Court File No.

***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.**

# PRE-FILING REPORT OF THE PROPOSED MONITOR ALVAREZ & MARSAL CANADA INC.

**MAY 11, 2015**

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## 1.0 INTRODUCTION

1.1 Alvarez & Marsal Canada Inc. ("**A&M**" or the "**Proposed Monitor**") understands that Nelson Education Ltd. ("**Nelson Education**") and Nelson Education Holdings Ltd. ("**Nelson Holdings**" and, collectively, "**Nelson**" or the "**Applicants**") intend to bring an application before this Court seeking certain relief under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**"), in the form of an Order granting, among other things, a stay of proceedings until June 10, 2015 and appointing A&M as Monitor (the "**Monitor**", and the proposed Order, the "**Proposed Initial Order**"). The proceedings to be commenced by the Applicants under the CCAA are referred to herein as the "**CCAA Proceedings**". As described below, the CCAA Proceedings are being commenced to effect the going concern sale of Nelson Education's business and the transfer of substantially all of Nelson Education's assets and property to its First Lien Lenders (as defined below).

1.2 The purpose of this pre-filing report (the "**Report**") is to provide the Court with:

(1) information regarding the following:

(a) A&M's qualifications to act as Monitor;

(b) background information with respect to Nelson;

(c) events leading up to the CCAA Proceedings;

(d) proposed sale transaction;

(e) Nelson's cash management system;

(f) Nelson's five-week cash flow forecast;

(g) key employee retention plan;

(h) court ordered charges sought in the Proposed Initial Order; and

(2) the Proposed Monitor's conclusions and recommendations in connection with the foregoing.

## 2.0 TERMS OF REFERENCE AND DISCLAIMER

2.1 In preparing this report, the Proposed Monitor has been provided with, and has relied upon, unaudited financial information, books and records and financial information prepared by Nelson, and discussions with management of Nelson (collectively, the "**Information**"). Except as otherwise described in this Report in respect of Nelson's cash flow forecast:

(a) the Proposed Monitor has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the Proposed Monitor has not audited or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Canadian Auditing Standards ("**CASs**") pursuant to the *Chartered Professional Accountants Canada Handbook* ("**CPA Handbook**") and, accordingly, the Proposed Monitor expresses no opinion or other form of assurance contemplated under CASs in respect of the Information; and

(b) some of the information referred to in this Report consists of forecasts and projections. An examination or review of the financial forecasts and projections, as outlined in the CPA Handbook, has not been performed.

2.2 Future oriented financial information referred to in this Report was prepared based on management's estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, even if the assumptions materialize, and the variations could be significant.

2.3 Unless otherwise stated, all monetary amounts contained in this Report are expressed in Canadian dollars.

## 3.0 A&M'S QUALIFICATION TO ACT AS MONITOR

3.1 Alvarez & Marsal Canada Securities ULC ("**A&M Securities**"), an affiliate of A&M, was engaged in March 2013 to act as financial advisor to Nelson Education to assist the company in reviewing and considering potential strategic alternatives. A&M Securities was further engaged in September 2014 to assist Nelson Education with a sale and investment solicitation process (as described later in this Report).

3.2 The Proposed Monitor is familiar with the business and operations of Nelson, their personnel, and the key issues and stakeholders in the proposed CCAA Proceedings. A&M is a trustee within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act* (Canada) and is not subject to any of the restrictions on who may be appointed as monitor set out in section 11.7(2) of the CCAA.

3.3 The senior A&M professional personnel with carriage of this matter include experienced insolvency and restructuring practitioners who are Chartered Professional Accountants, Chartered Insolvency and Restructuring Professionals and licensed Trustees in Bankruptcy and whom have acted in CCAA matters of a similar nature in Canada.

3.4 A&M is a subsidiary of Alvarez & Marsal Holdings, LLC ("**A&M Holdings**"). A&M Holdings and its subsidiaries (together, the "**A&M Firm**") comprise an international professional services firm, providing, among other things, bankruptcy, insolvency and restructuring services. From time to time, the A&M Firm's non-Canadian groups have been engaged by Cengage Learning, Inc. and its subsidiaries ("**Cengage**") to provide financial, interim management and tax advisory services, including during Cengage's proceedings under Chapter 11 of Title 11 of the *United States Bankruptcy Code* (the "**U.S. Bankruptcy Code**").[1] Cengage provides educational content

[1] Cengage commenced Chapter 11 proceedings in July 2013 and completed its financial restructuring and emerged from its Chapter 11 reorganization on March 31, 2014.

and certain operational support to Nelson Education through an Operating Agreement and a Master Services Agreement, and both of these agreements are to be assumed under the Proposed Transaction (defined below). As described later in this Report, Apax Partners (through related entities) (collectively, "**Apax**") is a shareholder in each of Nelson Holdings and Cengage. Following the completion of the Proposed Transaction, Apax will not have an equity interest in the purchaser of the Nelson business. The A&M Firm's Nelson and Cengage engagements have been segregated such that there is no communication or sharing of information regarding Nelson and Cengage as between the respective engagement teams.

3.5 The Proposed Monitor has retained Davies Ward Phillips & Vineberg LLP ("**Davies**") to act as its independent legal counsel.

3.6 A&M has consented to act as Monitor of the Applicants should this Court grant the Applicants' request to commence the CCAA Proceedings.

## 4.0 BACKGROUND INFORMATION

<u>General</u>

4.1 This Report should be read in conjunction with the Affidavit of Greg Nordal, President and Chief Executive Officer of Nelson Education sworn May 11, 2015 (the "**Nordal Affidavit**") for additional background and other information regarding Nelson.

4.2 Nelson Education is an education publishing company, providing learning solutions to universities, colleges, students, teachers, professors, libraries, government agencies, schools, professionals and corporations across the country. It is also a leading developer of digital educational resources.

4.3 As described in the Nordal Affidavit, in July 2007, the business and assets of Nelson Education were acquired by certain private equity investors together with the U.S. business and assets of Thomson Learning for a combined total value of approximately US$7.75 billion, of which approximately US$550 million was attributed to the Canadian business. As a result of, among other factors, certain *Investment Canada Act* (Canada) restrictions with respect to non-Canadian acquisition of a majority interest in a Canadian book publisher, Nelson Education was structured as a separate entity from the U.S. business and, as further discussed below, was financed primarily through two tiers of debt facilities.

4.4 Nelson Education operates two business segments: (i) “K-12”, which produces and distributes print and digital products for kindergarten to grade 12 across all subject areas; and (ii) “Higher Education”, which offers tailored learning solutions for the post-secondary education market, including universities, colleges and trade schools, in the major fields of study.

4.5 Nelson’s corporate headquarters are located in Scarborough, Ontario in an owned 230,000 square foot facility. Nelson employs approximately 335 full-time, permanent, non-unionized employees and approximately 38 part-time, non-unionized employees.

4.6 As described in the Nordal Affidavit and further discussed below, Nelson Education currently has in the aggregate over US$430 million (CAD$544 million) of secured first and second lien debt (including accrued interest) outstanding under its credit agreements, resulting in an unsustainable leverage ratio of debt to EBITDA (earnings before interest, taxes, depreciation and amortization), net of pre-publication expenditures, of approximately 17:1 based on the preliminary fiscal year ending results as at March 31, 2015**.** The Nelson business has also been negatively impacted by a general decline over the past several years in the Canadian kindergarten to grade 12 market (the “**K-12 Market**”) and higher education market (the “**Higher Education Market**”).

Corporate Organization

4.7 Nelson Education is the sole operating entity in the Nelson group of companies. Nelson Education is a corporation organized under the *Canada Business Corporations Act* (the "**CBCA**") and is a direct, wholly owned subsidiary of Nelson Holdings. Nelson Holdings is also a corporation organized under the CBCA and is a guarantor under each of the First Lien Credit Agreement and Second Lien Credit Agreement (each defined below). Nelson Holdings directly owns 100% of the shares of Nelson Education. Nelson Holdings' shares are owned by certain entities owned by OMERS Administration Corporation and certain funds of APAX Partners.

Financing / Credit Agreements

4.8 As described in the Nordal Affidavit, Nelson Education is financed primarily through two tiers of debt facilities which were established at the time of the acquisition of the business and assets in 2007, as follows:

(a) first lien debt pursuant to a First Lien Credit Agreement (the "**First Lien Credit Agreement**") dated as of July 5, 2007 among Nelson, Royal Bank of Canada ("**RBC**"), as Administrative Agent, Collateral Agent and Swing Line Lender, as succeeded by Wilmington Trust, National Association, as Administrative Agent and Collateral Agent (the "**First Lien Agent**") and the lenders party thereto (the "**First Lien Lenders**"); and

(b) second lien debt pursuant to a Second Lien Credit Agreement (the "**Second Lien Credit Agreement**", together with the First Lien Credit Agreement, the "**Credit Agreements**") dated July 5, 2007 among Nelson, RBC, as Administrative Agent and Collateral Agent (the "**Second Lien Agent**") and the lenders party thereto (the "**Second Lien Lenders**").

4.9 As at the date of this Report, Nelson Education has, in the aggregate, in excess of US$430 million of outstanding debt (including accrued interest) under the Credit Agreements, with approximately US$268,753,930, plus accrued interest, outstanding under the First Lien Credit Agreement and approximately US$153,218,764, plus accrued interest, outstanding under the Second Lien Credit Agreement.

4.10 The First Lien Credit Agreement matured on July 3, 2014, and Nelson Education was not able to repay the outstanding principal. Interest and fees accruing under the First Lien Credit Agreement are being paid in the ordinary course. Nelson Holdings guaranteed the obligations of Nelson Education under the First Lien Credit Agreement, and as security for repayment of amounts owed under the facility, each of Nelson Education and Nelson Holdings granted first-priority security over all or substantially all of their respective assets, including a pledge of the shares of Nelson Education by Nelson Holdings.

4.11 The Second Lien Credit Agreement matures on July 3, 2015. Nelson Education is in default of the Second Lien Credit Agreement as it has not made quarterly interest payments since March 31, 2014. Nelson Holdings guaranteed the obligations of Nelson Education under the Second Lien Credit Agreement, and as security for repayment of amounts owed under the facility, each of Nelson Education and Nelson Holdings granted second-priority security over all or substantially all of their respective assets.

4.12 As part of the arrangements as between each of the Credit Agreements, Nelson, RBC, in its capacity as collateral agent for the obligations under the First Lien Credit Agreement (including its successors and assigns), and RBC, in its capacity as collateral agent for the obligations under the Second Lien Credit Agreement (including its successors and assigns), entered into an Intercreditor Agreement (the "**Intercreditor Agreement**") dated July 5, 2007, a copy of which is attached as Exhibit **"F"** to the Nordal Affidavit.

Security Opinion

4.13 The Proposed Monitor has obtained an independent legal opinion from Davies on the security granted in respect of the First Lien Credit Agreement and the Second Lien Credit Agreement (collectively, the "**Security**"). Davies has provided an opinion to the Proposed Monitor that Nelson has granted valid security interests to the First Lien Agent on behalf of the First Lien Lenders and the Second Lien Agent on behalf of the Second Lien Lenders, respectively, in substantially all of the assets of Nelson, which have been properly perfected by registration pursuant to the Ontario *Personal Property Security Act*, subject to the standard assumptions, qualifications and limitations contained in the opinion. The opinion also confirms that there are no registrations prior in time to those in favour of the First Lien Agent and Second Lien Agent other than one registration pertaining to a motor vehicle lease agreement.

Financial Information

4.14 A copy of Nelson Education's financial statements for the following periods are attached as Exhibits **"A"** and **"B"**, respectively, to the Nordal Affidavit:

(a) audited financial statements for the fiscal year ended as at March 31, 2014; and

(b) unaudited financial statements as at December 31, 2014.

4.15 Nelson Education's unaudited balance sheet as at December 31, 2014 reported total assets of approximately $262.7 million of which $86.2 million were current assets. Nelson Education's liabilities amounted to approximately $657.6 million, including approximately $529.6 million of current liabilities and approximately $128.0 million of non-current liabilities. The current liabilities include approximately $31.2 million of accounts payable, approximately $8.8 million of deferred revenue and approximately $489.5 million of the current portion of long term debt.

4.16 Based on preliminary financial statements for the fiscal year ended March 31, 2015, Nelson Education's revenue was approximately $129 million and its EBITDA, net of pre-publication expenditures, was approximately $31.5 million, and for the twelve-month period ended March 31, 2014, Nelson Education's revenue was approximately $128 million and its EBITDA, net of pre-publication expenditures, was approximately $31.7 million. Nelson Education's financial leverage (measured as the ratio of debt to EBITDA, net of pre-publication expenditures) was approximately 17:1 for the fiscal year ended March 31, 2015. As noted above, Nelson Education has not been able to repay the current principal amounts due and outstanding pursuant to the First Lien Credit Agreement and has not made certain interest payments under the Second Lien Credit Agreement.

4.17 A copy of Nelson Holdings' unaudited financial statements as at March 31, 2014 is attached as Exhibit **"C"** to the Nordal Affidavit. Nelson Holdings had assets with a book value of approximately $161.8 million. Of this asset value, approximately $122.5 million consists of an intercompany note owing by Nelson Education to Nelson Holdings and approximately $39.3 million consisted of its investment in Nelson Education. Nelson Holdings had liabilities of approximately $123.4 million, of which approximately $122.2 million was a promissory note to its parent company.

4.18 Nelson Education entered into an Operating Agreement and a Master Services Agreement pursuant to which, among other things, Cengage provides educational content and certain related operational support to Nelson Education. Nelson Education pays approximately US$22 million annually for such content and operational support. The Operating Agreement expires on January 1, 2018, subject to automatic extensions for successive one-year renewal periods unless terminated by either party on at least 270 days' written notice prior to the expiry of the agreement.

## 5.0 EVENTS LEADING UP TO THE PROPOSED CCAA PROCEEDINGS

5.1 Commencing in April 2013, with the assistance of its professional advisors, Nelson Education engaged in discussions and explored a variety of transaction alternatives with a steering committee of its First Lien Lenders (the "**First Lien Steering Committee**") as well as the Second Lien Agent, in an effort to achieve a transaction that would, among other things, address Nelson Education's obligations under its Credit Agreements, protect value, improve the financial position of Nelson, and create stability for the business, including Nelson Education's employees, customers, lenders and other key stakeholders.

5.2 These negotiations ultimately resulted in a transaction framework on the terms set out in a First Lien Term Sheet dated September 10, 2014 (the "**First Lien Term Sheet**") for a sale or restructuring of the business. In connection with the First Lien Term Sheet, Nelson Education and Nelson Holdings entered into a support agreement (the "**First Lien Support Agreement**") with First Lien Lenders representing approximately 88% of the principal amounts outstanding under the First Lien Credit Agreement (the "**Consenting First Lien Lenders**"). The Consenting First Lien Lenders comprise 21 of the 22 First Lien Lenders. The only First Lien Lender that is not a Consenting First Lien Lender is also a Second Lien Lender.

5.3 Pursuant to the terms of the First Lien Term Sheet and the First Lien Support Agreement, Nelson, with the assistance of its financial advisor, on September 22, 2014 commenced a sale and investment solicitation process (the "**SISP**") to identify one or more potential purchasers of, or investors in, the Nelson Business. Dean Mullett, Managing Director of A&M Securities intends on filing an affidavit for the the Sales Approval Motion (as defined below) (the "**Mullett Affidavit**") describing the strategic review process undertaken, the SISP and the proposed sale transaction for Nelson.

5.4 A total of 168 potential buyers and 11 potential lenders were contacted as part of the SISP, of which seven parties submitted non-binding expressions of interest. The SISP ultimately did not result in an executable transaction that would result in proceeds to repay the obligations under the First Lien Credit Agreement in full or that would otherwise be supported by the First Lien Lenders. As a result of this process, the Applicants are of the view that there is no value available beyond the value of the obligations under the First Lien Credit Agreement.

5.5 Nelson Education's advisors have had numerous exchanges and discussions with Canadian Heritage in connection with the Proposed Transaction. Nelson Education does not believe that there are any further consents required from Canadian Heritage prior to the completion of the Proposed Transaction.

## 6.0 PROPOSED SALE TRANSACTION

6.1 Pursuant to the First Lien Support Agreement, Nelson Education is proceeding at this time with a sale transaction (the "**Proposed Transaction**") pursuant to which the First Lien Lenders will exchange and release all of the indebtedness owing under the First Lien Credit Agreement in exchange for:

(a) 100% of the common shares of a newly incorporated entity (the "**Purchaser Holdco**") that will own 100% of the common shares of the Purchaser to which substantially all of Nelson Education's assets would be transferred; and

(b) the obligations under a new US$200 million first lien term facility to be entered into by the Purchaser.

6.2 The Proposed Transaction includes, among other things: (i) the transfer of substantially all of Nelson Education's assets to the Purchaser; (ii) the assumption by the Purchaser of substantially all of Nelson Education's trade payables, contractual obligations and employment obligations (other than certain obligations in respect of former employees, obligations relating to matters in respect of the Second Lien Credit Agreement, and the Nelson Education Promissory Note (as defined in the Nordal Affidavit)); and (iii) offers of employment by the Purchaser to all of Nelson Education's employees.

6.3 Under the Proposed Transaction, the Purchaser will not assume certain of Nelson Education's obligations, including: (i) any of Nelson Education's obligations to the Second Lien Agent or the Second Lien Lenders under the Second Lien Credit Agreement; (ii) any liabilities relating to excluded assets, including excluded contracts (if any); (iii) any pre-closing environmental liabilities of Nelson Education, except as required under applicable law; (iv) any liabilities of Nelson Education with respect to any pre-closing infringement, misappropriation, misuse or passing off of intellectual property, if any; and (v) any other liability of Nelson Education not expressly assumed under the Purchase Agreement, including the Nelson Education Promissory Note.

6.3 Pursuant to the Proposed Transaction, the Purchaser may, in its sole and absolute discretion, at any time up to three business days prior to the closing of the Proposed Transaction, elect to not acquire any of the assets, properties, and rights of Nelson Education, including contracts of Nelson Education specified by the Purchaser as excluded contracts.

6.4 Nelson Education maintains the ability under the Proposed Transaction to complete a sale transaction that would result in proceeds sufficient to repay the obligations under the First Lien Credit Agreement in full prior to the closing of the Proposed Transaction.

6.5 On May 11, 2015, Nelson Education, Nelson Holdings, the First Lien Agent, Cortland Capital Market Services LLC, as sub-agent and supplemental administrative agent appointed in connection with the implementation of the Proposed Transaction (the "**Supplemental Agent**") and Consenting First Lien Lenders party thereto entered into a supplemental support agreement (the "**Supplemental Support Agreement**") pursuant to which, upon entry of an Approval and Vesting Order approving the Proposed Transaction in the form attached to the Purchase Agreement, the Company agreed to enter into the Purchase Agreement and the Supplemental Agent (the sole shareholder of Purchaser Holdco on behalf of the First Lien Lenders) agreed to cause the Purchaser to enter into the Purchase Agreement with Nelson Education.

6.6 As a result of the Proposed Transaction, the indebtedness under the First Lien Credit Agreement will be partially satisfied and any remaining indebtedness under the First Lien Credit Agreement will be forgiven by the First Lien Lenders. The Purchaser will not assume any of Nelson's obligations to the Second Lien Agent or the Second Lien Lenders in respect of the Second Lien Credit Agreement.

6.7 The Applicants have determined that it is necessary to seek protection under the CCAA in order to preserve enterprise value and continue as a going concern while seeking to implement the Proposed Transaction. In the Nordal Affidavit, the affiant submits that, based on the results of the SISP, there is no value available to the Second Lien Lenders and that the CCAA Proceedings are required in order to transfer Nelson Education's assets and property in satisfaction of the indebtedness owing to the First Lien Lenders free and clear of the obligations under the Second Lien Credit Agreement.

6.8 The Applicants intend to bring a motion to be heard on a date to be set by this Court to, among other things, approve the Proposed Transaction (the "**Sale Approval Motion**"). Subject to the Court's approval of the Proposed Transaction at the Sale Approval Motion, Nelson Education is seeking to complete the Proposed Transaction as efficiently as reasonably possible in order to minimize the impact of the CCAA Proceedings on the Nelson Education Business. Pursuant to the Purchase Agreement, the Proposed Transaction must be completed by June 2, 2015 or such later date as may be agreed to by the Majority Initial Consenting First Lien Lenders and Nelson.

## 7.0 CASH MANAGEMENT SYSTEM

7.1 Nelson Education has a banking relationship with RBC and the Applicants' cash management system (the "**Cash Management System**") is operated through Nelson Education's accounts held at RBC in Toronto. Nelson Education utilizes the following bank accounts:

(a) Canadian dollar operating account for cash receipts from customers, payroll funding and certain payments to vendors;

(b) U.S. dollar operating account for cash receipts from Cengage (payments for back office functions that Nelson Education provides to Cengage as well as revenue attribution payments) and disbursements to Cengage;

(c) Canadian dollar and U.S. dollar positive pay accounts for disbursements to third party vendors related to day-to-day operations; and

(d) Canadian dollar payroll account for payments relating to payroll transactions outside of the typical bi-monthly payroll payments.

7.2 Nelson Education also has one restricted cash account held with Valiant Trust in respect of certain payments payable under the key employee retention program (as described below).

7.3 Nelson Holdings does not maintain its own bank accounts. To the extent Nelson Holdings needs to make payments, generally for interest expense, such payments are made from Nelson Education's operating bank accounts and are accounted for through intercompany accounts with Nelson Holdings.

7.4 The Applicants intend to continue using the existing Cash Management System during the CCAA Proceedings, and are seeking the approval of the Court to do so. As described in the Nordal Affidavit, the current Cash Management System includes the necessary accounting controls to enable the Applicants, as well as their creditors and this Court, to trace funds though the system and ensure that all transactions are adequately ascertainable. The Proposed Monitor is of the view that the continued use of the Cash Management System is required and appropriate in order for Nelson Education to continue its operations and advance towards a closing of the Proposed Transaction.

## 8.0 CCAA CASH FLOW FORECAST

8.1 The Applicants, with the assistance of the Proposed Monitor, have prepared a five-week cash flow forecast (the "**Cash Flow Forecast**") for the period May 11, 2015 to June 12, 2015 (the "**Cash Flow Period**"). A copy of the Cash Flow Forecast is attached to this Report as **Appendix "A".**

8.2 The Cash Flow Forecast is presented on a weekly basis during the Cash Flow Period and represents Nelson's estimates of projected cash flows during the Cash Flow Period. The Cash Flow Forecast has been prepared using the probable and hypothetical assumptions set out in the notes to the Cash Flow Forecast (the "**Cash Flow Assumptions**").

8.3 The Proposed Monitor has reviewed the Cash Flow Forecast to the standard required of a Court-appointed Monitor by section 23(1)(b) of the CCAA. Section 23(1)(b) requires a Monitor to review the debtor's cash flow statement as to its reasonableness and to file a report with the Court on the Monitor's findings. Pursuant to this standard, the Proposed Monitor's review of the Cash Flow Forecast consisted of inquiries, analytical procedures and discussions related to information supplied to it by certain key members of management and employees of Nelson. The Proposed Monitor reviewed information provided by management for the Cash Flow Assumptions. Since the Cash Flow Assumptions need not be supported, the Proposed Monitor's procedures with respect to them were limited to evaluating whether they were consistent with the purpose of the Cash Flow Forecast.

8.4 Based on the Proposed Monitor's review, nothing has come to its attention that causes it to believe, in all material respects, that:

(i) the Cash Flow Assumptions are not consistent with the purpose of the Cash Flow Forecast;

(ii) as at the date of this Report, the Cash Flow Assumptions are not suitably supported and consistent with the plans of the Applicants or do not provide a reasonable basis for the Cash Flow Forecast, given the Cash Flow Assumptions; or

(iii) the Cash Flow Forecast does not reflect the Cash Flow Assumptions.

8.5 The Cash Flow Forecast projects that the Applicants will fund their operations in the Cash Flow Period from cash on hand. The estimated cash position as at the commencement of the CCAA Proceedings is approximately $21.2 million. The Cash Flow Forecast assumes forecast receipts of approximately $6.1 million and forecast disbursements of approximately $11.0 million over the five week period, resulting in a projected cash balance of approximately $16.3 million at the end of the Cash Flow Period.

8.6 The Applicants intend to make payments for goods, educational content and services supplied pre-filing and post-filing in the ordinary course as set out in the Cash Flow Forecast and as permitted by the Proposed Initial Order. As such, the Applicants are seeking Court approval to allow them to pay ordinary course pre-filing amounts to Nelson Education's suppliers, service providers and content providers and to allow them to satisfy obligations in respect of existing customer programs in order to obtain continued support from those parties and minimize disruptions during the CCAA Proceedings, for the benefit of the ongoing Nelson business.

8.7 Upon completion of the Proposed Transaction, which remains subject to, among other things, approval by this Court, substantially all of Nelson Education's assets, including Nelson

Education's cash, will be transferred to the Purchaser. Under the Purchase Agreement, the parties have agreed to a cash reserve of $1.15 million to remain with Nelson Education, with any remaining funds to be provided to the Purchaser on the earlier of 18 months or the wind-down of Nelson Education. The amount of the cash reserve was determined with the assistance of the Proposed Monitor and is based on the estimated professional fees and other post-closing expenses of the Applicants.

8.8 The Cash Flow Forecast has been prepared solely for the purpose described above, and readers are cautioned that it may not be appropriate for other purposes.

## 9.0 KEY EMPLOYEE RETENTION PROGRAM

9.1 In January 2014, Nelson Education developed a key employee retention program (the "**KERP**") in order to incent certain key employees that were considered to be critical to the preservation of enterprise value to remain with the company as it pursued a restructuring. Nelson Education consulted with the First Lien Steering Committee when developing the KERP. The KERP was reviewed and approved by Nelson Education's Board of Directors.

9.2 Under the KERP, eligible employees will become eligible to receive retention payments if they remain with the company until their applicable retention date (collectively, the "**Retention Payments**"). Remaining Retention Payments under the KERP in the aggregate amount of approximately $340,000 (which is held in a separate escrow account) become payable to certain eligible employees on June 30, 2015 and are to be paid by no later than July 15, 2015.

9.3 The Proposed Monitor supports the KERP as: (i) it would be detrimental to the restructuring process if Nelson were required to find replacements for the three employees still to be paid their Retention Payments, particularly given that the KERP has been in place for approximately 15 months; and (ii) the KERP is reasonable and appropriate in the circumstances and provides appropriate incentives for the remaining eligible employees to remain in their current positions.

## 10.0 COURT ORDERED CHARGES SOUGHT IN THE PROPOSED INITIAL ORDER

10.1 The Proposed Initial Order provides for three charges (collectively, the "**Charges**"), as described below.

Administration Charge

10.2 The Proposed Initial Order provides for a charge in an amount not to exceed $1.0 million, in favour of the Monitor, counsel to the Monitor, counsel to the Applicants, the First Lien Agent, the Supplemental Agent, and counsel to the First Lien Agent, the Supplemental Agent and the First Lien Steering Committee, and the financial advisor to the First Lien Steering Committee (the "**Administration Charge**").

10.3 The Proposed Monitor assisted the Applicants in the calculation of the Administration Charge and is of the view that it is reasonable and appropriate in the circumstances, having regard to the nature of the CCAA Proceedings, potential work involved at peak times and the size of charges approved in similar proceedings.

10.4 In connection with the Sale Approval Motion, the Applicants expect to seek to amend the Administration Charge to reduce it to an aggregate amount of $400,000 for the benefit of the Monitor and its counsel only, effective upon the completion of the Proposed Transaction.

Directors' and Officers' Charge

10.5 The Proposed Initial Order provides that the Applicants jointly and severally indemnify their directors and officers against obligations and liabilities that they may incur as directors and officers of the Applicants after the commencement of the CCAA Proceedings, except to the extent that the obligation or liability was incurred as a result of an officers' or directors' gross negligence or wilful misconduct.

10.6 The Proposed Initial Order provides for a charge in an amount of $2.2 million (the "**Directors' Charge**") in favour of the Applicants' directors and officers as security for any obligations or liabilities that may arise after the commencement of the CCAA Proceedings, except to the extent that such obligation or liability is incurred as a result of a directors' or officers' gross negligence or wilful misconduct.

10.7 Nelson has a liability insurance policy for the potential benefit of the directors and officers (the "**D&O Policy**") that covers an aggregate annual limit of $15 million. The D&O Policy also includes certain additional coverage for the directors and officers of the Applicants in certain circumstances where indemnification is unavailable of up to $1 million in excess of coverage otherwise provided by the D&O Policy.

10.8 The Proposed Monitor assisted the Applicants in the calculation of the Directors' Charge, taking into consideration the amount of the Applicants' payroll, vacation pay and federal and provincial sales tax liabilities. The Proposed Monitor is of the view that the Directors' Charge is required and reasonable in the circumstances.

KERP Charge

10.9 The Proposed Initial Order provides for a charge in an amount not to exceed $340,000 (the "**KERP Charge**") in favour of the eligible employees as security for all amounts becoming payable under the KERP.

10.10 The Proposed Monitor is of the view that the KERP Charge is required and is reasonable in the circumstances.

10.11 In connection with the Sale Approval Motion, the Applicants expect to seek a release and discharge of the KERP Charge effective upon the completion of the Proposed Transaction and the assumption by the Purchaser of all of the obligations under the KERP pursuant to the terms of the Purchase Agreement.

Priority Charges Created by the Proposed Initial Order

10.12 The priorities of the Charges are proposed as follows:

(a) First – Administration Charge (to the maximum amount of $1.0 million);

(b) Second – Directors' Charge (to the maximum amount of $2.2 million); and

(c) Third – KERP Charge (to the maximum amount of $340,000).

10.13 In summary, the Proposed Monitor has assisted in the preparation and/or reviewed the calculations that support the Charges and believes that the amounts are reasonable in the circumstances.

## 11.0 IMPACT OF PROPOSED CCAA PROCEEDINGS

11.1 The Applicants are seeking an Order under the CCAA that is intended to accomplish, among other things, the following:

(a) the ongoing operations of Nelson Education's business;

(b) continued payment of obligations to trade suppliers, service providers, content providers and employees incurred in the ordinary course, including pre-filing amounts incurred in the ordinary course;

(c) completion of the Proposed Transaction, including:

i. the going-concern sale of Nelson Education's business and the transfer of substantially all of Nelson Education's assets and property to the Purchaser free and clear of claims relating to the Second Lien Credit Agreement;

ii. the assumption by the Purchaser of substantially all of Nelson Education's trade payables, contractual obligations and employment obligations incurred in the ordinary course and as reflected in Nelson Education's balance sheet, including the remaining Retention Payments under the KERP;

iii. an offer of employment to all of Nelson Education's employees; and

iv. the exchange and release of all of the indebtedness owing to the First Lien Lenders under the First Lien Credit Agreement in exchange for: (i) 100% of the common shares of the Purchaser Holdco which will own 100% of the common shares of the Purchaser; and (ii) the obligations under a new US $200 million first lien term facility to be entered into by the Purchaser.

11.2 Under the Proposed Transaction, certain liabilities will not be assumed by the Purchaser, including:

(a) to the Second Lien Agent or the Second Lien Lenders under the Second Lien Credit Agreement;

(b) certain obligations in respect of former employees;

(c) any liabilities relating to excluded assets, including excluded contracts, if any;

(d) any pre-closing environmental liabilities of Nelson, except as required under applicable law;

(e) any liabilities of Nelson with respect to any pre-closing infringement, misappropriation, misuse or passing off of intellectual property, if any; and

(f) any other liability of Nelson not expressly assumed under the proposed Purchase Agreement.

## 12.0 PROPOSED MONITOR'S RECOMMENDATION

12.1 For the reasons set out in this Report, the Proposed Monitor is of the view that the relief requested by the Applicants is reasonable and respectfully recommends that this Court make the Order granting the relief requested by the Applicants.

All of which is respectfully submitted to this Court this eleventh day of May, 2015.

**Alvarez & Marsal Canada Inc.**
**in its capacity as Proposed Monitor**
**of Nelson Education Ltd. and**
**Nelson Education Holdings Ltd.**

Per: ______________________

Name: Alan J. Hutchens
Title: Senior Vice President

# Appendix "A"

(see attached)

# Nelson Education Ltd.

**Cash flow forecast for the 5-week period May 11, 2015 to June 12, 2015**
**(Unaudited, in '000s CAD)**

| Week Ending, Friday: | Notes | Week 1 5/15/2015 Forecast | Week 2 5/22/2015 Forecast | Week 3 5/29/2015 Forecast | Week 4 6/5/2015 Forecast | Week 5 6/12/2015 Forecast | Total |
|---|---|---|---|---|---|---|---|
| **Receipts** | | | | | | | |
| Sales receipts | 2 | 999 | 827 | 746 | 1,545 | 1,839 | 5,956 |
| Other receipts | 2 | - | - | 150 | - | - | 150 |
| **Total Receipts** | | **999** | **827** | **896** | **1,545** | **1,839** | **6,106** |
| **Disbursements** | | | | | | | |
| Operating expenses | 3 | 247 | 755 | 233 | 191 | 231 | 1,657 |
| Payroll & benefits | 4 | 1,504 | 5 | 1,304 | 5 | 1,501 | 4,319 |
| KERP | 5 | - | - | - | - | - | - |
| Other expenses | 6 | 167 | 486 | 298 | 337 | 236 | 1,524 |
| Capital expenditures and plate spend | 7 | 263 | 143 | 354 | 219 | 199 | 1,178 |
| Professional fees | 8 | 225 | 125 | 280 | 835 | 25 | 1,490 |
| Financing charges | 9 | - | - | 820 | - | - | 820 |
| **Total Disbursements** | | **2,406** | **1,515** | **3,288** | **1,587** | **2,192** | **10,987** |
| **Net Operating Cash Flow** | | **(1,407)** | **(688)** | **(2,392)** | **(41)** | **(352)** | **(4,881)** |
| Beginning Cash Balance | 1 | 21,200 | 19,793 | 19,105 | 16,713 | 16,671 | 21,200 |
| Net Cash Flow | | (1,407) | (688) | (2,392) | (41) | (352) | (4,881) |
| **Ending Cash Balance** | | **19,793** | **19,105** | **16,713** | **16,671** | **16,319** | **16,319** |

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

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

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 that payments in respect of employee compensation, utility services, suppliers, content providers and other normal business obligations will be paid in the ordinary course. The Company, with the assistance of the Monitor, 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 estimated opening cash balance as at May 11, 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. All employees are paid a salary and are entitled to participate in the Company’s benefit program, defined contribution pension plan and incentive plan. All employees are paid bi-weekly, two weeks in arrears. The Company offers all of its employees comprehensive medical and dental benefits through Sun Life Financial.

5) Key Employee Retention Program

Nelson Education entered in to a Key Employee Retention Program ("KERP") agreement with certain employees in 2014. The final payment of approximately $340,000 to certain employees is expected to be paid in July 2015.

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. Plate spend is tracked at the ISBN level (title by title). 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, the Monitor and its legal counsel, the First Lien Agent, the Supplemental Agent and the financial advisor and legal counsel to the First Lien Agent, the Supplemental Agent and the First Lien Steering Committee.

9) Financing Charges

*Consent Fee:*

As per the Support Agreement entered into between the consenting First Lien Lenders and Nelson Education on September 30, 2014, Nelson paid an Early Consent Fee to the consenting First Lien Lenders equal to such lenders' pro rata share of (i) 2% of the aggregate principal amount outstanding; plus (ii) a percentage of the aggregate principal amount outstanding calculated based on an annual rate of 10%, less the interest rate paid under the existing First Lien Credit Agreement for the period of July 4, 2014 to September 30, 2014.

Thereafter, on a monthly basis until termination of the Support Agreement, Nelson pays a monthly cash consent fee to the consenting First Lien Lenders calculated as a percentage of the aggregate principal amount outstanding, using an annual rate of 10% less the interest rate paid under the existing First Lien Credit Agreement.

*Interest Expense:*

Under its First Lien Credit Agreement, Nelson pays interest quarterly at a rate of Base Rate (3.25%) + 1.5% on First Lien debt plus an additional 2% default rate since July 4, 2014.

# Appendix “B”

(see attached)

NELSON EDUCATION | Canada's Learning Advantage

NELSON EDUCATION LTD. 1120 Birchmount Road Toronto ON M1K 5G4 416 752 9100 Fax 416 752 9646 Toll free 1 800 668 0671 www.nelson.com

Alvarez & Marsal Canada Inc.
Royal Bank Plaza South Tower
200 Bay Street, Suite 2900
Toronto, ON, M5J 2J1

Attention: Mr. Alan J. Hutchens

May 8, 2015

Dear Sirs:

**Re: Nelson Education Ltd. ("Nelson Education") and Nelson Education Holdings Ltd. ("Holdings", together with Nelson Education, the "Applicants") – CCAA section 10(2) Prescribed Representations with Respect to Cash Flow Forecast**

In connection with the application by the Applicants for the commencement of proceedings under the *Companies' Creditors Arrangement Act*, the management of Nelson Education has, with the assistance of Alvarez & Marsal, prepared the attached 5-week projected cash flow statement of Nelson Education for the period May 11, 2015 to June 12, 2015 (the "**Cash Flow Statement**") and the list of assumptions on which the Cash Flow Statement is based. The purpose of the Cash Flow Statement is to determine the liquidity requirements of Nelson Education during the CCAA proceedings.

Nelson Education confirms that the hypothetical assumptions on which the Cash Flow Statement is based are reasonable and consistent with the purpose described herein, and the probable assumptions are suitably supported and consistent with the plans of the Nelson Education and provide a reasonable basis for the projections. All such assumptions are disclosed in notes to the Cash Flow Statement (the "**Notes**").

Since the projections are based on assumptions regarding future events, actual results will vary from the information presented, and the variations may be material.

The projections have been prepared solely for the purpose described herein, using the probable and hypothetical assumptions set out in the Notes. Consequently, readers are cautioned that the Cash Flow Statement may not be appropriate for other purposes.

Yours truly,

Per: Name: Michael Andrews
Title: CFO & SVP Finance
(authorized director or officer of Nelson Education)

**IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED**
**IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NELSON EDUCATION LTD. AND NELSON EDUCATION HOLDINGS LTD.**

Court File No: ________________

***ONTARIO***
**SUPERIOR COURT OF JUSTICE-COMMERCIAL LIST**

Proceeding Commenced at Toronto

**PRE-FILING REPORT**

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