lease with the longest extending through 2019. Subsequently, we sublet vacant space more quickly and at higher rates than previously estimated. Accordingly, the reserve initially established was reduced by $11.5 million in the period ended December 31, 2010 to reflect the more recent positive sublet experience.

A summary of the significant components of the severance/restructuring and other charges is as follows:

	Successor Company 2012			
	Severance/ restructuring accrual at December 31, 2011	Severance/ restructuring expense	Cash payments	Severance/ restructuring accrual at December 31, 2012
Severance costs	$ 16,071	$ 5,284	$ (19,213)	$ 2,142
Other accruals	19,679	4,091	(7,622)	16,148
	$ 35,750	$ 9,375	$ (26,835)	$ 18,290

	Successor Company 2011			
	Severance/ restructuring accrual at December 31, 2010	Severance/ restructuring expense	Cash payments	Severance/ restructuring accrual at December 31, 2011
Severance costs	$ 5,587	$ 28,801	$ (18,317)	$ 16,071
Other accruals	25,593	4,000	(9,914)	19,679
	$ 31,180	$ 32,801	$ (28,231)	$ 35,750

	Successor Company 2010			
	Severance/ restructuring accrual at March 10, 2010	Severance/ restructuring expense	Cash payments	Severance/ restructuring accrual at December 31, 2010
Severance costs	$ 14,392	$ 282	$ (9,087)	$ 5,587
Other accruals	47,765	(11,525)	(10,647)	25,593
	$ 62,157	$ (11,243)	$ (19,734)	$ 31,180

	Predecessor Company 2010			
	Severance/ restructuring accrual at December 31, 2009	Severance/ restructuring expense	Cash payments	Severance/ restructuring accrual at March 9, 2010
Severance costs	$ 16,414	$ -	$ (2,022)	$ 14,392
Other accruals	50,000	-	(2,235)	47,765
	$ 66,414	$ -	$ (4,257)	$ 62,157

10. Income Taxes

The components of loss before taxes by jurisdiction are as follows:

	Successor Company			Predecessor Company
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10, 2010 December 31, 2010	For the Period January 1, 2010 to March 9, 2010
U.S.	$ (47,755)	$ (2,187,025)	$ (406,627)	$ (292,665)
Foreign	(45,327)	(95,498)	(89,171)	(19,331)
Loss before taxes	$ (93,082)	$ (2,282,523)	$ (495,798)	$ (311,996)

Total income taxes by jurisdiction are as follows:

	Successor Company			Predecessor Company
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10, 2010 December 31, 2010	For the Period January 1, 2010 to March 9, 2010
Income tax expense (benefit)				
U.S.	$ (7,045)	$ (101,698)	$ 18,477	$ 499
Foreign	1,102	1,545	(6,548)	(719)
	$ (5,943)	$ (100,153)	$ 11,929	$ (220)

Significant components of the expense (benefit) for income taxes attributable to loss from continuing operations consist of the following:

	Successor Company			Predecessor Company
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10, 2010 to December 31, 2010	For the Period January 1, 2010 to March 9, 2010
Current				
Foreign	$ 1,102	$ 3,958	$ -	$ -
U.S. - Federal	-	-	(2,775)	-
U.S. - State and other	3,031	13,506	4,207	499
Total current	4,133	17,464	1,432	499
Deferred				
Foreign	-	(2,413)	(6,548)	(719)
U.S. - Federal	(9,201)	(98,655)	15,465	-
U.S. - State and other	(875)	(16,549)	1,580	-
Total deferred	(10,076)	(117,617)	10,497	(719)
Income tax expense (benefit)	$ (5,943)	$ (100,153)	$ 11,929	$ (220)

The reconciliation of the income tax rate computed at the statutory tax rate to the reported income tax expense (benefit) attributable to continuing operations is as follows:

	Successor Company			Predecessor Company
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10, 2010 to December 31, 2010	For the Period January 1, 2010 to March 9, 2010
Statutory rate	(35.0)%	(35.0)%	(35.0)%	(12.5)%
Permanent items	3.7	0.1	0.1	0.1
Goodwill impairment	-	12.0	-	-
Transfer pricing adjustments	(0.1)	-	-	-
Reorganization expense	5.9	-	-	-
Bargain purchase gain	(11.6)	-	-	-
Foreign rate differential	10.3	1.0	2.4	(21.8)
State and local taxes	0.0	(0.4)	(2.5)	-
Alternative Minimum Tax Credit	-	-	(0.6)	-
Increase in valuation allowance	20.4	17.9	38.0	34.1
Effective tax rate	(6.4)%	(4.4)%	2.4 %	(0.1)%

The significant components of the net deferred tax assets and liabilities are shown in the following table:

	2012	2011
Tax asset related to		
Net operating loss and other carryforwards	$ 40,358	$ 111,185
Returns reserve/inventory expense	74,523	86,235
Pension and postretirement benefits	19,968	26,291
Interest	537,624	507,741
Deferred revenue	105,714	130,803
Deferred compensation	13,601	30,392
Other, net	18,927	17,943
Valuation allowance	(512,234)	(822,485)
	298,481	88,105
Tax liability related to		
Intangible assets	(260,428)	(34,330)
Depreciation and amortization expense	(118,573)	(70,667)
Other, net	(1,210)	(1,028)
	(380,211)	(106,025)
Net deferred tax liabilities	$ (81,730)	$ (17,920)

The net deferred tax liability balance is stated at prevailing statutory income tax rates. Deferred tax assets and liabilities are reflected on our consolidated balance sheets as follows:

	2012	2011
Current deferred tax assets	$ 42,858	$ 14,152
Noncurrent deferred tax liability	(124,588)	(32,072)
	$ (81,730)	$ (17,920)

A reconciliation of the gross amount of unrecognized tax benefits, excluding accrued interest and penalties, is as follows:

Predecessor Company	
Balance at January 1, 2010	$ 64,655
Additions based on tax positions related to the prior year	-
Additions based on tax positions related to the current year	-
Balance at March 9, 2010	$ 64,655

Successor Company	
Balance at March 10, 2010	$ 64,655
Additions based on tax positions related to the prior year	-
Additions based on tax positions related to the current year	-
Reductions based on tax positions related to the prior year	(243)
Balance at December 31, 2010	$ 64,412
Additions based on tax positions related to the prior year	-
Additions based on tax positions related to the current year	-
Balance at December 31, 2011	$ 64,412
Reductions based on tax positions related to the prior year	(105)
Additions based on tax positions related to the current year	-
Balance at December 31, 2012	$ 64,307

At December 31, 2012, we had $64.3 million of gross unrecognized tax benefits (excluding interest and penalties), of which $52.1 million, if recognized, would reduce the Company's effective tax rate. We expect the amount of unrecognized tax benefit disclosed above not to change significantly over the next 12 months.

With a few exceptions, we are currently open for audit under the statute of limitation for Federal, state and foreign jurisdictions for years 2009 to 2012. However, carryforward attributes from prior years may still be adjusted upon examination by tax authorities if they are used in a future period.

We report penalties and tax-related interest expense as a component of the provision for income taxes in the accompanying consolidated statement of operations. At December 31, 2012 and 2011, we had $5.9 million and $3.7 million, respectively, of accrued interest and penalties in the accompanying consolidated balance sheet.

As part of the 2012 Chapter 11 Reorganization, we realized approximately $1.3 billion of cancellation of debt income. We will be able to exclude this cancellation of debt income of $1.3 billion from taxable income since HMH was insolvent (liabilities greater than the fair value of its assets) by this amount at the time of the exchange. Although we will not have to pay current cash taxes from this transaction, we will need to reduce our tax attributes, such as net operating loss carryovers and tax credit carryovers and also reduce our tax basis of our assets to offset the $1.3

billion of taxable income that did not have to be recognized due to insolvency. As a result, our net operating losses and credit carryforwards will be reduced on January 1, 2013, and a portion of our tax basis in our assets will also be reduced at that time.

As of December 31, 2012, we have approximately $390.7 million of Federal tax loss carryforwards, which will expire through 2032. In addition, we have foreign tax credit carryforwards of $5.3 million, which will expire through 2022. As noted above, these tax attributes will be reduced on January 1, 2013 as a result of the 2012 Chapter 11 Reorganization.

Based on the our assessment of historical pre-tax losses and the fact that we did not anticipate sufficient future taxable income in the near term to assure utilization of certain deferred tax assets, the Company recorded a valuation allowance at December 31, 2012 and 2011 of $512.2 million and $822.5 million, respectively. We have decreased our valuation allowance by $310.3 million in 2012, and increased our valuation allowance by $388.0 million, and $317.9 million, respectively, for 2011 and 2010.

11. Retirement and Postretirement Benefit Plans

Retirement Plan

We have a noncontributory, qualified defined benefit pension plan (the "Retirement Plan"), which covers certain employees. The Retirement Plan is a cash balance plan, which accrues benefits based on pay, length of service, and interest. The funding policy is to contribute amounts subject to minimum funding standards set forth by the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. The Retirement Plan's assets consist principally of common stocks, fixed income securities, investments in registered investment companies, and cash and cash equivalents. We also have a nonqualified defined benefit plan, or nonqualified plan, that covers employees who earn over the qualified pay limit as determined by the Internal Revenue Service. The nonqualified plan accrues benefits for the executive officers based on service and pay. Benefits for all other employees accrue based on the cash balance plan calculation. The nonqualified plan is not funded. We use a December 31 date to measure the pension and postretirement liabilities. In 2007, both the qualified and nonqualified pension plans eliminated participation in the plans for new employees hired after October 31, 2007.

We also had a foreign defined benefit plan. On July 20, 2011, we entered into a bulk annuity policy with a third party which effectively terminated the foreign defined benefit plan. This policy covers all known plan beneficiaries and liabilities and represents a full transfer of the plan’s financial and longevity risk to the third party. The policy is held in the name of the plan trustees. This termination did not constitute a settlement of liability under applicable accounting guidance for pension plans. Following a full plan data cleansing, the bulk annuity policy is expected to be converted into individual annuity policies at which point the plan will be discharged of all future liability with respect to the plan beneficiaries. We anticipate the conversion to individual annuity policies along with the liability discharge to occur in the first half of 2013. The foreign defined benefit plan had benefit obligations of $16.4 million and $14.3 million as of December 31, 2012 and 2011, respectively. The plan had assets of $16.6 million and $14.6 million December 31, 2012 and 2011, respectively. Further, the plan had a net pension benefit asset of $0.2 million and $0.2 million, at December 31, 2012 and 2011, respectively. The foreign defined benefit plan is included in the accompanying table for all years presented.

During 2012, we amended the postretirement medical benefits plan resulting in the benefit contributions for certain participants to remain at the current year level for all future years. The result of the plan change was to reduce our accrued postretirement benefits liability by approximately $8.7 million with the offset to other comprehensive income in accordance with the accounting guidance for other postretirement defined benefit plans.

We are required to recognize the funded status of defined benefit pension and other postretirement plans as an asset or liability in the balance sheet and are required to recognize actuarial gains and losses and prior service costs and credits in other comprehensive income and subsequently amortize those items in the statement of operations. Further, we are required to use a measurement date equal to the fiscal year end.

The following table summarizes the Accumulated Benefit Obligations ("ABO"), the change in Projected Benefit Obligation ("PBO"), and the funded status of our plans as of and for the financial statement period ended December 31, 2012 and 2011:

	2012	2011
ABO at end of period	$ 204,420	$ 196,898
Change in PBO		
PBO at beginning of period	$ 196,898	$ 186,169
Service cost	-	-
Interest cost on PBO	8,288	9,120
Actuarial (gain) loss	8,860	10,497
Benefits paid	(10,136)	(9,045)
Exchange rates	510	157
PBO at end of period	$ 204,420	$ 196,898
Change in plan assets		
Fair market value at beginning of period	$ 132,408	$ 126,196
Actual return (loss)	15,669	3,628
Company contribution	17,168	11,460
Benefits paid	(10,136)	(9,045)
Exchange rates	597	169
Fair market value at end of period	$ 155,706	$ 132,408
Funded status	$ (48,714)	$ (64,490)

Amounts recognized in the consolidated balance sheets at December 31, 2012 and 2011 consist of:

	2012	2011
Noncurrent liabilities	$ (48,714)	$ (64,490)

Additional year-end information for pension plans with ABO in excess of plan assets at December 31, 2012 and 2011 consist of:

	2012	2011
PBO	$ 187,998	$ 182,549
ABO	187,998	182,549
Fair value of plan assets	138,987	117,843

Amounts not yet reflected in net periodic benefit cost and recognized in accumulated other comprehensive income at December 31, 2012 and 2011 consist of:

	2012	2011
Net gain (loss)	$ (2,204)	$ (14,954)
Accumulated other comprehensive income (loss)	$ (2,204)	$ (14,954)

Weighted average assumptions used to determine the benefit obligations (both PBO and ABO) at December 31, 2012 and 2011 are:

	2012	2011
Discount rate	3.8%	4.4%
Increase in future compensation	N/A	N/A

Net periodic pension cost includes the following components:

	Sucessor Company			Predecessor Company
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10, 2010 to December 31, 2010	For the Period January 1, 2010 to March 9, 2010
Service cost	$ -	$ -	$ -	$ -
Interest cost on projected benefit obligation	8,288	9,120	7,816	1,580
Expected return on plan assets	(9,047)	(8,175)	(5,443)	(1,318)
Amortization of net (gain) loss	13	-	-	2
Net pension expense	(746)	945	2,373	264
Loss (gain) due to settlement	84	20	-	-
Net cost (gain) recognized for the period	$ (662)	$ 965	$ 2,373	$ 264

Significant actuarial assumptions used to determine net periodic pension cost at December 31, 2012, 2011 and 2010 are:

	2012	2011	2010
Discount rate	4.4 %	5.1 %	5.6 %
Increase in future compensation	N/A	N/A	N/A
Expected long-term rate of return on assets	6.7 %	6.7 %	7.0 %

Assumptions on Expected Long-Term Rate of Return as Investment Strategies
We employ a building block approach in determining the long-term rate of return for plan assets. Historical markets are studied and long-term relationships between equities and fixed income are preserved congruent with the widely accepted capital market principle that assets with higher volatility generate a greater return over the long run. Current market factors such as inflation and

interest rates are evaluated before long-term capital market assumptions are determined. The long-term portfolio return is established via a building block approach and proper consideration of diversification and rebalancing. Peer data and historical returns are reviewed for reasonability and appropriateness. We regularly review the actual asset allocation and periodically rebalances investments to a targeted allocation when appropriate. The current targeted asset allocation is 50% with equity managers and 50% with fixed income managers. For 2013, we will use a 7.0% long-term rate of return for the Retirement Plan. We will continue to evaluate the expected rate of return assumption, at least annually, and will adjust as necessary.

Plan Assets
Plan assets for the U.S. tax qualified plans consist of a diversified portfolio of fixed income securities, equity securities, real estate, and cash equivalents. Plan assets do not include any of our securities. The U.S. pension plan assets are invested in a variety of funds within a Collective Trust (“Trust”). The Trust is a group trust designed to permit qualified trusts to comingle their assets for investment purposes on tax-exempt basis. The U.K pension plan assets are invested in a single bulk annuity policy with a third party.

Investment Policy and Investment Targets
The tax qualified plans consist of the U.S. pension plan and the U.K. pension scheme. It is our practice to fund amounts for our qualified pension plans at least sufficient to meet minimum requirements of local benefit and tax laws. The investment objectives of our pension plan asset investments is to provide long-term total growth and return, which includes capital appreciation and current income. The nonqualified noncontributory defined benefit pension plan is generally not funded. Assets were invested among several asset classes.

The percentage of assets invested in each asset class at December 31, 2012 and 2011 is shown below.

2012 Asset Class	Percentage in Each Asset Class
Equity	40.7 %
Fixed income	41.0
Real estate investment trust	4.1
Annuity policies	10.6
Other	3.6
	100.0 %

2011 Asset Class	Percentage in Each Asset Class
Equity	44.0 %
Fixed income	43.0
Annuity policies	10.8
Other	2.2
	100.0 %

Fair Value Measurements

The fair value of our pension plan assets by asset category and by level at December 31 were as follows:

	For the Year ended December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash and cash equivalents	$ 1,123	$ 1,123	$ -
Equity securities			
U.S. large cap growth	5,096	-	5,096
U.S. large cap value	5,152	-	5,152
U.S. large cap passive	17,442	-	17,442
U.S. small / mid cap growth	4,328	-	4,328
U.S. small / mid cap value	4,325	-	4,325
Non-U.S. equities	27,006	-	27,006
Government bonds	19,877	-	19,877
Corporate bonds	34,567	-	34,567
Mortgage-backed securities	8,551	-	8,551
Asset-backed securities	506	-	506
Commercial Mortgage-Backed Securities	425	-	425
Real Estate	6,355	-	6,355
Annuity policies	16,423	-	16,423
Other	4,530	-	4,530
	$ 155,706	$ 1,123	$ 154,583

	For the Year ended December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash and cash equivalents	$ 1,005	$ 1,005	$ -
Equity securities			
U.S. large cap growth	8,944	-	8,944
U.S. large cap value	9,333	-	9,333
U.S. large cap passive	13,034	-	13,034
U.S. small / mid cap growth	3,877	-	3,877
U.S. small / mid cap value	3,983	-	3,983
Non-U.S. equities	19,102	-	19,102
Government bonds	17,535	-	17,535
Corporate bonds	29,249	-	29,249
Mortgage-backed securities	9,239	-	9,239
Asset-backed securities	472	-	472
Commercial Mortgage-Backed Securities	424	-	424
Annuity policies	14,349	-	14,349
Other	1,862	-	1,862
	$ 132,408	$ 1,005	$ 131,403

We recognize that risk and volatility are present to some degree with all types of investments. However, high levels of risk are minimized through diversification by asset class, by style of each fund.

Estimated Future Benefit Payments
The following benefit payments are expected to be paid.

Fiscal Year Ended	Total Pension
2013	13,530
2014	19,526
2015	18,944
2016	19,819
2017	10,514
2018–2021	50,238

Expected Contributions
We expect to contribute approximately $11.2 million in 2013; however, the actual funding decision will be made after the 2013 valuation is completed.

Postretirement Benefit Plan
We also provide postretirement medical benefits to retired full-time, nonunion employees hired before April 1, 1992, who have provided a minimum of five years of service and attained age 55.

The following table summarizes the Accumulated Postretirement Benefit Obligation ("APBO"), the changes in plan assets, and the funded status of our plan as of and for the financial statement periods ended December 31, 2012 and 2011.

	2012	2011
Change in APBO		
APBO at beginning of period	$ 35,970	$ 36,546
Service cost (benefits earned during the period)	250	372
Interest cost on APBO	1,087	1,840
Plan Amendments	(8,674)	-
Employee contributions	646	716
Actuarial (gain) loss	3,042	(540)
Benefits paid	(2,748)	(2,964)
APBO at end of period	$ 29,573	$ 35,970
Change in plan assets		
Fair market value at beginning of period	$ -	$ -
Company contributions	2,102	2,248
Employee contributions	646	716
Benefits paid	(2,748)	(2,964)
Fair market value at end of period	$ -	$ -
Funded status	$ 29,573	$ 35,970

Amounts for postretirement benefits accrued in the consolidated balance sheets at December 31, 2012 and 2011 consist of:

	2012	2011
Current liabilities	$ (2,342)	$ (2,252)
Noncurrent liabilities	(27,231)	(33,718)
Net amount recognized	$ (29,573)	$ (35,970)

Amounts not yet reflected in net periodic benefit cost and recognized in accumulated other comprehensive income at December 31, 2012 and 2011 consist of:

	2012	2011
Net gain (loss)	$ (5,298)	$ (2,256)
Prior service cost	7,638	-
Accumulated other comprehensive income (loss)	$ 2,340	$ (2,256)

Weighted average actuarial assumptions used to determine APBO at year-end December 31, 2012 and 2011 are:

	2012	2011
Discount rate	3.8 %	4.5 %
Health care cost trend rate assumed for next year	7.4 %	7.6 %
Rate to which the cost trend rate is assumed to decline		
(ultimate trend rate)	4.5 %	4.5 %
Year that the rate reaches the ultimate trend rate	2027	2027

Net periodic postretirement benefit cost included the following components:

	Successor Company			Predecessor Company
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10, 2010 to December 31, 2010	For the Period January 1, 2010 to March 9, 2010
Service cost	$ 250	$ 372	$ 300	$ 57
Interest cost on APBO	1,269	1,840	1,583	319
Amortization of unrecognized prior service cost	(1,035)	-	-	(15)
Amortization of net (gain) loss	-	-	-	(226)
Net periodic postretirement benefit expense	$ 484	$ 2,212	$ 1,883	$ 135

Significant actuarial assumptions used to determine postretirement benefit cost at December 31, 2012, 2011 and 2010 are:

	2012	2011	2010
Discount rate	4.5 %	5.2 %	5.8 %
Health care cost trend rate assumed for next year	7.6%	7.8%	8.1%
Rate to which the cost trend rate is assumed to decline			
(ultimate trend rate)	4.5%	4.5%	4.5%
Year that the rate reaches the ultimate trend rate	2027	2027	2027

Assumed health care trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects on the expense recorded in 2012 and 2011 for the postretirement medical plan:

	2012	2011
One-percentage-point increase		
Effect on total of service and interest cost components	$ 23	$ 47
Effect on postretirement benefit obligation	303	1,076
One-percentage-point decrease		
Effect on total of service and interest cost components	(25)	(55)
Effect on postretirement benefit obligation	(276)	(1,278)

The following table presents the change in other comprehensive income, net of tax expense of $85, for the year ended December 31, 2012 related to our pension and postretirement obligations.

	Pension Plans	Postretirement Benefit Plan	Total
Sources of change in accumulated other comprehensive income (loss)			
New prior service cost	$ -	$ 8,588	$ 8,588
Net loss (gain) arising during the period	(2,129)	(3,045)	(5,174)
Amortization of prior service credit	-	(1,036)	(1,036)
Total accumulated other comprehensive Income (loss) recognized during the period	$ (2,129)	$ 4,507	$ 2,378

Estimated amounts that will be amortized from accumulated other comprehensive income (loss) over the next fiscal year.

	Total Pension Plans	Total Postretirement Plan
Prior service credit (cost)	$ -	$ 1,381
Net gain (loss)	(337)	(309)
	$ (337)	$ 1,072

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, are expected to be paid:

Fiscal Year Ended	Postretirement Plan
2013	$ 2,342
2014	2,274
2015	2,193
2016	2,107
2017	2,057
2018-2022	9,445

Expected Contribution

We expect to contribute approximately $2.3 million in 2013.

Defined Contribution Retirement Plan

We maintain a defined contribution retirement plan, the Houghton Mifflin 401(k) Savings Plan, which conforms to Section 401(k) of the Internal Revenue Code, and covers substantially all of our eligible employees. Participants may elect to contribute up to 50.0% of their compensation subject to an annual limit. We provided a matching contribution in amounts up to 4.5% of employee compensation until March 1, 2009 when the employer contribution was suspended. The contribution was reinstated on July 1, 2010, where we provided a matching contribution in amounts up to 1.5% of employee compensation and further increased to 3.0% of employee contribution effective May 2011. The 401(k) contribution expense amounted to $4.9 million and $4.0 million for the years ended December 31, 2012 and 2011, respectively. For the period March 10, 2010 through December 31, 2010 the contribution expense was $1.0 million. We did not make any discretionary contribution in 2012, 2011 and 2010.

12. Share-Based Compensation

Certain employees participate or participated in various equity plans of the Predecessor and Successor Company which provide for the grant of stock options and restricted stock to certain executive employees and independent members of the Board of Directors. The stock underlying such plans for the Predecessor Company was held in trust for the equity recipients. The stock related to award forfeitures remains outstanding and may be reallocated to new recipients. After the date of the March 2010 Restructuring, the equity awards pertaining to the Predecessor Company were no longer charged to our financial results as the employees were no longer related to the Predecessor Company.

The vesting terms for equity awards generally range from 1 to 4 years over equal annual installments and generally expire seven years after the date of grant. Restricted stock is common stock that is subject to a risk of forfeiture only upon voluntary termination or termination for cause, as defined. Total compensation expense related to stock option grants and restricted stock issuances recorded in the year ended December 31, 2012 was approximately $6.3 million of which approximately $4.3 million was recorded in selling and administrative expense and approximately $2.0 million was recorded in reorganization items, net. Total compensation expense related to stock option grants and restricted stock issuances recorded in the year ended December 31, 2011, for the period January 1, 2010 to March 9, 2010, and for the period March 10, 2010 to December

31, 2010 was approximately $8.6 million, $0.9 million, and $4.3 million, respectively, and was recorded in selling and administrative expense.

Stock Options

The following tables summarize option activity for HMH employees in stock options for the periods ended December 31, 2012 and 2011:

	Successor Company		
	Number of Shares		Weighted Average Exercise Price
Balance at December 31, 2010	26,976,957	$	9.54
Granted	468,224		5.37
Forfeited	(14,522,175)		8.58
Cancelled	(9,213,225)		8.67
Balance at December 31, 2011	3,709,781	$	5.90
Granted	4,912,281		25.00
Forfeited	(749,159)		5.37
Cancelled	(2,960,622)		6.03
Balance at December 31, 2012	4,912,281	$	25.00
Options Exercisable at end of year	460,526	$	25.00

The intrinsic value of a stock option is the amount by which the current market value of the underlying stock exceeds the exercise price of the option as of the balance sheet date. There was no intrinsic value of options outstanding and exercisable at December 31, 2012, 2011 and 2010.

We estimate the fair value of stock options using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected volatility of our stock over the option's expected term, the risk-free interest rate over the option's expected term, and our expected annual dividend yield.

The fair value of each option granted was estimated on the grant date using the Black-Scholes valuation model with the following assumptions:

	Successor Company		
	For the Year Ended December 31, 2012	For the Year Ended December 31, 2011	For the Period March 10 2010 to December 31, 2010
Expected term (years) [a]	4.0	7.0	7.0
Expected dividend yield	0.00%	0.00%	0.00%
Expected volatility [b]	24.21%-26.54%	25.88%	22.68%-24.12%
Risk-free interest rate [c]	0.67%-0.76%	2.40%	1.77%-3.11%

(a) The expected term is the number of years that we estimate that options will be outstanding prior to exercise.

(b) We have estimated volatility for options granted based on the historical volatility for a group of companies believed to be a representative peer group, selected based on industry and market capitalization.

(c) The risk-free interest rate is based on the U.S. Treasury yield for a period commensurate with the expected life of the option.

The accounting standard for stock-based compensation requires companies to estimate forfeitures at the time of grant and periodically revise those estimates in subsequent periods if actual forfeitures differ from those estimates. Stock-based compensation expense is recorded only for those awards expected to vest using an estimated forfeiture rate based on historical forfeiture data coupled with and estimated derived forfeiture rate of peers.

As of December 31, 2012, there remained approximately $16.0 million of unearned compensation expense related to unvested stock options to be recognized over a weighted average term of 3.5 years.

The weighted average grant date fair value was $25.00, $4.54 and $7.01 for options granted in 2012, 2011 and 2010 (Successor Period), respectively.

The following tables summarize information about stock options outstanding and exercisable under the plan at December 31, 2012:

Successor Company					
	Options Outstanding			Options Exercisable	
Range of Exercise Price	Options Outstanding at December 31, 2012	Weighted Average Remaining Contractual life	Weighted Average Exercise Price	Options Exercisable at December 31, 2012	Weighted Average Exercise Price
$ 25.00	4,912,281	3.5	$ 25.00	460,526	$ 25.00
	4,912,281	3.5	$ 25.00	460,526	$ 25.00

Restricted Stock (Successor Company)

The following table summarizes restricted stock activity for grants to HMH employees and directors in our restricted stock units from March 10, 2010 to December 31, 2012:

	Numbers of Units	Weighted Average Grant Date Fair Value
Balance at December 31, 2010	-	$ -
Granted	138,354	4.54
Vested	-	-
Forfeited	-	-
Balance at December 31, 2011	138,354	$ 4.54
Granted	22,200	25.00
Vested	-	-
Cancelled	(138,354)	4.54
Balance at December 31, 2012	22,200	$ 25.00

13. Fair Value Measurements

The accounting standard for fair value measurements among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. The accounting standard establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

Level 1 Observable input such as quoted prices in active markets for identical assets or liabilities;

Level 2 Observable inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3 Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques identified in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

(a) Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;

(b) Cost approach: Amount that would be currently required to replace the service capacity of an asset (current replacement cost); and

(c) Income approach: Valuation techniques to convert future amounts to a single present amount based on market expectations (including present value techniques).

On a recurring basis, we measure certain financial assets and liabilities at fair value, including our money market funds, short-term investments which consist of U.S. treasury securities and U.S. agency securities, and foreign exchange forward contracts. The accounting standard for fair value measurements defines fair value as the price that would be received to sell an asset or paid to

transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. In determining fair value, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as consider counterparty and its credit risk in its assessment of fair value.

The following tables present our financial assets and liabilities measured at fair value on a recurring basis at December 31, 2012 and December 31, 2011:

	Successor Company 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Valuation Technique
Financial assets				
Money market funds	$ 299,918	$ 299,918	$ -	(a)
U.S. treasury securities	97,134	97,134	-	(a)
U.S. agency securities	48,907	-	48,907	(a)
Foreign exchange forward contracts	475	-	475	(a)
	$ 446,434	$ 397,052	$ 49,382	

	Successor Company 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Valuation Technique
Financial assets				
Money market funds	$ 368,701	$ 368,701	$ -	(a)
	$ 368,701	$ 368,701	$ -	
Financial liabilities				
Foreign exchange forward contracts	$ 1,113	$ -	$ 1,113	(a)
	$ 1,113	$ -	$ 1,113	

Our money market funds and U.S. treasury securities are classified within Level 1 of the fair value hierarchy because they are valued using quoted prices in active markets for identical instruments. Our U.S. agency securities are classified within level 2 of the fair value hierarchy because they are valued using other than quoted prices in active markets. In addition to $299.9 million and $368.7 million invested in money market funds as of December 31, 2012 and December 31, 2011, respectively, we had $29.2 million and $44.9 million of cash invested in bank accounts as of December 31, 2012 and December 31, 2011, respectively.

Our foreign exchange forward contracts consist of Euro forward contracts and are classified within Level 2 of the fair value hierarchy because they are valued based on observable inputs and are available for substantially the full term of our derivative instruments.

The following table presents our nonfinancial assets and liabilities measured at fair value on a nonrecurring basis during 2012 and 2011:

	Successor Company 2012	Significant Unobservable Inputs (Level 3)	Total Impairment	Valuation Technique
Nonfinancial assets				
Property, plant, and equipment	$ -	$ -	$ 2,590	(b)
Pre-publication costs	7,160	7,160	413	(b)
Other intangible assets	-	-	5,000	(a) (c)
	$ 7,160	$ 7,160	$ 8,003	
Nonfinancial liabilities				
Other accruals	$ 16,148	$ 16,148	$ -	(c)
	$ 16,148	$ 16,148	$ -	

	Successor Company 2011	Significant Unobservable Inputs (Level 3)	Total Impairment	Valuation Technique
Nonfinancial assets				
Property, plant, and equipment	$ -	$ -	$ 5,640	(b)
Pre-publication costs	320	320	33,424	(b)
Goodwill	520,088	520,088	1,442,500	(a) (c)
Other intangible assets	373,030	373,030	192,600	(a) (c)
	$ 893,438	$ 893,438	$ 1,674,164	
Nonfinancial liabilities				
Other accruals	$ 19,679	$ 19,679	$ -	(c)
	$ 19,679	$ 19,679	$ -	

Our nonfinancial assets, which include goodwill, other intangible assets, property, plant, and equipment, and pre-publication costs, are not required to be measured at fair value on a recurring basis. However, if certain trigger events occur, or if an annual impairment test is required, we evaluate the nonfinancial assets for impairment. If an impairment did occur, the asset is required to be recorded at the estimated fair value.

We review internal and external software development costs, included within property, plant, and equipment, for impairment. The carrying amounts of software development costs are periodically compared to net realizable value and impairment charges are recorded, as appropriate, when amounts expected to be realized are lower. For the year ended December 31, 2012 and 2011, software development costs of $2.6 million and $5.6 million, respectively, were impaired as the products will not be sold in the marketplace.

Pre-publication costs recorded on the balance sheet are periodically reviewed for impairment by comparing the unamortized capitalized costs of the assets to the fair value of those assets. For the years ended December 31, 2012 and 2011, pre-publication costs of $0.4 million and $33.4 million, respectively, were impaired as the programs will not be sold in the marketplace.

In evaluating goodwill for impairment, we first compare our reporting unit's fair value to its carrying value. We estimate the fair values of our reporting units by considering market multiple and recent transaction values of peer companies, where available, and projected discounted cash flows, if reasonably estimable. There was no impairment recorded for goodwill for the year ended December 31, 2012. Impairment recorded for goodwill for the year ended December 31, 2011 was $1,442.5 million. There was no impairment recorded for the periods January 1, 2010 to March 9, 2010, and March 10, 2010 to December 31, 2010.

We perform an impairment test for our other intangible assets by comparing the assets fair value to its carrying value. Fair value is estimated based on recent market transactions, where available, and projected discounted cash flows, if reasonably estimable. There was a $5.0 million impairment recorded for the year ended December 31, 2012 relating to one specific tradename intangible asset that was fully impaired. Certain tradename intangible assets and other intangible assets were written down to their fair value of $373.0 million resulting in an impairment charge of $192.6 million which was included in earnings for the year ended December 31, 2011. There was no impairment recorded for the period January 1, 2010 to March 9, 2010. Impairment charges were $87.0 million for the period March 10, 2010 to December 31, 2010. The fair value of goodwill and other intangible assets are estimates, which are inherently subject to significant uncertainties, and actual results could vary significantly from these estimates.

Other accruals include restructuring charges which were valued using our internal estimates using a discounted cash flow model, and we have classified the other accruals as Level 3 in the fair value hierarchy.

Fair Value of Debt

The following table presents the carrying amounts and estimated fair market values of our debt at December 31, 2012 and December 31, 2011. The fair value of debt is deemed to be the amount at which the instrument could be exchanged in an orderly transaction between market participants at the measurement date.

	Successor Company December 31, 2012		Successor Company December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Debt				
$250,000 Term loan	$ 248,125	$ 249,986	$ -	$ -
$2,668,690 Term loan	-	-	2,581,690	1,484,472
Revolving loan	-	-	235,751	135,557
10.5% notes	-	-	300,000	189,000

The fair market values of our debt were estimated based on quoted market prices on a private exchange for those instruments that are traded and are classified as level 2 within the fair value hierarchy, at December 31, 2012 and December 31, 2011. The fair market values require varying degrees of management judgment. The factors used to estimate these values may not be valid on any subsequent date. Accordingly, the fair market values of the debt presented may not be indicative of their future values.

14. Commitments and Contingencies

Lease Obligations

We have operating leases for various real property, office facilities, and warehouse equipment that expire at various dates through 2019. Certain leases contain renewal and escalation clauses for a proportionate share of operating expenses.

The future minimum rental commitments under all noncancelable leases (with initial or remaining lease terms in excess of one year) for real estate and equipment are payable as follows:

	Operating Leases
2013	$ 43,818
2014	41,434
2015	41,208
2016	33,441
2017	14,947
Thereafter	18,082
Total minimum lease payments	$ 192,930
Total future minimal rentals under subleases	$ 41,905

For the year ended December 31, 2012 and 2011 rent expense, net of sublease income, was $38.0 million and $39.3 million, respectively. The rent expense, net of sublease income, for the period January 1, 2010 to March 9, 2010 was $6.3 million and for the period March 10, 2010 to December 31, 2010 was $18.4 million. On March 10, 2010, in connection with purchase accounting, the accrual estimate was revised and the estimate was adjusted to fair value. In the period March 10, 2010 to December 31, 2010, the accrual for the vacant space was reduced by $11.5 million; thus, lowering rent expense, to reflect the subleasing of space sooner and at higher rates than originally assumed. For the year ended December 31, 2012 and 2011, the rent expense included a $4.1 million and $3.5 million charge as additional real estate was vacated.

Purchase Commitments

During 2008, we entered into a print services agreement with a third party for a term of five years commencing January 1, 2009 whereby the third party will provide platemaking, printing, binding and disposition services for the Company. The agreement expands the previous relationship between the two companies. We are obligated to purchase $175.0 million per contract year for a total of $875.0 million over the five-year term. Effective January 1, 2012, the print service agreement was amended to extend the agreement for two years and modify some of the aggregate spend and savings covenants. As of December 31, 2012, our remaining purchase commitment was approximately $171.0 million.

Contingencies

We are involved in ordinary and routine litigation and matters incidental to our business. Litigation alleging infringement of copyrights and other intellectual property rights has become extensive in the educational publishing industry. Specifically, there have been various settled, pending and threatened litigation that allege we exceeded the print run limitation or other restrictions in licenses granted to us to reproduce photographs in our textbooks. While management believes that there is a reasonable possibility we may incur a loss associated with the pending and threatened litigation, we are not able to estimate such amount, but we do not expect any of these matters to have a material adverse effect on our results of operations, financial position or cash flows. We have

insurance over such amounts and with coverage and deductibles as management believes is reasonable. There can be no assurance that our liability insurance will cover all events or that the limits of coverage will be sufficient to fully cover all liabilities. We were contingently liable for $11.7 million and $11.6 million of performance related surety bonds for our operating activities as of December 31, 2012 and 2011, respectively. An aggregate of $26.2 million of letters of credit existed each year at December 31, 2012 and 2011 of which $6.4 million backed the aforementioned performance related surety bonds each year in 2012 and 2011.

We routinely enter into standard indemnification provisions as part of license agreements involving use of our intellectual property. These provisions typically require us to indemnify and hold harmless licensees in connection with any infringement claim by a third party relating to the intellectual property covered by the license agreement. The assessment business routinely enters into contracts with customers that contain provisions requiring us to indemnify the customer against a broad array of potential liabilities resulting from any breach of the contract or the invalidity of the test. Although the term of these provisions and the maximum potential amounts of future payments we could be required to make is not limited, we have never incurred any costs to defend or settle claims related to these types of indemnification provisions. We therefore believe the estimated fair value of these provisions is inconsequential, and have no liabilities recorded for them as of December 31, 2012 and December 31, 2011.

15. Related Party Transactions

Debt-for-Equity Exchange

As discussed in Note 2, upon the Company's emergence from Chapter 11 bankruptcy proceedings, holders of the Term Loan, Revolving Loan, and 10.5% Senior Notes were issued post-emergence shares of new common stock pursuant to the final Plan on a pro rata basis. Certain of these holders of the Term Loan, Revolving Loan, and 10.5% Senior Notes were also equity holders prior to the consummation of the Plan. The amount of the gain attributable to the debt to equity conversion, net of elimination of fees and other charges, of $1,010.3 million, which is associated to the holders of the Term Loan, Revolving Loan, and 10.5% Senior Notes that were also equity holders prior to the consummation of the Plan, was charged to capital in excess of par value.

Transactions with Former Officer:

Officer Loan

On March 9, 2010, we entered into a credit agreement with an entity controlled by an executive of the Company at that time, whereby the entity was granted a loan in the aggregate principal amount of $20.0 million for the sole purpose of satisfying certain obligations of that officer with regards to the acquisition of equity of the Predecessor Company. The loan bore interest at a rate per annum equal to 2.69% and had a maturity date of March 9, 2015.

On November 16, 2010, we entered into an amended and restated credit agreement whereby the loan of $20.0 million was divided into a tranche A loan with an aggregate principal amount of $12.2 million and a tranche B loan with an aggregate principal amount of $7.8 million. Both tranches of the loan continued to bear interest at a rate per annum equal to 2.69%. The tranche A loan had a maturity date of March 9, 2015 and the tranche B loan has a maturity date of September 30, 2030. There are no required principal or interest payments during the term of the loan with the interest accruing to the outstanding balance. While the officer was employed by the Company, the loan entity earned a fee equal to approximately $0.1 million per month ("Earned Fee") that was used to repay the amount outstanding under the loan. The Earned Fee was approximately $1.1 million which was

recorded as professional fees which is a component of administrative expenses in our statement of operations for the period March 10, 2010 to December 31, 2010.

We fully reserved the remaining balance of the loan due to the long term nature of the maturity date and uncertainty of collectability. The total amount of $18.9 million was recorded in selling and administrative expenses in our statement of operations for the period March 10, 2010 to December 31, 2010.

Officer Separation Agreement

On May 7, 2011, the Company entered into a separation agreement with an executive of the Company. Under the terms on the agreement, the former executive agreed to act as a senior advisor to the Company for a year. For these services, the former executive received a consulting fee of $2.0 million and the potential to receive an additional $3.0 million in success fees predicated upon certain criteria. The success fee was fully earned and paid in October 2011.

Other Transactions

We paid $10.0 million to an entity controlled by a former executive of the Company at that time for consulting services rendered in connection with the March 9, 2010 financial restructuring. The $10.0 million payment has been recorded as professional fees, which is a component of administrative expenses, in our statement of operations for the period March 10, 2010 to December 31, 2010.

16. Segment Reporting

As of December 31, 2012, we had two reportable segments (Education and Trade Publishing). We measure and evaluate our reportable segments based on segment net sales and segment Adjusted EBITDA. We exclude from segment Adjusted EBITDA certain corporate related expenses, as our corporate functions do not meet the definition of a segment, as defined in the accounting guidance relating to segment reporting. In addition, certain transactions or adjustments that our Chief Operating Decision Maker considers to be non-recurring and/or non-operational, such as amounts related to goodwill and other intangible asset impairment charges and restructuring related charges, as well as amortization expenses, are excluded from segment Adjusted EBITDA. Although we exclude these amounts from segment Adjusted EBITDA, they are included in reported consolidated operating income (loss) and are included in the reconciliation below.

(in thousands)	Year Ended December 31,			Total
	Education	Trade Publishing	Corporate/Other	
2012				
Net sales	$ 1,128,591	$ 157,050	$ -	$ 1,285,641
Adjusted EBITDA	329,723	28,774	(38,685)	319,812
2011				
Net sales	$ 1,169,645	$ 125,650	$ -	$ 1,295,295
Adjusted EBITDA	278,930	12,888	(53,620)	238,198
For the period March 10, 2010 to December 31, 2010				
Net sales	$ 1,290,429	$ 106,713	$ -	$ 1,397,142
Adjusted EBITDA	510,871	15,161	(53,281)	472,751
For the period January 1, 2010 to March 9, 2010				
Net sales	$ 92,718	$ 17,187	$ -	$ 109,905
Adjusted EBITDA	(20,609)	(2,431)	(8,974)	(32,014)

Reconciliation of Adjusted EBITDA to the consolidated statements of operations is as follows:

(in thousands)	Successor			Predecessor
	Year Ended December 31, 2012	Year Ended December 31, 2011	For the Period March 10, 2010 to December 31, 2010	For the Period March 10, 2010 to December 31, 2010
Total Adjusted EBITDA	$ 319,812	$ 238,198	$ 472,751	$ (32,014)
Consolidated interest expense	(123,197)	(244,582)	(258,174)	(157,947)
Provision (benefit) for income taxes	5,943	100,153	(11,929)	220
Depreciation expenses	(58,131)	(58,392)	(48,649)	(10,900)
Amortization expenses (including capitalized permission settlements)	(370,291)	(474,825)	(475,099)	(88,265)
Non-cash charges - stock compensation	(4,227)	(8,558)	(4,274)	(925)
Non-cash charges - gain (loss) on foreign currency and interest hedge	1,688	(811)	90,250	(7,361)
Non-cash charges - asset impairment charges	(8,003)	(1,674,164)	(103,933)	(4,028)
Purchase accounting adjustments (a)	16,511	(22,732)	(113,182)	-
Fees, expenses or charges for equity offerings, debt or acquisitions	(267)	(3,839)	(1,513)	-
Non-recurring debt restructuring (b)	-	-	(30,000)	(9,564)
Non-recurring restructuring (c)	(6,716)	-	-	-
Severance, separation costs and facility closures (d)	(9,375)	(32,818)	(23,975)	(992)
Reorganziation items, net (e)	149,114	-	-	-
Net loss	$ (87,139)	$ (2,182,370)	$ (507,727)	$ (311,776)

(a) Represents certain non-cash accounting adjustments, most significantly relating to deferred revenue, and inventory costs , that we were required to record as a direct result of the March 9, 2010 Restructuring and the acquisitions for the years ended 2012, 2011 and 2010.
(b) Represents fees paid and charged to operations relating to the March 9, 2010 Restructuring.
(c) Represents non-recurring restructuring costs (other than severance and real estate) such as consulting and realignment.
(d) Represents costs associated with the restructuring. Included in such costs are severance, facility integration and vacancy of excess facilities. 2010 costs also includes program integration and related inventory obsolescence and consulting costs.
(e) Represents net gain associated with the Chapter 11 Reorganization.

Segment information as of December 31, 2012 and 2011 is as follows:

(in thousands)

	2012	2011
Goodwill - Education	$ 520,088	$ 520,088
Goodwill - Trade Publishing	-	-
	$ 520,088	$ 520,088
Other intangible assets, net - Education	$ 937,531	$ 1,158,994
Other intangible assets, net - Trade Publishing	129,521	115,219
	$ 1,067,052	$ 1,274,213

The following is a schedule of net sales by geographic region:

(in thousands)

Year Ended December 31, 2012	
Net sales - U.S.	$ 1,223,852
Net sales - International	61,789
Total net sales	$ 1,285,641
Year Ended December 31, 2011	
Net sales - U.S.	$ 1,240,807
Net sales - International	54,488
Total net sales	$ 1,295,295
For the period January 1, 2010 to March 9, 2010	
Net sales - U.S.	$ 105,312
Net sales - International	4,593
Total net sales	$ 109,905
For the period March 10, 2010 to December 31, 2010	
Net sales - U.S.	$ 1,301,143
Net sales - International	95,999
Total net sales	$ 1,397,142

17. Quarterly Results of Operations (Unaudited)

	Three Months Ended			
2012:	**March 31,**	**June 30,**	**September 30,**	**December 31,**
Net sales	$ 165,229	$ 344,204	$ 494,013	$ 282,195
Gross profit	731	135,320	236,302	81,864
Operating income (loss)	(152,349)	(21,897)	81,492	(27,933)
Reorganization items, net	-	(156,894)	-	7,780
Net income (loss)	(225,347)	105,474	66,938	(34,204)
2011:				
Net sales	$ 152,465	$ 328,605	$ 574,509	$ 239,716
Gross profit	(24,095)	107,877	279,632	11,816
Operating income (loss)	(194,706)	(73,735)	64,588	(1,833,277)
Net income (loss)	(274,267)	(138,501)	20,642	(1,790,244)

Reorganization items, net for the year ended December 31, 2012 was $149.1 million. The amount represents expense and income amounts that were recorded to the statement of operations as a result of the bankruptcy proceedings. Reorganization items were incurred starting with the date of the bankruptcy filing through the date of bankruptcy emergence.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Our management is responsible for the integrity and objectivity of all information presented in this report. The Financial Statements were prepared in conformity with accounting principles generally accepted in the United States of America and include amounts based on our best estimates and judgments. We believe that the Financial Statements fairly reflect the form and substance of transactions and that the Financial Statements fairly represent our financial condition and results of operations.

As of the end of the period covered by this report, we were not subject to, and have never been subject to, the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended. Since this report is not filed with the Securities Exchange Commission, we are not required to conduct an evaluation (as required under Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), under the supervision and with the participation of the principal executive officer and principal financial officer, of our "disclosure controls and procedures" (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act).

Item 9B. Other Information

None.

Item 10. Directors, Executive Officers and Corporate Governance

As of March 15, 2013, the executive officers and directors of HMH Holdings were as follows:

Name	Age	Position
Executive Officers		
Linda K. Zecher	59	President, Chief Executive Officer and Director
Eric L. Shuman	58	Executive Vice President and Chief Financial Officer
William F. Bayers	58	Executive Vice President, Secretary and General Counsel
Timothy L. Cannon	58	Executive Vice President, Strategy and Alliances
Mary J. Cullinane	46	Chief Content Officer and Executive Vice President, Corporate Affairs
Lee R. Ramsayer	48	Executive Vice President, U.S. Sales
John K. Dragoon	52	Executive Vice President and Chief Marketing Officer
Gary L. Gentel	60	President, HMH Trade Publishing
Joanne M. Karimi	54	Executive Vice President, Human Resources
Brook Colangelo	35	Senior Vice President and Chief Information Officer
Mark P. Short	48	Senior Vice President, International Markets
Directors		
Lawrence K. Fish	68	Chairman of the Board
John R. McKernan, Jr.	64	Director and Chair of Compensation Committee
John F. Killian	58	Director and Chair of Audit Committee
L. Gordon Crovitz	54	Director
Sheru Chowdhry	39	Director
Jill A. Greenthal	56	Director and Chair of Nominating, Ethics and Governance Committee

E. Rogers Novak, Jr.. . . . . .64 Director
Linda K. Zecher . . . . 59 Director

The following information provides a brief description of the business experience of each executive officer and director.

Executive Officers

Linda K. Zecher, President, Chief Executive Officer and Director

Linda joined Houghton Mifflin Harcourt in September 2011 as President, Chief Executive Officer and Director. Previously, she served as Corporate Vice President of Microsoft's Worldwide Public Sector organization since 2009. She also served as Microsoft’s Vice President Public Sector, Americas and Asia Pacific from 2008 to 2009, and as Vice President, US Public Sector from 2003 to 2008. Prior to joining Microsoft in 2003, Linda held leadership positions with Texas Instruments, Bank of America, PeopleSoft, Oracle and Evolve Corp. She currently serves on the U.S. State Department’s Board for Overseas Schools, the Focused Ultrasound Surgery Foundation Advisory Council, and the Emily Couric Leadership Forum. Linda is also a former member of the Intelligence National Security Association, the Virginia Piedmont Technology Council, and James Madison University’s Board of Visitors. Linda’s extensive sales, marketing and technology experience enables her to provide the Company with effective leadership in the conduct of its rapidly changing business.

Eric L. Shuman, Executive Vice President, Chief Financial Officer

Eric joined the Company in October 2009 as Executive Vice President and K-12 Chief Operating Officer. From November 2011 to January 2012, he served as Executive Vice President and K-12 Chief Operating Officer and Interim Chief Financial Officer. He began his current role with the Company in January 2012. Prior to joining Houghton Mifflin Harcourt, Eric was with Thomson Lifelong Learning Group, a division of Thomson Corporation, where he served as Chief Executive Officer from September 2005 to December 2007. Previously, Eric was Senior Vice President and Chief Financial Officer from June 1994 to September 2005 for Thomson Reuters, and Vice President and Corporate Controller for Thomson Newspapers.

William F. Bayers, Executive Vice President, Secretary and General Counsel

Bill joined Houghton Mifflin Harcourt in May of 2007 as Senior Vice President, Secretary and General Counsel and was made Executive Vice President, Secretary and General Counsel in March 2008. Previously, he served as Vice President and General Counsel of Harcourt Education Group. Bill oversees all legal, regulatory and corporate matters for the Company. He is a graduate of Harvard College and Harvard Law School.

Timothy L. Cannon, Executive Vice President, Strategy and Alliances

Before joining HMH in November 2011, Tim was Senior Director of Business Strategy for Microsoft’s Worldwide Public Sector organization from September 2008 to November 2011, where he oversaw the development and execution of business strategies to better serve Government, Education and Health customers and partners worldwide. Prior to that role, Tim was Senior Director of Business Strategy for Microsoft’s U.S Public Sector from October 2006 to September 2008. He has also held leadership roles at companies like Digital Equipment Corporation and Oracle. Tim serves on the board of the Center for Entrepreneurship and Innovation at the University of Florida and on the advisory board for the School of Engineering at George Mason University.

Mary J. Cullinane, Chief Content Officer and Executive Vice President, Corporate Affairs

Mary joined HMH in February 2012. Prior to joining HMH, Mary served as Worldwide Senior Director, Innovation and Education Policy for Microsoft from May 2010 to December 2011. Prior to that role, Mary served as Director, Innovation and Business Development for Microsoft from July 2008 until May 2010 and as Director, U.S. Partners In Learning for Microsoft from February 2006 to July 2008. Mary holds a Master of Public Policy and Administration from Columbia University and a Bachelor of Arts from The College of New Jersey.

Lee R. Ramsayer, Executive Vice President, U.S. Sales

Before joining Houghton Mifflin Harcourt in February 2012, Lee served as Senior Vice President of Sales for Monster Worldwide, Inc.'s Government Solutions sector. Prior to his role at Monster, Lee served as Manager, Government Sales and Consulting Services for Microsoft from January 2004 to February 2005. Lee currently serves on the board of Innovate Education, a national organization focused on STEM education.

John K. Dragoon, Executive Vice President and Chief Marketing Officer

John joined Houghton Mifflin Harcourt in April 2012. Previously, he served as Chief Marketing Officer and Channel Chief of Novell from October 2003 to April 2011, where he led the company's Marketing and Partner programs for over seven years. Prior to joining Novell, John served as Senior Vice President, Marketing and Product Management at Art Technology Group (ATG) from 2002 to 2003. Before ATG, John served as Vice President, Operations at Internet Capital Group from 2000 to 2002. John also spent more than 16 years at IBM, where he held a number of marketing and sales positions. He holds an MBA from Cornell University and a BS from Union College.

Gary L. Gentel, President, HMH Trade Publishing

Gary joined Houghton Mifflin Harcourt in October 2003 as Corporate Vice President and Director of Trade Sales and was promoted to Interim President of the combined Trade Group in July 2007. He was given the permanent position in December of that year. Previously, he served as President of Candlewick Press—a children's publisher based in Cambridge, SVP of Trade Sales at Scholastic Books, and SVP and Publisher of The Grosset and Dunlap Group at GP Putnam's Sons—now a division of Penguin Books. Gary started his publishing career as a Sales Representative at Random House in 1980, rising to VP of Children's Sales by 1990.

Joanne M. Karimi, Executive Vice President, Human Resources

Joanne joined Houghton Mifflin Harcourt in February of 2011. From June 2010 to November 2010, Joanne served as Leader of Human Capital for PacifiCord, the U.S. subsidiary of a Taiwan-based Biomedical company called Health Banks that specializes in biotechnology, stem cell therapy, and cord blood processing and storage. Prior to her role at Pacificord, Joanne worked as an independent consultant from January 2008 until June 2010 and as Executive Vice President, Human Resources for CCI Valve, a company focused on design and manufacture of severe service control and isolation valves for the severe service applications of the power, oil and gas and nuclear industries, from July 2007 to September 2008. She also worked at Faro Technologies from August 1998 to April 2007.

Brook Colangelo, Senior Vice President and Chief Information Officer

Brook joined HMH from the White House where he held the role of Chief Information Officer from January 2009 to January 2013. In November 2008 he joined President-Elect Obama's team as Deputy Technology Team Leader to lead the technology effort for the Obama-Biden transition

project. From June 2007 to November 2008 he was the CIO for the Democratic National Convention Committee. He also held senior IT leadership roles with The American Red Cross' Hurricane Recovery Program and QRS Newmedia. Brook holds an honors degree in Political Communications from The George Washington University.

Mark P. Short, Senior Vice President, International Markets

Mark joined HMH in December 2012 from Pearson Education where he served as Senior Vice President, Sales and Marketing, English Language Training from August 2008 to October 2012. He had served as Vice President, Sales and Marketing for Pearson Education from February 2007 to August 2008.   Prior to that, he held a number of senior regional management, sales and marketing roles across Asia Pacific, Latin America, and Europe as part of Pearson's global education business. As head of the International Markets division, Mark leads a sales, marketing and business development team responsible for extending the HMH's global footprint across key markets in Asia Pacific, Latin America and the Middle East.

Directors

Lawrence K. Fish, Director and Chairman of the Board

Lawrence K. Fish has served as a member of the board of directors since August 2010 and Chairman of the Board since January 2011. Mr. Fish served as Chairman and Chief Executive Officer of Citizens Financial Group, Inc. ("Citizens") from 2005 to 2008 and before as Chairman, President and Chief Executive Officer, from 1992, of Citizens. Mr. Fish is a member of the Board of Trustees of Massachusetts Institute of Technology. He serves on the boards of Textron Inc., Tiffany & Co., and NBH Holdings Corp. He is also an Honorary Trustee of the Brookings Institution in Washington D.C. Mr. Fish's extensive experience in the areas of finance, marketing, general management and corporate governance enables him to provide the Company with effective leadership on the board of directors.

John R. McKernan, Jr., Director and Chair of Compensation Committee

John R. McKernan, Jr. served as a member of the board of directors from August 2010 through June 2012 and rejoined the board in September 2012. Mr. McKernan is currently Chairman and Chief Executive Officer of McKernan Enterprises, Inc., in Portland, Maine. He is the former Chairman of Education Management Corporation, a provider of post-secondary education in North America, where he served as Chief Executive Officer from September 2003 until February 2007 and continues to serve as a director. Mr. McKernan is a director of BorgWarner Inc. and served as Governor of the State of Maine from 1987 to 1995. Mr. McKernan is currently Chairman of the Board of Directors of The Foundation for Maine's Community Colleges and serves on the board of the U.S. Chamber of Commerce's Institute for a Competitive Workforce. Mr. McKernan brings to the board superior leadership capabilities, knowledge of the legal and legislative processes and significant prior experience as a director.

John F. Killian, Director and Chair of Audit Committee

John F. Killian has served as a member of the board of directors since January 2011. Mr. Killian was Executive Vice President for Verizon and served as Verizon's Chief Financial Officer from March 2009 through October 2010. Prior to becoming CFO, Mr. Killian was President of Verizon Business from October 2005 until March 2009, the Senior Vice President and Chief Financial Officer of Verizon Telecom from June 2003 until October 2005, and the Senior Vice President and Controller of Verizon Telecom from April 2002 until June 2003. Mr. Killian serves on the board of directors at ConEdison Inc. and is a Chairman of the Board of Providence College. Mr. Killian brings extensive financial expertise to the board, as well as significant management and leadership experience.

L. Gordon Crovitz, Director

L. Gordon Crovitz has served as a member of the board of directors since August 2012. From 1980-2007 Mr. Crovitz held a number of positions with Dow Jones and the Wall Street Journal culminating in his role as Executive Vice President for Dow Jones and Publisher of The Wall Street Journal. He was co-founder of e-commerce software company Press+ in 2009. Mr. Crovitz serves on the Board of Directors at Minneapolis Star Tribune, Business Insider, Blurb and Marin Software. He is on the board of the American Association of Rhodes Scholars. Mr. Crovitz's management roles in the publishing industry and extensive experience as a director enables him to provide the Company with valuable guidance.

Sheru Chowdhry, Director

Sheru Chowdhry served as a member of the board of directors from March 2010 through March 2012 and rejoined the board in June 2012. Mr. Chowdhry joined Paulson & Co. Inc., a hedge fund, in 2004 as a Senior Vice President and has been a Managing Director and Head of Distressed & Bankruptcy Research since 2008. Previously, he was a research analyst at DebtTraders Inc., covering distressed and bankrupt securities, and an investment banker in the Mergers & Acquisitions Group at JP Morgan Securities. Mr. Chowdhry's financial expertise and significant experience with debt and equity capital markets render him a valuable member of the board.

Jill A. Greenthal, Director and Chair of Nominating, Ethics, and Governance Committee

Jill A. Greenthal has served as a member of the board of directors since June 2012. Ms. Greenthal has been a Senior Advisor in Private Equity at the Blackstone Group since 2007, working closely with the company's global media and technology teams to assist in investments in those sectors. She also currently serves as a director of Akamai Technologies, Orbitz Worldwide, Michaels Stores and The Weather Channel Companies. Prior to 2007, Ms. Greenthal was an investment banker and partner at Blackstone and Credit Suisse First Boston. Ms. Greenthal has extensive experience in the media industry and in advising technology and media companies, which enables her to provide valuable guidance to the Company.

E. Rogers Novak, Jr., Director

E. Rogers Novak, Jr. has served as a member of the board of directors since November 2012. He is a founder and managing member of Novak Biddle Venture Partners, an early-stage venture fund focused on investment opportunities in businesses focused on education, security, big data analytics, and business-to-business-to-consumer. Roger formerly served as Lead Director of Blackboard which was acquired by Providence Equity Partners. Roger currently serves on several private company boards and is a member of the External Relations Council for the Department of Homeland Security's Predict project. He also serves on the Board of Trustees for Kenyon College where he sits on the Budget, Financial and Audit Committee and the Information Resources Committee. From 2008 to 2011, Roger held a seat on the Board of the National Venture Capital Association and was their Treasurer and a member of their Executive Committee from 2009 to 2011. Mr. Novak's significant prior experience as a director, especially in the education technology sector, render him a valuable member of the board.

Board of Directors

HMH Holdings' board of directors is currently composed of eight individuals, one of whom is the Chief Executive Officer. A majority of the Directors, including the Chairperson, must be "independent" under NYSE standards. The independent directors are Lawrence K. Fish, John R. McKernan, Jr., John F. Killian, L. Gordon Crovitz, Jill A. Greenthal, and E. Rogers Novak, Jr.

Nomination Agreement
Paulson & Co., Inc. ("Paulson") and HMH have entered into a nomination agreement which provides that Paulson has the right to nominate two Directors, one of whom must be an "independent" Director under NYSE standards (the "Independent Director") and the other nominated by Paulson (the "Holder Director"). The initial Holder Director is Sheru Chowdhry and the Independent Director is John McKernan. Any vacancy in the Independent Director position shall be nominated by Paulson in consultation with the nominating committee of the Board of Directors and shall be subject to approval by the majority of the Board of Directors; any vacancy in the Holder Director shall be nominated by Paulson and (i) filled with a full-time Paulson employee or (ii) selected in consultation with the nominating committee and approved by a majority of the Board of Directors (excluding the Independent Director). The right to nominate the Independent Director terminates if Paulson holds less than 20% of the issued and outstanding New Common Stock and the right to nominate the Holder Director terminates if Paulson holds less than 15% of the issued and outstanding common stock. All nominating rights terminate upon an IPO. If Paulson transfers at least 20% of the issued and outstanding common stock to a Transferee, the nominating rights with respect to only the Holder Director (and any successor in the event of a vacancy) may be assigned to the Transferee (subject to the same termination events – 15% ownership threshold or an initial public offering). In the event that any other shareholder acquires 20% or more of the issued and outstanding common stock (a "Nominating Holder"), such Nominating Holder will also be entitled to nominate one director to the Board of Directors immediately pursuant to a nomination agreement (which HMH shall be required to enter into if the Nominating Holder so elects) in form and substance substantially similar to the Paulson nomination agreement. If the Nominating Holder became a Nominating Holder other than by acquiring the stock of an existing 20% shareholder, the size of the Board of Directors will be increased in order to elect the director chosen by such Nominating Holder. As with the Paulson nomination agreement, the Nominating Holder nomination agreement will terminate upon an IPO or if the Nominating Holder owns less than 15% of the outstanding common stock. As long as Paulson or a Nominating Holder does not hold less than 20% of the issued and outstanding common stock, respectively, the directors nominated by Paulson or such Holder, respectively, will be eligible for re-election at each annual meeting until an initial public offering.

Board of Directors Committees
HMH Holdings' board of directors has three committees: the audit committee, the compensation committee and the nominating, ethics, and governance committee. Messrs. Killian, Chowdhry, Fish, and Mses. Greenthal serve on the audit committee, which oversees and meets with management, the internal auditors and the independent auditors to review internal accounting controls and accounting, auditing, and financial reporting matters. Mr. Killian is the audit committee financial expert. Messrs. McKernan, Chowdhry, Crovitz, Fish, and Killian serve on the compensation committee, which reviews the compensation of HMH's executive officers, executive bonus allocations and other compensation matters. Ms. Greenthal, Messrs. Crovitz, Fish, and Novak serve on the nominating, ethics and governance committee, which identifies individuals qualified to become members of the board of directors, develops and recommends corporate governance guidelines and oversees the evaluation of the board of directors and management.

Code of Ethics

We have adopted a Code of Conduct policy which applies to all officers and employees of the Company. The Code Conduct is the foundation of our ethics and compliance program and covers a wide range of areas. Many of our policies are summarized in the Code of Conduct, including our policies regarding conflict of interest, honest and ethical conduct, discrimination and harassment, confidentiality and compliance with laws and regulations applicable to the conduct of our business. All employees are required to comply with the Code of Conduct and are subject to disciplinary action, including termination, for violations. The Code of Conduct is published on our website at www.hmhco.com under the heading "Investor Relations" and is also available in print to any person who requests it by writing to: Houghton Mifflin Harcourt, Investor Relations, 222 Berkeley Street, Boston, Massachusetts 02116. Any amendments to the Code of Conduct or the grant of a waiver from a provision of the Code Conduct requiring disclosure under applicable SEC rules will be disclosed on our website. Under our Code of

Conduct all employees have a duty to report any violation or suspected violation of the policy or the law to the appropriate personnel as identified in the policy.

Item 11. Executive Compensation

Compensation Discussion and Analysis

Compensation Program Philosophy and Objectives

Following the Company's emergence from bankruptcy in June 2012, we implemented a compensation program designed to help us attract and retain a management team capable of implementing our plan of reorganization. To be successful, our employees needed to overcome uncertain economic conditions. Therefore, we structured a compensation program designed to protect our assets in the near-term and position us for future growth. Now that the Company has successfully emerged from bankruptcy, the current Compensation Committee plans to do a thorough review of the Company's compensation goals and policies, and overall compensation objectives in 2013 for 2014 to ensure that its compensation programs continue to align executive compensation of key employees with the best interests of stockholders by rewarding performance based upon the attainment of annual financial and strategic goals.

The goal of the Company's compensation program for its named executive officers is the same as for the entire Company, which is to foster compensation policies and practices that attract, engage, and motivate high caliber talent by offering a competitive pay and benefits program. The Company is committed to a total compensation philosophy and structure that provides flexibility in responding to market factors; rewards and recognizes superior performance; attracts highly skilled, experienced, and capable employees; and is fair and fiscally responsible. Most of the Company's compensation elements simultaneously fulfill one or more of our performance, alignment, or retention objectives.

The Process of Setting Executive Compensation

Our Compensation Committee meets throughout the year to evaluate the performance of our named executive officers, to determine their bonuses for the prior fiscal year, to establish the individual and corporate performance objectives for each executive for the current fiscal year, and to consider and approve any grants of equity incentive compensation. Our Compensation Committee also reviews the appropriateness of the financial measures used in our incentive plans and the degree of difficulty in achieving specific performance targets. Our Compensation Committee engages in an active dialogue with our Chief Executive Officer concerning strategic objectives and performance targets. All Compensation Committee decisions are recommended to the Board of Directors and the Board of Directors ultimately makes the final determination.

In making compensation decisions, the Compensation Committee considers the following:

- *Company Performance*. The Compensation Committee reviews the Company's operational performance and the achievement of its pre-established goals for the fiscal year.

- *Executives' Performance*. The Compensation Committee evaluates an executive's performance during the year including leadership qualities, responsibilities, and contribution to the Company's performance. The relative importance of each factor varies among the Company's named executive officers depending on their positions and the particular operations or functions for which they are responsible.

- *Recommendations of the Chief Executive Officer*. The Compensation Committee considers the recommendations of the Company's Chief Executive Officer, who assesses the performance of the other named executive officers and adjustments to their base salary and other elements of compensation.

Management's Role in the Compensation-Setting Process

Our Chief Executive Officer, Ms. Zecher, plays a significant role in the compensation-setting process. Ms. Zecher evaluates the performance of the other named executive officers, recommends business performance targets and objectives for the other named executive officers, and recommends salary and bonus levels and option awards for other executive officers. All recommendations of Ms. Zecher are subject to Compensation Committee approval. Ms. Zecher's compensation, performance targets, and objectives are reviewed by the Compensation Committee and upon approval are recommended to the Board of Directors. The Board of Directors sets Ms. Zecher's compensation.

Elements of Executive Compensation

Base Salary

Base pay provides executives with a base level of regular income. In determining a named executive officer's base salary, we consider the executive's qualifications, experience, and industry knowledge, the quality and effectiveness of their leadership at our Company, the scope of their responsibilities and future potential, the goals and objectives established for the executive, the executive's past performance, internal pay equity, and other factors as deemed appropriate. In addition, we consider the other components of executive compensation and the mix of performance pay to total compensation. The Compensation Committee does not apply any specific weighting to these factors. The minimum salaries for the named executive offers are as reflected in applicable employment agreements.

The 2012 annual base salaries for our named executive officers were as follows:

Named Executive Officer	Salary
Linda Zecher	$750,000
Eric Shuman	$500,000
John Dragoon	$400,000
Bethlam Forsa	$400,000
William Bayers	$400,000

Annual Cash Bonus

Our bonus program is intended to motivate and reward performance by providing incentive bonuses based upon meeting and exceeding individual and Company performance goals. Other than for our Chief Executive Officer, we award annual incentive bonuses under a bonus plan (the Bonus Plan). Each named executive officer has a specified payout target as a percentage of base salary based on the executive's position and level of responsibility. The named executive officers had the following bonus targets (as a percentage of base salary) for 2012:

Named Executive Officer	Bonus Target Percentages
Linda Zecher	125%
Eric Shuman	100%
John Dragoon	100%
Bethlam Forsa	100%
William Bayers	100%

Under the Bonus Plan, the total maximum bonus for each executive is allocated between two bonus objectives – individual performance (25%) and EBITDA (75%) as established in the Company's annual budget. The relative weight or percentage of the maximum available bonus for each objective is based on the importance of the objective for the year and the ability of the executive to influence the result. The payout based on the applicable financial metrics is determined in accordance with the following schedule:

% Achievement of EBITDA Target	Payout as a Percentage of EBITDA Component of Total Maximum Bonus Opportunity
0% - 89.79%	0.0%
89.8% - 92.99%	25.0%
93.0% - 96.49%	50.0%
96.5% - 99.99%	75.0%
100% - 101.79%	100.0%
101.8% - 103.49%	120.0%
103.5% and up	140.0%

For 2012, the Company's Operating EBITDA target was $301 million. The Bonus Plan is meant to be self-funding and although the Company achieved its' $301 million operating EBITDA target, there was not sufficient funding to pay 100% of the bonus level. Therefore, the EBITDA component of the bonus was paid at the 75% level subject to adjustments made by the Chief Executive Officer and approved by the Board.

With respect to our named executive officers other than Ms. Zecher, Ms. Zecher recommends to the Board of Directors the size of an award by considering his or her individual performance as measured against pre-set individual performance targets and objectives. Each named executive officer receives his or her bonus amount based on the assessment of individual performance relative to such predetermined specific performance goals. With respect to our Chief Executive Officer, the Compensation Committee reviews and evaluates her performance against pre-set performance goals determined by the Compensation Committee.

Ms. Zecher's performance objectives included an EBITDA target and personal objectives. Based on its review of Ms. Zecher's 2012 performance, the Compensation Committee determined that Ms. Zecher achieved substantially all of her goals, and awarded a bonus equal to 96% of her target bonus.

The personal objectives for each of Messrs. Shuman, Dragoon and Bayers, which comprised 25% of his respective target bonus, were substantially consistent with Ms. Zecher's personal objectives, and were deemed by the Compensation Committee to have been achieved after taking into account each named executive officer's respective efforts in connection with the Company's emergence from bankruptcy, and pro-rating the amount for Mr. Dragoon to reflect the portion of the fiscal year he was actually employed by us. Our Chief Executive Officer recommended that Messrs. Shuman, Dragoon and Bayers be paid an annual bonus in an amount equal to 96%, 62.5% and 100%, respectively, of each officer's target bonus, and such awards were approved by the Compensation Committee.

Ms. Forsa's employment with us terminated on January 3, 2013. As part of the negotiation of her separation agreement with us, Ms. Forsa was awarded 100% of her target bonus.

Equity Incentives
Equity awards are a significant component of our executive officer compensation. In connection with our emergence from bankruptcy all awards granted prior to our emergence from bankruptcy were cancelled. All equity awards are now granted under our 2012 Management Incentive Plan (the "MIP"), which is designed to align the interests of our stockholders and executive officers by increasing the proprietary interest of our executive officers in our growth and success, to advance our interests by attracting and retaining key employees, and motivating such executives to act in our long-term best interests. We grant equity awards to promote the success and enhance the value of the Company by providing participants with an incentive for outstanding performance. Equity-based awards also provide the Company with the flexibility to motivate, attract, and retain the services of employees upon whose judgment, interest, and special effort the successful conduct of our operation is largely dependent. We believe that equity awards

provide long-term incentives to executive officers because they tie the executive officers' financial interests to those of our shareholders.

As part of the negotiations with creditors in connection with our emergence from bankruptcy, we established the overall size of the option pool (10% of the fully-diluted outstanding shares) as well as the allocation of initial grants under the MIP to executive officers, which are set forth below:

Named Executive Officer	Stock Options Granted (#)	Percentage of Fully-Diluted Outstanding Shares
Linda Zecher	1,842,105	2.25%
Eric Shuman	818,714	1.00%
John Dragoon	614,035	.75%
Bethlam Forsa	491,228	.60%
William Bayers	327,485	.40%

The exercise price of all stock options granted by the Board of Directors cannot be less than 100% of the fair market value (as determined under the MIP) of the common stock on the date of the grant. The stock options granted in fiscal 2012 have an exercise price of $25.00 per share, which is equal to the value of our common stock established in the Plan of Reorganization as of the date of emergence from bankruptcy. Stock options generally are subject to a four-year vesting schedule and expire seven years after the date of grant.

Employee Benefits
Executive officers participate in other employee benefit plans generally available to all employees on the same terms, such as a 401(k) plan with a Company matching contribution. In addition, certain executive officers participate in an executive life insurance plan. We also provide parking, tax preparation, moving expenses, and tax gross-ups for moving expenses to certain of our named executive officers. These plans are designed to enable us to attract and retain our workforce in a competitive marketplace.

Change in Control Severance Plan
We believe that companies should provide reasonable severance benefits to executive officers due to the greater level of difficulty they face in finding comparable employment in a short period of time and greater risk of job loss or modification as a result of a change-in-control transaction than other employees. In recognition of the need to retain key personnel during a period of significant change and uncertainty, we adopted a Change in Control Severance Plan in December 2012. The Change in Control Severance Plan is designed (i) to retain our executives and (ii) to align their interests with our stockholders' interests so that they can consider transactions that are in the best interests of our stockholders and maintain their focus without concern regarding how any such transaction might personally affect them. The Change in Control Severance Plan provides for "double trigger" severance payments, which means that both a change in control and a termination of employment must occur in order for a named executive officer's severance benefits to be triggered in connection with a change in control.

See "Potential Post-Employment Payments Upon Termination or Change in Control" for a more detailed description of the benefits payable under the Change in Control Severance Plan.

Reasonableness of Compensation
The Compensation Committee does not adhere to rigid formulas when determining the amount and mix of compensation elements. Compensation elements for each executive are reviewed in a manner that optimizes the executive's contribution to the Company and reflects an evaluation of the compensation paid by the Company's competitors. The Compensation Committee reviews both current pay and the opportunity for future compensation to achieve an appropriate mix between equity incentive awards and cash payments in order to meet its objectives. The mix of compensation elements is designed to reward recent results and motivate long-term performance through a combination of cash and equity incentive awards.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis with management and, based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Annual Report.

Members of the Compensation Committee:

John R. McKernan, Jr. (chair)
Sheru Chowdhry
L. Gordon Crovitz
Lawrence K. Fish
John F. Killian
E. Rogers Novak, Jr.

Summary Compensation Table For Fiscal Year 2012

The following table sets forth the cash and non-cash compensation paid by us or incurred on our behalf to our named executive officers during 2012, our last completed fiscal year.

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)(1)	Non-Equity Incentive Plan Compensation ($)(2)	All Other Compensation ($)(3)	Total ($)
Linda Zecher Chief Executive Officer	2012	750,000	__	__	10,205,262	900,000	67,409	11,922,671
Eric Shuman Executive Vice President/ Chief Financial Officer	2012	500,000	__	__	4,535,676	480,000	17,075	5,532,751
John Dragoon (4) Executive Vice President/ Chief Marketing Officer	2012	284,615	__	__	3,401,754	250,000	3,915	3,940,284
Bethlam Forsa (5) Executive Vice President/ K-12 Product Development	2012	400,000	__	__	2,721,403	400,000	7,350	3,528,753
William Bayers Executive Vice President/ General Counsel, Secretary	2012	400,000	__	__	1,814,267	400,000	26,420	2,640,687

(1) Represents the aggregate grant date fair value of stock options granted during the year in accordance with the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic 718, Stock Compensation (disregarding any forfeiture assumptions). See Note 12 to our consolidated financial for the assumptions made in determining these values. These values do not correspond to the actual values that may be realized by our named executive officers for these awards.

(2) Represents awards made pursuant to the Bonus Plan in respect of the year indicated, although the awards were actually paid in the following year.

(3) For Ms. Zecher, this amount represents Company-paid life insurance premiums ($12,564); parking ($5,220); moving expenses ($29,843); and tax gross-ups for moving ($19,782). For Mr. Shuman, this amount represents employer matching contributions to our 401(k) plan ($7,350); parking ($5,220) and Company-paid life insurance premiums ($4,505). For Mr. Dragoon, this amount represents parking ($3,915). For Ms. Forsa, this amount represents employer matching contributions to our 401(k) plan ($7,350). For Mr. Bayers, this amount represents employer matching contributions to our 401(k) plan ($7,350); parking ($5,220); tax preparation assistance ($1,571) and Company-paid life insurance premiums ($12,279).

(4) Mr. Dragoon was hired on April 9, 2012.

(5) Ms. Forsa's employment terminated effective January 3, 2013.

Grants of Plan-Based Awards For Fiscal Year 2012

The following table details grants to our named executive officers during 2012:

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1)					
	Grant Date	**Threshold ($)**	**Target ($)**	**Maximum ($)**	**All Other Option Awards: Number of Securities Underlying Options(#) (3)**	**Exercise Price of Option Awards($)**	**Grant Date Fair Value of Option Awards($)(2)**
Linda Zecher	6/22/12		937,500		1,842,105	25.00	10,205,262
Eric Shuman	6/22/12	218,750	500,000	650,000	818,717	25.00	4,535,676
John Dragoon	6/22/12	175,000	400,000	520,000	614,035	25.00	3,401,754
Bethlam Forsa	6/22/12	175,000	400,000	520,000	491,228	25.00	2,721,403
William Bayers	6/22/12	175,000	400,000	520,000	327,485	25.00	1,814,267

(1) For a description of the material terms of these awards, please see the "Compensation Discussion and Analysis—Elements of Executive Compensation—Annual Cash Bonus Plans."

(2) We estimated the fair value of option awards on the grant date using the Black-Scholes option-pricing model and in accordance with the FASB ASC Topic 718. See Note 12 to our consolidated financial statements for the assumptions made in determining these values.

(3) For Ms. Zecher, the options vested 25% on the date of grant and vest 25% on June 22, 2013, June 22, 2014 and June 22, 2015. For all other executives, the options vest over four years with 25% vesting on June 22, 2013, June 22, 2014, June 22, 2015 and June 22, 2016.

Employment Agreements

We have entered into an employment agreement with each of our named executive officers. For a description of the severance benefits each executive is entitled to receive upon a termination of employment pursuant to the terms of his or her employment agreement, please see "*Potential Post-Employment Payments Upon Termination or Change in Control*".

Linda Zecher

Ms. Zecher's employment agreement provides that Ms. Zecher will continue to serve as our President and Chief Executive Officer until her employment is terminated by us or by Ms. Zecher, which may be at any time, with or without cause, subject to the provisions of her employment agreement. In consideration for her receipt of stock options, the agreement contains a covenant not to engage in any business that competes with us or to solicit employees or customers during the term of her employment and for a period of one year thereafter, as well as non-disparagement, confidentiality, and intellectual property provisions. The provisions of Ms. Zecher's employment agreement that relate to equity grants are no longer effective following our emergence from bankruptcy.

Ms. Zecher is entitled to receive an annual base salary of $750,000 and is eligible for an annual target bonus of 125% of her base salary based on the achievement of performance goals established by our Board of Directors for such fiscal year. Ms. Zecher is entitled to four weeks of vacation per year.

Eric Shuman
Mr. Shuman's employment agreement provides that Mr. Shuman will continue to serve as our Executive Vice President/Chief Financial Officer until his employment is terminated by us or by Mr. Shuman, which may be at any time, with or without cause, subject to the provisions of his employment agreement. In consideration for his receipt of stock options, the agreement contains a covenant not to engage in any business that competes with us or to solicit employees or customers during the term of his employment and for a period of one year thereafter, as well as non-disparagement and intellectual property provisions.

Mr. Shuman is entitled to receive an annual base salary of $500,000, and in accordance with the terms of his employment agreement, the Bonus Plan, and our benefit policies, is eligible for an annual target bonus of 100% of his base salary. Mr. Shuman is entitled to four weeks of vacation per year.

John Dragoon
We entered into an employment agreement on March 27, 2012, with John Dragoon with an effective date of April 9, 2012. Mr. Dragoon's employment agreement provides that Mr. Dragoon will continue to serve as our Executive Vice President and Chief Marketing Officer until his employment is terminated by us or by Mr. Dragoon, which may be at any time, with or without cause, subject to the provisions of his employment agreement. In consideration for his receipt of stock options, the agreement contains a covenant not to engage in any business that competes with us or to solicit employees or customers during the term of his employment and for a period of one year thereafter, as well as non-disparagement, confidentiality, and intellectual property provisions.

Mr. Dragoon is entitled to receive an annual base salary of $400,000, and in accordance with the terms of his employment agreement, the Bonus Plan, and our benefit policies, is eligible for an annual target bonus of 100% of his base salary. Mr. Dragoon is entitled to four weeks of vacation per year.

Bethlam Forsa
Ms. Forsa's employment terminated effective January 3, 2013, and we subsequently entered into a separation agreement with her dated January 10, 2013.

Prior to the termination of her employment, Ms. Forsa's employment agreement provided that Ms. Forsa would serve as our Executive Vice President – Publishing Operations until December 31, 2013, subject to automatic one-year extensions unless either we or Ms. Forsa provided ninety days' notice not to extend the term or until her employment is terminated by us or Ms. Forsa, which may be at any time, with or without cause, subject to the provisions of her employment agreement. The agreement contained a covenant not to engage in any business that competes with us or to solicit employees or customers during the term of her employment and for a period of one year thereafter, as well as non-disparagement, confidentiality, and intellectual property provisions.

During 2012, Ms. Forsa was entitled to receive an annual base salary of $400,000, and in accordance with the terms of her employment agreement, the Bonus Plan, and our benefit policies, was eligible for an annual target bonus of 100% of her base salary. Ms. Forsa was entitled to four weeks of vacation per year.

William Bayers
Mr. Bayers' employment agreement provides that Mr. Bayers will continue to serve as our Executive Vice President, General Counsel and Secretary until his employment is terminated by us or by Mr. Bayers, which may be at any time, with or without cause, subject to the provisions of his employment agreement. The employment agreement also contains confidentiality and intellectual property provisions.

Mr. Bayers is entitled to receive an annual base salary of $400,000, and in accordance with the terms of his employment agreement, the Bonus Plan and our benefit policies, is eligible for an annual target bonus of 100% of his base salary. Mr. Bayers' is entitled to four weeks of vacation per year. He also is entitled to prior service credit for purposes of eligibility under the Company's post-retirement medical plan.

Outstanding Equity Awards at Fiscal Year-End 2012

	Option Awards			
	Number of Securities Underlying Unexercised Options			
Name	**Exercisable (#)(1)**	**Unexercisable (#)(2)**	**Option Exercise Price ($)**	**Option Expiration Date**
Linda Zecher	460,526.25	1,381,578.75	25.00	6/21/19
Eric Shuman	—	818,714	25.00	6/21/19
John Dragoon	—	614,035	25.00	6/21/19
Bethlam Forsa	—	491,228	25.00	6/21/19
William Bayers	—	327,485	25.00	6/21/19

(1) For Ms. Zecher, the options vested 25% on the date of grant and vest 25% on June 22, 2013, June 22, 2014 and June 22, 2015. For all other executives, the options vest over four years with 25% vesting on June 22, 2013, June 22, 2014, June 22, 2015 and June 22, 2016.

(2) Upon a change of control, all option awards will become immediately vested and exercisable.

Potential Post-Employment Payments Upon Termination or Change in Control

Change in Control Severance Plan

We maintain the HMH Holdings (Delaware), Inc. Change in Control Severance Plan to help retain key executives by reducing personal uncertainty that may arise from the possibility of a change in control, and to promote their objectivity and neutrality in evaluating transactions that may be in the best interest of the Company and our shareholders. The plan establishes objective criteria to determine whether a change in control has occurred, and provides for severance payments and benefits only on a “double trigger” basis. The “double trigger” design is intended to further our goals to retain key executives upon a change in control.

Each named executive officer participates in the Change in Control Severance Plan. Under this plan, if the executive’s employment is terminated by us other than for “cause” (as defined in the MIP as described below under “Equity Award Provisions”), death or disability, or if the executive resigns for “good reason” within two years after a “change in control” or the period commencing on the date of entry into a definitive agreement or following a public announcement by the Company of a transaction or transactions that would result in a change in control (but not earlier than six months preceding the change in control), then HMH or its successor will be obligated to pay or provide the following benefits upon the employee’s execution of a release of claims:

- A lump sum payment equal to two times annual base salary; plus
- A lump sum payment equal to 200% (in the case of Ms. Zecher and Mr. Shuman) or 100% (for other named executive officers) of the officer’s target annual bonus; plus
- A lump sum payment equal to a pro-rata portion of the target annual bonus.

The plan provides for a cutback of severance payments to the safe harbor amount if the payments would be subject to the excise tax imposed by Section 4999 of the Code but only if such reduction would result in a greater net payment to the executive than he or she would have received without such reduction but after paying the excise tax.

The term "good reason" generally means (a) material adverse change in duties or reporting relationship, (b) reduction in salary or annual bonus opportunity not in connection with an across-the-board reduction for other senior executives of the Company, or (c) forced relocation to a place of employment more than fifty miles from the employee's place of employment immediately prior to the change in control; provided, however, that no termination of an employee's employment will constitute a termination for good reason unless (i) the executive has first provided the Company with written notice specifically identifying the acts or omissions constituting the grounds for good reason within thirty days after the executive has or should reasonably be expected to have had knowledge of the occurrence thereof, (ii) the Company has not cured such acts or omissions within thirty days of its actual receipt of such notice, and (iii) the effective date of the employee's termination for good reason occurs no later than ninety days after the initial existence of the facts or circumstances constituting good reason.

The term "change in control" generally means, unless otherwise provided in any employment agreement between the Company and the applicable employee, the occurrence of any one of the following events:

(i) any person (as such term is used in Section 13(d) of the Exchange Act) (other than a "permitted holder" (as defined in the Change in Control Severance Plan)), together with its affiliates (other than a permitted holder), is or becomes the beneficial owner, directly or indirectly, of more than 50% of the outstanding common stock or voting power of the Company by merger, consolidation, reorganization, or otherwise;

(ii) the sale of all or substantially all of the Company's assets, determined on a consolidated basis, to any person or group (as such term is used in Section 13(d) of the Exchange Act) of persons (other than any permitted holder or their affiliates); or

(iii) the Company combines with another company if, immediately after such combination, the shareholders of the Company immediately prior to the combination hold, directly or indirectly, less than 50% of the capital stock (of any class or classes) having general voting power under ordinary circumstances, in the absence of contingencies, to elect the directors of the Company of the combined entity; provided, however, that for purposes of this definition, no group will be deemed to have been formed solely by virtue of the execution and delivery of the Restructuring Support Agreement and the Investor Rights Agreement (each as defined in the Change in Control Severance Plan). In addition, the Board of Directors may specifically provide that an event or transaction that would not otherwise qualify as a Change in Control be treated as a Change in Control for purposes of the Plan.

Equity Award Provisions

According to the terms of our MIP, if a named executive officer's employment is terminated due to their death or disability or for any other reason except by us for "cause" (as defined below), the unvested portion of their equity awards will expire on the date they are terminated. The vested portion of stock option awards will remain exercisable until the earlier of either the expiration of the option period or 12 months after such termination in the case of termination due to death or disability, 30 days in the case of a voluntary resignation, or 90 days (180 days for Ms. Zecher) after any other termination other than termination by us for cause.

If we terminate any named executive officer's employment for cause, both the unvested equity awards and vested portions of the stock options will terminate on the same date their employment is terminated.

Upon a change in control (as defined as in the Change in Control Severance Plan, except that the Board of Directors does not have an explicit right to provide that an event or transaction that would not otherwise qualify as a change in control be treated as a change in control for purposes of the MIP), and unless otherwise determined by the Compensation Committee and specified in the applicable award notice, all

stock options outstanding under the MIP will vest and become exercisable with respect to 100% of the shares of our common stock covered by such stock option.

As a condition to the receipt of a stock option grant, the executive signs a restrictive covenant agreement, which restricts competition and solicitation during employment and for one year thereafter, as well as customary confidentiality and non-disparagement provisions.

For purposes of the MIP, the term “cause” generally means, unless an award notice under the MIP states otherwise, (i) commission or guilty plea or plea of no contest to a felony (or its equivalent under applicable law) or any crime that involves moral turpitude, (ii) conduct that constitutes fraud or embezzlement or any acts of dishonesty in relation to his or her duties with the Company or our affiliates, (iii) engaging in gross negligence, bad faith, or intentional misconduct which causes either reputational or economic harm to the Company or our affiliates, (iv) continued refusal to substantially perform his or her essential duties with respect to the Company or our affiliates, which refusal is not remedied within ten days after written notice from the Board of Directors, or (v) breach of obligations under any service contract with the Company or our affiliates or any written Company employment policy, including any code of conduct, which is not cured, if curable, within ten days after Company notification of such breach.

Employment Agreement for Linda Zecher
If Ms. Zecher’s employment is terminated by us without “cause” (as defined above in the MIP) or by her for “good reason” (as defined below), subject to her execution of a release of claims, she will be entitled to (i) severance payment over twelve months equal to two times base salary; (ii) twelve months of COBRA payments; and (iii) a pro rata bonus for the year in which her employment terminates, based on the actual performance results for the year of termination and payable at such time as bonuses are generally paid.

For purposes of Ms. Zecher’s employment agreement, “good reason” includes a resignation by her during the 30-day period commencing six months after either (i) a “change in control” (as defined in the MIP as described above), or (ii) the date that a majority (but not less than five) members of the Board of Directors is replaced during any twelve-month period by directors whose appointment or election is not endorsed by a majority of the members of the Board of Directors before the date of the appointment or election.

As noted above, the provisions of Ms. Zecher’s employment agreement that relate to equity grants are no longer effective following our emergence from bankruptcy. If Ms. Zecher becomes eligible for payments under both the Change in Control Severance Plan and her employment agreement, she would be entitled to the cash payments as dictated by the Severance Plan and any benefits continuation provided by her employment agreement.

Employment Agreement for Eric Shuman
If Mr. Shuman’s employment is terminated by us without cause prior to a change in control, we will provide him with severance consideration equal to continued salary for twelve months.

Employment Agreement for John Dragoon
If Mr. Dragoon’s employment is terminated by us without “cause” (as that term is commonly understood in connection with executive actions or inactions) prior to a change of control, he will be entitled to receive, subject to his execution of a release of claims in favor of the Company, (i) severance payments equal to one year’s base salary, (ii) six months of COBRA payments if he elects COBRA; and (iii) a pro rata bonus for the year in which his employment terminates, based on the actual performance results for the year of termination, payable at such time as executive bonuses are generally paid.

Separation Agreement for Bethlam Forsa
Ms. Forsa separated from the Company, effective January 3, 2013. We entered into a separation agreement with her dated January 10, 2013, providing for severance in the amount of $400,000, monthly COBRA costs totaling $21,984.60, each payable over a twelve-month period, and her 2012 bonus equal to $400,000, paid on the first payroll date following her execution and non-revocation of the separation

agreement. As a condition to the receipt of any severance payments, Ms. Forsa executed a release of claims against the Company. Additionally, she continues to be subject to the restrictive covenant agreement of her employment agreement and confidentiality and intellectual property agreement, which subjects her to a noncompete for one year following termination, as well as non-disparagement, confidentiality, and intellectual property provisions.

Employment Agreement for William Bayers
If Mr. Bayers' employment is terminated by us for any reason other than for cause prior to a change in control, we will provide him with a severance payment equal to one year of continued base salary upon his execution of a separation and release agreement.

Termination Payments

The following table sets forth the payments each of our named executive officers would have received if their employment had been terminated by us without cause or by the executive for good reason on December 31, 2012 and there was no change of control.

		Amount Payable		
Name	**Benefit**	**Death, Disability, Voluntary Resignation, Termination for Cause ($)**	**Termination By Us Without Cause ($)**	**Resignation for Good Reason ($)**
Linda Zecher (1)	Cash Severance	—	2,400,000	—
	COBRA Payments	—	17,433	—
Eric Shuman (2)	Cash Severance	—	500,000	—
John Dragoon (3)	Cash Severance	—	525,000	—
	COBRA Payments	—	4,182	—
Bethlam Forsa (4)	Cash Severance	—	400,000	400,000
	COBRA Payments	—	21,985	21,985
William Bayers (5)	Cash Severance	—	400,000	—

(1) Upon a termination by us without cause or a resignation for good reason, Ms. Zecher would be entitled to two times base salary, a prorated bonus (which for this purpose is assumed to be the actual bonus payable for fiscal year 2012), and 12 months of COBRA payments.

(2) Upon a termination by us without cause, Mr. Shuman would be entitled to continued base salary for twelve months.

(3) Upon a termination by us without cause, Mr. Dragoon would be entitled to base salary, a prorated bonus (which for this purpose is assumed to be the actual bonus payable for fiscal year 2012), and six months of COBRA payments.

(4) Represent the amounts Ms. Forsa would have received under her employment agreement if her employment had been terminated on December 31, 2012 and does not reflect additional amounts

provided by her separation agreement.

(5) Upon a termination by us without cause, Mr. Bayers would be entitled to continued base salary for twelve months

Change of Control Termination

The following table sets forth the payments each of our named executive officers would have received if a change of control occurred, and, following a change of control, their employment had been terminated by us without cause or by the named executive officer for good reason, in each case on December 31, 2012. Although outstanding unvested stock options would become vested in connection with a change of control, the value of such acceleration is deemed to be $0 as of December 31, 2012 because as of such date the fair market value of the common stock did not exceed the exercise price of the stock options.

		Amounts Payable Upon a Change in Control ($)		
Name	**Benefit**	**Termination Without Cause**	**Resignation for Good Reason**	**Death, Disability, Termination for Cause**
Linda Zecher (1)	Cash Severance	4,275,000	4,275,000	—
	COBRA Payments	—	17,433	—
	Option Acceleration Value	—	—	—
Eric Shuman (1)	Cash Severance	2,480,000	2,480,000	—
	Option Acceleration Value	—	—	—
John Dragoon (2)	Cash Severance	1,462,500	1,462,500	—
	Option Acceleration Value	—	—	—
Bethlam Forsa (3)	Cash Severance	400,000	400,000	—
	Option Acceleration Value	—	—	—
William Bayers (2)	Cash Severance	1,600,000	1,600,000	—
	Option Acceleration Value	—	—	—

(1) Ms. Zecher's and Mr. Shuman's cash severance amounts upon a termination without cause or resignation for good reason consist of two times the sum of base salary and target bonus plus a prorated bonus for the year of termination (which for this purpose is assumed to be the actual bonus payable for fiscal year 2012). Under certain circumstances, if Ms. Zecher resigns for good reason, pursuant to her employment agreement, she would be entitled to benefits continuation.

(2) Mr. Dragoon's and Mr. Bayers' cash severance amounts upon a termination without cause or resignation for good reason consist of two times base salary plus target bonus and a prorated bonus for the year of termination (which for this purpose is assumed to be the actual bonus payable for fiscal year 2012).

(3) Represent the amounts Ms. Forsa would have received under her employment agreement if her employment had been terminated on December 31, 2012.

Board Compensation

The Nominating, Ethics and Governance committee of our Board of Directors is responsible for reviewing and recommending non-employee director compensation to the full board for its approval. We pay our non-employee directors a mix of cash and equity-based compensation. We do not provide any perquisites or retirement benefits to our non-employee directors. We do not provide any additional compensation to our employee directors.

The cash compensation paid to our non-employee directors consists of an annual retainer for board and committee service, plus an annual retainer for service as chair of certain committees with respect to the full board. Our non-employee directors (other than the Chairman of the Board) receive annual compensation of $165,000, of which $80,000 is payable in cash and $85,000 is payable in the form of restricted stock units (RSUs) described below. Our Chairman receives annual compensation of $250,000, of which $120,000 is payable in cash and $130,000 is payable in RSUs. The Company also reimburses all of its directors for expenses they incur in connection with attending Board meetings and committee meetings.

In addition, each non-employee director will earn a fee for service on a committee and service as a committee chairperson, as applicable. Each member of the Audit Committee (other than the Chairperson) receives an annual retainer of $10,000, and the Chairperson of the Audit Committee receives an annual retainer of $25,000. Each member of the Compensation Committee (other than the Chairperson) receives an annual retainer of $10,000, and the Chairperson of the Compensation Committee receives an annual retainer of $25,000. Each member of the Nominating, Ethics and Governance Committee (other than the Chairperson) receives an annual retainer of $5,000, and the Chairperson of the Nominating, Ethics and Governance Committee receives an annual retainer of $12,500. Cash compensation is payable quarterly. The schedule of retainers paid to our non-employee directors in effect as of December 31, 2012 is as follows:

Position	Annual Retainer for Membership	Additional Retainer for Chair role
Board of Directors	$165,000	$85,000
Audit Committee	$10,000	$15,000
Compensation Committee	$10,000	$15,000
Nominating, Ethics and Governance Committee	$5,000	$7,500

The grants of RSUs in fiscal 2012 were valued based on the $25 per share value established in our Plan of Reorganization in connection with our emergence from bankruptcy. All subsequent grants of restricted stock units will be granted at the fair market value of the common stock at the time of grant. The RSUs generally vest on the first anniversary of the date of grant, subject to continued service as a member of the Board.

Prior to June 22, 2012, The cash compensation paid to our non-employee directors consisted of an annual retainer for board and committee service. Our non-employee directors (other than the Chairman of the Board) receive annual cash compensation of $144,000. Our Chairman received annual cash compensation of $216,000. The Company also reimbursed all of its directors for expenses they incur in connection with attending Board meetings and committee meetings.

Director Compensation Table – Fiscal 2012

Name	Fees Earned or Paid in Cash ($)(1)	Stock Awards ($) (2)	Other ($) (3)	Total
Lawerence K. Fish	188,000	130,000	78,170	396,170
John F. Killian	139,500	85,000	-	224,500
Jill A. Greenthal	53,228	85,000	-	138,228
L. Gordan Crovitz	33,750	85,000	-	118,750
John R. McKernan, Jr.	103,630	85,000	-	188,630
E. Rogers Novak, Jr.	9,130	85,000	-	94,130
Sheru Chowdhry (4)	-	-	-	-
William Hagerty	79,500	-	-	79,500
Robert Schmitz	72,000	-	-	72,000
William Campbell	72,000	-	-	72,000
Todd Boehly (4)	-	-	-	-
Anthony Salcito (5)	-	-	-	-

(1) Represents the aggregate cash retainers for board and committee service.
(2) Represents the aggregate grant date fair value of stock options granted during the year in accordance with the FASB ASC Topic 718 (disregarding any forfeiture assumptions. See Note 12 to our consolidated financial statements for the assumptions made in determining these values. These values do not correspond to the actual value that may be realized by our non-employee directors for these awards. As of December 31, 2012, each of Messrs. Killian, Greenthal, Crovitz, McKernan and Novak held 3,400 RSUs, and Mr. Fish held 5,200 RSUs. No other non-employee directors held any stock awards.
(3) Represents portion of salary and benefits paid to Mr. Fish's executive assistant not attributed to services rendered to the Company
(4) Mr. Chowdhry and Mr. Boehly are not considered independent directors and did not receive any director compensation.
(5) Mr. Salcito resigned from the Board of Directors on February 3, 2012 and did not receive any director compensation in 2012.

Stock Plans

The board of directors of HMH Holdings administers the HMH Management Incentive Plan (the "Plan") pursuant to which the board, or a committee designated by the board may, from time to time, grant option and stock awards to employees and employees of our subsidiaries who, in the opinion of the board, are in a position to make a significant contribution to our success. The board of directors may grant options that vest over time or options that vest based on the attainment of performance goals specified by the board of directors. The stock related to award forfeitures remains outstanding and may be reallocated to new recipients.

Item 12. Security Ownership of Certain Beneficial Owner's and Management and Related Stockholders Matters

As of February 28, 2013, common stock was the only class of HMH Holdings' capital stock that was outstanding, and there were 69,958,989 shares of common stock outstanding as of that date. The table below sets forth certain information regarding the beneficial ownership of the outstanding shares of common stock of HMH Holdings as of February 28, 2013 by:

- each person who is known to be the beneficial owner of more than 5% of HMH Holdings' common stock;
- each member of HMH Holdings' board of directors and each of our executive officers individually; and
- all members of HMH Holdings' board of directors and executive officers as a group.

Beneficial ownership has been determined under rules promulgated by the SEC. The information does not necessarily indicate beneficial ownership for any other purpose. Shares of common stock subject to options currently exercisable and convertible securities currently convertible, or exercisable or convertible within 60 days after the dates of this report, are deemed outstanding for purposes of computing the percentage beneficially owned by the person or entity holding such securities but are not deemed outstanding for purposes of computing the percentage beneficially owned by any other person or entity.

Each individual or entity shown on the table has furnished information with respect to beneficial ownership. Except as otherwise indicated below, the address of each executive officer and director listed below is c/o HMH Holdings (Delaware), Inc., 222 Berkeley Street, Boston, Massachusetts 02116.

Name of beneficial owner	Shares of common stock beneficially owned	Percentage
Affiliates of Paulson & Co. Inc.[(1)]	18,183,856	26.0%
Affiliates of Anchorage Advisors L.L.C.[(2)]	6,833,320	9.8%
Affiliates of Blackrock Financial Management, Inc.[(3)]	6,161,679	8.8%
Affiliates of Avenue Investments L.P.[(4)]	6,053,596	8.7%
Affiliates of Q Investments L.P.[(5)]	5,253,801	7.5%
Affiliates of Oak Hill Advisors L.P.[(6)]	4,304,296	6.2%
Lehman Commercial Paper Inc.[(7)]	4,247,858	6.1%
Lawrence K. Fish	-	*
John R. McKernan, Jr.	-	*
L. Gordon Crovitz	-	*
Jill A. Greenthal	-	*
John F. Killian	-	*
Sheru Chowdry	-	*
E. Rogers Novak, Jr.	-	*

Linda K. Zecher[8]	460,526	*
Eric L. Shuman..........	-	*
John K. Dragoon..........	-	*
Bethlam Forsa..........	-	*
William F. Bayers..........	-	*
All Directors and Executive Officers as a group (16 persons)…..	460,526	*

* Less than 1%.

(1) The information with respect to the affiliates of Paulson & Co. Inc. includes the shares of common stock held by funds affiliated with Paulson & Co., Inc. including Paulson Advantage Master LTD which owns 5.6%, Paulson Advantage Plus Master LTD which owns 12.5%, and Paulson Credit Opportunities Master LTD which owns 7.7%. Address is 1251 Avenue of the Americas, New York, New York 10020.

(2) The information with respect to the affiliates of Anchorage Advisors L.L.C. includes the shares of common stock held by funds affiliated with Anchorage Advisors L.L.C. including Anchorage Capital Master Offshore LTD which owns 6.4%. Address is 610 Broadway, New York, New York 10012.

(3) The information with respect to the affiliates of Blackrock Financial Management, Inc. includes the shares of common stock held by funds affiliated with Blackrock Financial Management, Inc. including Blackrock Credit Investors Master Fund LP which owns 5.2%. Address is c/o Blackrock, Inc., 55 East 52nd St., New York, New York 10055.

(4) The information with respect to the affiliates of Avenue Investments L.P. includes the shares of common stock held by funds affiliated with Avenue Investments L.P. including Avenue Investments L.P. which owns 6.7%. Address is 399 Park Avenue, New York, New York 10022.

(5) The information with respect to the affiliates of Q Investments, L.P. includes the shares of common stock held by funds affiliated with Q Investments L.P. including R2 Top Hat LTD which owns 5.9%. Address is 301 Commerce Street, Fort Worth, Texas 76102.

(6) The information with respect to the affiliates of Oak Hill Advisors, L.P. includes the shares of common stock held by funds affiliated with Oak Hill Advisors L.P. Address is 1114 Avenue of the Americas, New York, New York 10036.

(7) The information with respect to Lehman Commercial Paper Inc. includes the shares of common stock held by Lehman Commercial Paper Inc. which owns 6.1%. Address is 1271 Avenue of the Americas, New York, New York 10020.

(8) Includes 460,526 shares issuable with respect to options exercisable within 60 days of February 28, 2013.

.

The following table provides information with respect to our equity compensation plans under which our equity securities were authorized for issuance as of December 31, 2012.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and restricted stock units	Weighted-average exercise price of outstanding options, warrants and restricted stock units	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	8,618,692	$25.00	3,252,654
Equity compensation plans not approved by security holders	-	-	-
Total			

Item 13. Certain Relationships and Related Transactions

Investor Rights Agreement

In connection with our restructuring, on June 22, 2012, we entered into an Investor Rights Agreement (the "Investor Rights Agreement") with our new shareholders. The Investor Rights Agreements contains, among others, provisions granting our shareholders party thereto from time to time certain registration rights as described in further detail below and provisions related to confidentiality, holdback agreements, our public reporting obligations and our obligation to register our common stock under the Exchange Act after October 1, 2013 in certain circumstances.

Registration Rights

The Investor Rights Agreement provides our shareholders party thereto from time to time with certain registration rights.

Any holder or holders who own at least 25% of our outstanding common stock may require us to consummate an underwritten initial public offering after April 1, 2013 pursuant to the exercise of demand registration rights on a secondary basis so long as the total proposed offering size is at least $150 million (an "IPO Demand Right"). If an IPO Demand Right is exercised and the initial public offering price equates to a total equity value of our Company of not less than $1.5 billion, the holders exercising the IPO Demand Right may also, at their option, require all other stockholders to sell in such initial public offering their pro rata share of the common stock being sold, not to exceed 15% of the shares held by such holder (an "IPO Drag Right").

Any time after we become an Exchange Act public reporting company, we are required to use commercially reasonable efforts to file and cause to become effective a shelf registration statement (on Form S-3 if permitted) for the benefit of all holders party to the Investor Rights Agreement, and any individual holder of 15% or more of our outstanding common stock can demand an unlimited number of "shelf takedowns" so long as the total offering size exceeds $100 million.

Each holder or holders who own at least 15% of our outstanding common stock will have, after our initial public offering (i) one Form S-1 demand registration right per annum, which may be conducted in an underwritten offering as long as the total offering price is at least $100 million; and (ii) unlimited Form S-3 registration rights, which may be conducted in underwritten offerings as long as the total offering price is at least $100 million, each subject to customary cutback provisions.

Each holder party to the Investor Rights Agreement has unlimited piggyback registration rights with respect to underwritten offerings, subject to certain exceptions and limitations.

The foregoing registration rights are subject to certain cutback provisions and customary suspension/blackout provisions. We have agreed to pay all registration expenses under the Investor Rights Agreement, and, in limited circumstances, the underwriting fees and commissions for certain holders.

Indebtedness

Affiliates of certain of our stockholders, including the stockholders holding 5% or more of HMH Holdings' common stock listed in "Security ownership of certain beneficial owners and management," also currently own a portion of our indebtedness, including indebtedness outstanding under our Term Loan.

Debt-for-Equity Exchange

Upon the Company's emergence from Chapter 11 bankruptcy proceedings, holders of the Term Loan, Revolving Loan, and 10.5% Senior Notes were issued post-emergence shares of new common stock pursuant to the final Plan on a pro rata basis. Certain of these holders of the Term Loan, Revolving Loan, and 10.5% Senior Notes were also equity holders prior to the consummation of the Plan. The amount of

the gain attributable to the debt to equity conversion, net of elimination of fees and other charges, of $1,010.3 million, which is associated to the holders of the Term Loan, Revolving Loan, and 10.5% Senior Notes that were also equity holders prior to the consummation of the Plan, was charged to capital in excess of par value.

Item 14. Principal Accountant's Fees and Services

The table below provides a summary of the fees paid by us to our auditors, PricewaterhouseCoopers LLP, for the following periods:

	Years Ended December 31,	
	2012	2011
Audit fees	$ 1,857,139	$ 2,034,749
Audit-related fees	6,592	214,000
Tax fees	27,867	94,663
All other fees	1,800	-
Total	$ 1,893,398	$ 2,343,412

Audit fees consist of fees for professional services necessary to perform an audit of the financial statements, review of the quarterly and annual reports and statutory audits and other services required to be performed by our independent auditors.

Audit-related fees consist of fees for services that are reasonably related to the performance of the audit or review of our financial statements including the support of business acquisition and divestiture activities.

Tax fees consist of fees for professional services rendered for assistance with federal, state, local and international tax compliance, tax planning, and tax advice.

All other fees include licenses to technical accounting research software.

The Audit Committee approves in advance all audit and non-audit services to be provided by the independent auditors. Under the Audit Committee's pre-approval policy for 2012, the Chairman of the Audit Committee has the delegated authority from the Committee to pre-approve services with fees up to $200,000. Any such pre-approvals are to be reviewed and ratified by the Audit Committee at its next meeting. The Audit Committee requires the independent auditors and management to report on actual fees charged for each category of service periodically throughout the year.

Item 15. Exhibits, Financial Statement Schedules

Financial Statements – the response to this portion is set forth in Financial Statements and Supplementary Data.

Financial Statement Schedules – the response to this portion is set forth in Financial Statements and Supplementary Data. All other financial statement schedules are not required under the related instructions or are inapplicable and therefore have been omitted.

Exhibits – see below.

Exhibit No.	Title
2.1	Prepackaged Joint Plan of Reorganization of the Debtors Under Chapter 11 of the Bankruptcy Code 5.11.2012
3.1	Restated Certificate of Incorporation 6.21.2012
3.2	Amended and Restated By-laws 6.22.2012
4.1	Superpriority Senior Secured Debtor-in-Possession and Exit Term Loan Credit Agreement 5.22.2012
4.2	First Amendment to DIP/Exit Term Loan Credit Agreement 6.11.2012
4.3	Letter Waiver and Amendment No. 2 to Credit Agreement 6.20.2012
4.4	Term Facility Guarantee and Collateral Agreement 5.22.2012
4.5	Superpriority Senior Secured Debtor-in-Possession and Exit Revolving Loan Credit Agreement 5.22.2012
4.6	First Amendment to DIP/Exit Revolving Loan Credit Agreement 6.20.2012
4.7	Second Amendment to DIP/Exit Revolving Loan Credit Agreement 6.20.2012
4.8	Revolving Facility Guarantee and Collateral Agreement 5.22.2012
4.9	Term Loan/Revolving Facility Lien Subordination and Intercreditor Agreement 5.22.2012
4.10	Investor Rights Agreement 6.22.2012
4.11	Director Nomination Agreement 6.22.2012
10.1	2012 Management Incentive Plan
10.2	2012 Management Incentive Plan Form of Award Notice
10.3	2012 Change in Control Severance Plan
10.4	2012 Management Incentive Plan Restricted Stock Unit Award Notice
14.1	Code of Conduct
21.1	List of Subsidiaries

Schedule II
Valuation and Qualifying Accounts

2012	Balance at Beginning of Year	Net Charges to Expenses	Utilization of Allowances	Balance at End of Year
Allowance for doubtful accounts	$ 18,229	$ 2,113	$ (9,799)	$ 10,543
Reserve for returns	25,614	44,213	(44,043)	25,784
Reserve for royalty advances	12,262	8,770	(594)	20,438
Deferred tax valuation allowance	822,485	-	(310,251)	512,234
2011				
Allowance for doubtful accounts	$ 10,249	$ 8,910	$ (930)	$ 18,229
Reserve for returns	20,130	49,388	(43,904)	25,614
Reserve for royalty advances	3,700	8,802	(240)	12,262
Deferred tax valuation allowance	434,471	388,014	-	822,485
For the period March 10, 2010 to December 31, 2010				
Allowance for doubtful accounts	$ 5,527	$ 5,238	$ (516)	$ 10,249
Reserve for returns	21,395	38,751	(40,016)	20,130
Reserve for royalty advances	-	6,240	(2,540)	3,700
Deferred tax valuation allowance	246,134	188,337	-	434,471
For the period January 1, 2010 to March 9, 2010				
Allowance for doubtful accounts	$ 7,834	$ 437	$ (2,744)	$ 5,527
Reserve for returns	27,856	1,954	(8,415)	21,395
Reserve for royalty advances	109,541	740	(37)	110,244
Deferred tax valuation allowance	910,096	129,687	-	1,039,783

2012

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