Court File No. CV-15-10961-00CL

Nelson Education Ltd.
Nelson Education Holdings Ltd.

FIRST REPORT OF THE MONITOR

June 4, 2015

Court File No. CV-15-10961-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NELSON EDUCATION LTD. AND NELSON EDUCATION HOLDINGS LTD.

FIRST REPORT TO THE COURT
SUBMITTED BY FTI CONSULTING CANADA INC.,
IN ITS CAPACITY AS MONITOR

INTRODUCTION

1. On May 12, 2015, Nelson Education Ltd. and Nelson Education Holdings Ltd. (together, "**Nelson**") made an application (the "**Initial Application**") under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**") and an initial order (the "**Initial Order**") was made by the Honourable Mr. Justice Newbould of the Ontario Superior Court of Justice (Commercial List) (the "**Court**"), granting, *inter alia*, a stay of proceedings against Nelson until June 10, 2015, (the "**Stay Period**") and appointing Alvarez & Marsal Canada Inc. ("**A&M**") as monitor of Nelson (the "**Monitor**"). The proceedings commenced by Nelson under the CCAA will be referred to herein as the "**CCAA Proceedings**".

2. At the Initial Application, Royal Bank of Canada as Administrative Agent and Collateral Agent (the "**Second Lien Agent**") pursuant to a Second Lien Credit Agreement dated as of July 5, 2007 (the "**Second Lien Credit Agreement**") took the position that it had not had sufficient time to consider or prepare a response to the Initial Application. The Initial Order provided for a "comeback date" of May 29, 2015 (the "**Comeback Date**") and that on the Comeback Date any hearing was to be a true comeback hearing and that in moving to set aside or vary any provisions of the Initial Order, a moving party did not have to overcome any onus of demonstrating that the Initial Order be set aside or varied.

3. On the Comeback Date, the Second Lien Agent sought the appointment of FTI Consulting Canada Inc. ("**FTI**") in place of A&M. Pursuant to the Order of the Honourable Mr. Justice Newbould, FTI was appointed as Monitor.

4. A&M filed a pre-filing report dated May 11, 2015 (the "**Pre-Filing Report**") and a supplement to the Pre-Filing Report dated May 26, 2015. This is the first report of FTI in its capacity as Monitor (the "**First Report**"). The purpose of this, the Monitor's First Report is to inform the Court on the following:

   (a) The prior engagements of FTI Consulting, Inc. ("**FTI US**"), the ultimate parent of FTI, with respect to Nelson and Cengage Learning, Inc. ("**Cengage**");

   (b) The activities of the Monitor since the Comeback Date;

   (c) The receipts and disbursements of Nelson for the period May 9 to May 29, 2015;

   (d) Nelson's revised and extended cash flow forecast for the period May 30 to July 17, 2015 (the "**June 3 Forecast**"); and

(e) Nelson’s request for an Order in the form attached at Tab 2 of Nelson’s Notice of Motion dated June 3, 2015 (the “**June 3 Motion**”) amending and restating the Initial Order (the “**Amended and Restated Initial Order**”), and *inter alia*:

(i) Creating a charge securing any obligations of Nelson to Royal Bank of Canada, in its capacity as provider of the Cash Management System (“**RBC**”) that may arise in connection with RBC’s provision of the Cash Management System (the “**Cash Management Charge**”);

(ii) Prohibiting, from and after June 2, 2015, without further order of the Court, payments (including but not limited to interest and professional fees and expenses) to the First Lien Agent, the First Lien Lenders, the Second Lien Agent or the Second Lien Lenders;

(iii) Providing for the publication of notice of the CCAA Proceedings;

(iv) Creating a charge in the amount of $750,000 securing the fees and expenses of counsel to Nelson, Nelson’s financial advisor, the Monitor and the Monitor’s counsel (the “**Administration Charge**”);

(v) Extending the Stay Period to July 17, 2015;

and the Monitor’s recommendations with respect to the foregoing.

TERMS OF REFERENCE

5. In preparing this report, the Monitor has relied upon unaudited financial information of Nelson, Nelson's books and records, certain financial information prepared by Nelson and discussions with various parties (the "**Information**").

6. Except as described in this Report:

   (a) The Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would comply with Generally Accepted Assurance Standards pursuant to the Chartered Professional Accountants of Canada Handbook;

   (b) The Monitor has not examined or reviewed financial forecasts and projections referred to in this report in a manner that would comply with the procedures described in the Chartered Professional Accountants of Canada Handbook;

7. Future oriented financial information reported or relied on in preparing this report is based on management's assumptions regarding future events; actual results may vary from forecast and such variations may be material.

8. The Monitor has prepared this Report in connection with the June 3 Motion. The Report should not be relied on for other purposes.

9. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars. Capitalized terms not otherwise defined herein have the meanings defined in the Initial Order or the affidavit of Greg Nordal sworn May 11, 2015 filed in support of the Initial Application.

ENGAGEMENTS OF FTI US

10. Prior to executing its consent to act dated May 28, 2015, FTI undertook its normal conflict check procedures and satisfied itself that it had no conflict in accepting the appointment as Monitor. However, in the interests of full disclosure, the Monitor advises the Court of the following engagements of FTI US:

    (a) Pursuant to an engagement letter dated October 23, 2014, between FTI US and Nelson Education Ltd., FTI US was engaged to review Nelson's business to identify potential opportunities to enhance the financial and operational performance of the business. The Monitor understands that FTI US completed its mandate in January 2015. There are no amounts owing by Nelson to FTI US in respect of that mandate; and

    (b) FTI US served as an advisor to the Official Committee of Unsecured Creditors of Cengage (the "**Cengage UCC**") in the Chapter 11 proceedings of Cengage which commenced in July 2013 and from which Cengage emerged in March 2014. Pursuant to Cengage's restructuring plan, the Cengage UCC continued to have certain specific duties after the confirmation of the plan, primarily with respect to the settlement of unresolved claims against Cengage. The Monitor understands that Nelson's claim in the Cengage Chapter 11 proceedings was resolved prior to the confirmation of the restructuring plan and that the amount of work undertaken by FTI US since the plan confirmation has been *de minimis*.

11. The Monitor is of the view that none of the above mentioned engagements create a conflict for the Monitor nor do they create an appearance of potential conflict.

EXECUTIVE SUMMARY

12. The Monitor is of the view that the relief requested by Nelson is necessary, reasonable and justified. Accordingly, the Monitor respectfully recommends that Nelson's request for the Amended and Restated Initial Order be granted by this honourable Court.

ACTIVITIES OF THE MONITOR

13. Following its appointment, the Monitor has met and had discussions with the following parties to discuss the CCAA Proceedings and matters related to the proposed transaction for the sale of the business:

    (a) Nelson's Chief Executive Officer, Chief Financial Officer and Finance Controller;

    (b) A&M;

    (c) Nelson's counsel;

    (d) Representatives of the First Lien Lenders and their counsel; and

    (e) The Second Lien Agent and its counsel.

14. To date, all parties have provided the Monitor with their full co-operation and Nelson has provided unrestricted access to its premises, books and records. The Monitor has also implemented procedures for the monitoring of operations, receipts and disbursements of Nelson.

15. The Monitor has established a website at http://cfcanada.fticonsulting.com/nelsoneducationltd (the "**Monitor's Website**") on which updates on the CCAA Proceedings will be posted periodically, together with all Court materials filed in the CCAA Proceedings. The Monitor has obtained from A&M the materials which were previously posted to their website and has posted them to the Monitor's Website so that a full record is maintained.

16. In addition, the Monitor has established a contact number (416-649-8083) and an email address (nelsoneducationltd@fticonsulting.com) to allow stakeholders and other interested parties to communicate directly with the Monitor in order to address any questions or concerns in respect of the CCAA Proceedings.

RECEIPTS & DISBURSEMENTS FOR THE PERIOD TO MAY 29, 2015

17. Nelson's actual cash flow on a consolidated basis for the period from May 9 to May 29, 2015, was approximately $2.9 million better than the forecast filed in connection with the Initial Application (the "**May 11 Forecast**"), as summarized below:

	Forecast $000	Actual $000	Variance $000
Receipts:			
Sales Receipts	2,571	4,461	1,890
Other Receipts	150	107	(43)
Total Receipts	**2,721**	**4,568**	**1,847**
Disbursements:			
Operating Expenses	1,235	693	542
Payroll & Benefits	2,813	2,558	255
KERP	0	0	0
Other Expenses	951	777	174
Capex and Plate	760	445	315
Professional Fees	630	833	(203)
Financing Charges	820	810	10
Total Disbursements	**7,209**	**6,116**	**1,093**
Net Operating Cash Flow	**(4,488)**	**(1,548)**	**2,940**
Beginning Cash Balance	**21,200**	**21,378**	178
Net Operating Cash Flow	(4,488)	(1,548)	2,940
Ending Cash Balance	**16,712**	**19,830**	**3,118**

18. Explanations for the key variances in actual receipts and disbursements as compared to the May 11 Forecast are as follows:

(a) The favourable variance of approximately $1.8 million in sales receipts is believed to be a timing variance as a result of collections being received earlier than forecast and is expected to reverse in future weeks;

(b) The favourable variance of approximately $542,000 in operating expenses is primarily attributable to a lower spend on paper, print and binding than forecast. Approximately $282,000 of the variance is believed to be permanent in nature and the balance is believed to be a timing variance that is expected to reverse in future periods;

(c) The favourable variance of approximately $255,000 in payroll and benefits is believed to be a permanent variance arising primarily as a result of contingencies in the forecast that were not required;

(d) The favourable variance of approximately $174,000 in other expenses is believed to be a timing variance that is expected to reverse in future periods;

(e) The favourable variance of approximately $315,000 in capital expenditure and plate is believed to be a timing variance that is expected to reverse in future periods;

(f) The May 11 Forecast included estimated total payments of professional fees in the period ended May 29, 2015 of approximately $630,000, comprised of $100,000 for Nelson’s advisors, $350,000 for the Monitor and its counsel and $180,000 for the First Lien Lenders’ advisors. Actual payments totalled approximately $833,000, comprised of approximately $87,000 for Nelson’s advisors and approximately $746,000 for the First Lien Lenders’ advisors (each in respect of amounts incurred prior to the commencement of the CCAA Proceedings), giving rise to an overall unfavourable variance of approximately $203,000; and

(g) The favourable variance of approximately $178,000 in beginning cash balance resulted from the use of an estimate in the May 11 Forecast.

THE JUNE 3 FORECAST

19. The June 3 Forecast covers the period of the proposed extension to the Stay Period and is attached hereto as Appendix A. The June 3 Forecast shows a net cash outflow of approximately $7.7 million in the period May 30 to July 17, 2015, and is summarized below:

	$000
Receipts:	
Sales Receipts	9,586
Other Receipts	619
Total Receipts	**10,205**
Disbursements:	
Operating Expenses	5,010
Payroll & Benefits	7,065
KERP	340
Other Expenses	2,473
Capex and Plate	1,157
Professional Fees	1,845
Financing Charges	0
Total Disbursements	**17,890**
Net Operating Cash Flow	**(7,685)**
Beginning Cash Balance	19,830
Net Operating Cash Flow	(7,685)
Ending Cash Balance	**12,145**

20. The only significant change in the underlying assumptions in the June 3 Forecast as compared to the May 11 Forecast is the exclusion of payments on account of interest, costs and expenses of the First Lien Agent and the First Lien Lenders in accordance with the proposed Amended and Restated Initial Order.

THE CASH MANAGEMENT CHARGE

21. Nelson seeks the creation of the Cash Management Charge to secure any obligations that may arise in connection with the Cash Management System. Such obligation would typically be "chargebacks or similar liabilities that could arise for deposits that are not honoured by a counter-party's bank. The Monitor understands that under applicable arrangements, chargebacks could arise for a period of 30 days after a deposit from a Canadian institution and for a period of 90 days for non-Canadian institutions.

22. The proposed quantum of the Cash Management Charge has not yet been determined. Accordingly the Monitor is unable to comment on the proposed quantum of the Cash Management Charge in this Report.

23. The Monitor is of the view that in the circumstances of these CCAA Proceedings, the granting of the Cash Management Charge is appropriate. To the extent necessary and appropriate, the Monitor will provide its comments on the reasonableness of the proposed quantum of the Cash Management Charge once the proposed quantum has been determined.

PAYMENTS TO FIRST LIEN LENDERS AND SECOND LIEN LENDERS

24. Paragraph 47 of the Endorsement of the Honourable Mr. Justice Newbould dated June 2, 2015 states:

> "[47] In my view, on the basis of the evidence, there is no justification to pay all of the interest, costs and expenses of the first lien lenders but not pay the same to the second lien lenders. In the circumstances, it is only fair that pending further order, Nelson be prevented from paying any interest or other expenses to the first lien lenders unless the same payments owing to the second lien lenders are made, and it is so ordered."

25. Nelson proposes that the Amended and Restated Initial Order prohibit any payment to the First Lien Agent, the First Lien Lenders, the Second Lien Agent or the Second Lien Lenders without further Order of the Court, which is consistent with paragraph 47 of the Endorsement.

26. The Monitor supports the approach of making no payments to the First Lien Agent, the First Lien Lenders, the Second Lien Agent or the Second Lien Lenders without further Order of the Court and respectfully recommends that Nelson's request prohibiting such payments be granted.

NOTICE OF THE CCAA PROCEEDINGS

27. The Initial Order provided that notice of the CCAA Proceedings would not be sent to creditors, notice would not be published in any newspaper and no list of creditors would be published.

28. The proposed Amended and Restated Initial Order attached to the June 3 Motion continued to provide that no specific notice would be sent to creditors, no list of creditors would be published and notice of the CCAA Proceedings would not be published in any newspaper. The Monitor understands that Nelson now intends that the Amended and Restated Initial Order will provide for notice of the CCAA Proceedings to be published in The Globe and Mail.

29. Section 23(1)(a) of the CCAA states that the Monitor shall:

> "except as otherwise ordered by the court, when an order is made on the initial application in respect of a debtor company, (i) publish, without delay after the order is made, once a week for two consecutive weeks, or as otherwise directed by the court, in one or more newspapers in Canada specified by the court, a notice containing the prescribed information, and (ii) within five days after the day on which the order is made, (A) make the order publicly available in the prescribed manner, (B) send, in the prescribed manner, a notice to every known creditor who has a claim against the company of more than $1,000 advising them that the order is publicly available, and (C) prepare a list, showing the names and addresses of those creditors and the estimated amounts of those claims, and make it publicly available in the prescribed manner;"

30. The Monitor understands that Nelson is of the view that no creditor would be prejudiced by there being no notice of the CCAA Proceedings as no creditors, other than the First Lien Lenders and the Second Lien Lenders, are currently being affected by the CCAA Proceedings as all creditors are being paid in the normal course. The Monitor further understands that Nelson is of the view that providing notice to creditors that are unaffected by the CCAA Proceedings could have potentially detrimental impacts on the business.

31. The Monitor is of the view that, as a general principle, notice should be given of a CCAA proceeding so that creditors can make informed decisions with respect to their ongoing dealings with the debtor company. The Monitor does recognize the concerns of Nelson regarding the potential detrimental impacts on the business and is of the view that, in the specific circumstances of this case, publishing notice of the CCAA Proceedings in The Globe and Mail would provide a reasonable balance at this time between the concerns of Nelson and the rights of creditors, provided that specific notice of the CCAA Proceedings is also given at the appropriate time to any creditor that is or will become affected by the CCAA Proceedings. The Monitor understands that Nelson supports the provision of such specific notice. The Monitor may also suggest additional noticing in the event that future circumstances merit such additional notice.

THE ADMINISTRATION CHARGE

32. Nelson is seeking the creation of the Administration Charge in the amount of $750,000 with priority over the claims of the First Lien Agent, the First Lien Lenders, the Second Lien Agent or the Second Lien Lenders but not over the claims of any other person that is a “secured creditor” as defined in the CCAA.

33. The beneficiaries of the Administration Charge, if granted, would be counsel to Nelson, Nelson's financial advisor, the Monitor and the Monitor's counsel. The Monitor believes that it is appropriate that the proposed beneficiaries of the Administration Charge be afforded the benefit of a charge as they will be undertaking a necessary and integral role in the CCAA Proceedings.

34. The Monitor has considered the complexities of the CCAA Proceedings and the services to be provided by the beneficiaries of the Administration Charge and believes that a limit of $750,000 is reasonable in the circumstances.

35. Accordingly, the Monitor respectfully recommends that Nelson's request for the creation of the Administration Charge be granted.

EXTENSION OF THE STAY PERIOD

36. The Stay Period currently expires on June 10, 2015. Additional time is required for Nelson to complete a sale or restructuring. The continuation of the stay of proceedings is necessary to provide the stability needed during that time. Accordingly, Nelson now seeks an extension of the Stay Period to July 17, 2015.

37. The June 3 Forecast demonstrates that, subject to the underlying assumptions thereof, Nelson has sufficient liquidity to fund the CCAA Proceedings to July 17 2015.

38. Based on the information currently available, the Monitor believes that creditors would not be materially prejudiced by an extension of the Stay Period to July 17, 2015.

39. The Monitor also believes that Nelson has acted, and is acting, in good faith and with due diligence and that circumstances exist that make an extension of the Stay Period appropriate.

40. The Monitor therefore respectfully recommends that this Honourable Court grant Nelson's request for an extension of the Stay period to July 17, 2015.

The Monitor respectfully submits to the Court this, its First Report.

Dated this 4th day of June, 2015.

FTI Consulting Canada Inc.
In its capacity as Monitor of
Nelson Education Ltd. and Nelson Education Holdings Ltd.

Nigel D. Meakin	Toni Vanderlaan
Senior Managing Director	Senior Managing Director

Appendix A

The June 3 Forecast

Nelson

Cash flow forecast for the 13-week period May 30, 2015 to July 17, 2015
(Unaudited, in '000s CAD)

Week Ending, Friday:	Week 4 6/5/2015 Forecast	Week 5 6/12/2015 Forecast	Week 6 6/19/2015 Forecast	Week 7 6/26/2015 Forecast	Week 8 7/3/2015 Forecast	Week 9 7/10/2015 Forecast	Week 10 7/17/2015 Forecast	Total
Receipts								
Sales receipts	981	791	837	1,178	1,779	1,540	2,481	9,586
Other receipts	-	-	-	129	-	340	150	619
Total Receipts	**981**	**791**	**837**	**1,307**	**1,779**	**1,880**	**2,631**	**10,205**
Disbursements								
Operating expenses	147	228	758	234	256	986	2,401	5,010
Payroll & benefits	5	1,421	5	4,204	5	1,420	5	7,065
KERP	-	-	-	-	-	340	-	340
Other expenses	607	159	393	363	515	184	251	2,473
Capital expenditures and plate spend	207	106	78	346	233	73	113	1,157
Professional fees	190	685	300	225	165	140	140	1,845
Financing charges	-	-	-	-	-	-	-	-
Total Disbursements	**1,156**	**2,600**	**1,534**	**5,372**	**1,175**	**3,144**	**2,910**	**17,890**
Net Operating Cash Flow	**(174)**	**(1,809)**	**(698)**	**(4,065)**	**604**	**(1,264)**	**(280)**	**(7,685)**
Beginning Cash Balance	19,830	19,657	17,848	17,150	13,085	13,689	12,425	19,830
Net Cash Flow	(174)	(1,809)	(698)	(4,065)	604	(1,264)	(280)	(7,685)
Ending Cash Balance	**19,656**	**17,848**	**17,150**	**13,085**	**13,689**	**12,425**	**12,146**	**12,145**

To be read in conjunction with the attached Notes and Summary of Assumptions.

Nelson
Cash Flow Forecast
Notes and Summary of Assumptions

In the Matter of the CCAA Proceedings of Nelson Education Ltd. and Nelson Education Holdings Ltd., (together "Nelson").

Disclaimer

In preparing this cash flow forecast (the “Forecast”), the Company has relied upon unaudited financial information and has not attempted to further verify the accuracy or completeness of such information. The Forecast includes assumptions discussed below with respect to the requirements and impact of a filing under the Companies’ Creditors Arrangement Act (“CCAA”). Since the Forecast is based on assumptions about future events and conditions that are not ascertainable, the actual results achieved during the Forecast period will vary from the Forecast, even if the assumptions materialize, and such variations may be material. There is no representation, warranty or other assurance that any of the estimates, forecasts or projections will be realized.

Overview:

The Forecast assumes disbursements are made in accordance with the normal payment terms for the Companies’ creditors and consistent with the Companies’ historical practice. The Company, with assistance from its Financial Advisor, has prepared the Forecast based primarily on historical results and Management’s current expectations. The Forecast is presented in thousands of Canadian dollars.

Assumptions

1) **Opening Position**

The opening cash balance as at May 30, 2015.

2) **Receipts**

Receipts from sales are estimated based on current accounts receivable collections and Management's current sales forecast for both the Higher Education ("HE") and Kindergarten to Grade 12 ("K-12") businesses. Sales taxes are included in forecast receipts. Other receipts include monthly reimbursements from Cengage Learning USA ("Cengage") for certain expenses Nelson incurs on Cengage's behalf.

3) **Operating Expenses**

Operating expenses include Paper, Print, and Binding ("PP&B") costs which are forecast based on current accounts payable and Management's current cost of sales forecast for both the HE and K-12 businesses.

Operating expenses also include royalty payments to authors for Indigenous content originally created/published by Nelson and royalty payments to Cengage or other affiliated companies in the U.S. for agency products (i.e. products originally created/published by third parties).

4) **Payroll & benefits**

Disbursements include payroll, payroll taxes and employee benefits for salaried and hourly employees, and are forecast based on historical run-rates.

5) **Key Employee Retention Program**

Nelson Education entered in to a Key Employee Retention Program ("KERP") agreement with certain employees in 2014. The Forecast excludes the KERP monies that are being held in a separate account with Valiant Trust Company that is subject to an escrow agreement. The Forecast reflects the receipt of those monies and corresponding payment of the KERP in Week 9.

6) **Other expenses**

These disbursements include insurance, facility costs, sales tax remittance, service agreements with Cengage, selling, general and administrative expenses, marketing expenses, travel and entertainment and other ongoing operating expenses.

7) **Capital Expenditures and Plate Spend**

Capital expenditures are based on expected license renewals and hardware upgrades for laptops, cell phones and network equipment. In addition, ongoing capital expenditures includes maintenance costs required for Nelson’s facility, warehouse equipment and general infrastructure.

Plate spend comprises a significant capital outlay for the development of new content and material that generates revenue for a number of future fiscal periods. The cost of plate spend is based on the accumulation of costs, either external invoices paid to third-party vendors, or for internal labour and associated costs, as an allocation of time spent on a project based on actual hours incurred. For cash flow purposes only cash paid to third-party vendors is captured above. Internal labour costs are forecast in the payroll and benefits line item.

8) **Professional Fees**

These disbursements include payments to Nelson’s financial advisors and legal counsel and the Monitor and its legal counsel. The Forecast does not include payment for the First Lien Lender's or Second Lien Agent's financial or legal advisors.

9) **Financing Charges**

The forecast assumes that no payment will be made in respect of interest or fees for the First Lien Lenders or Second Lien Lenders.