

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

**Nelson Education Ltd.
Nelson Education Holdings Ltd.**

SECOND REPORT OF THE MONITOR

July 8, 2015

**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.

**SECOND 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. (together with its affiliates, “**A&M**”) as monitor of Nelson. The proceedings commenced by Nelson under the CCAA will be referred to herein as the “**CCAA Proceedings**”.

2. 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, Royal Bank of Canada (“**RBC**”)¹ 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 (the “**Monitor**”).
4. Pursuant to the Order of the Honourable Mr. Justice Newbould granted on June 8, 2015 (the “**Amended Initial Order**”), the Stay Period was extended to July 17, 2015. In accordance with the provisions of the Amended Initial Order, notice of the CCAA Proceedings was published in The Globe and Mail on June 18, 2015.
5. Pursuant to the Order of the Honourable Mr. Justice Newbould granted on June 29, 2015 (the “**Extension Order**”), the Stay Period was extended to August 31, 2015.

¹ RBC is 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”), a lender under the Second Lien Credit Agreement, a lender under the First Lien Credit Agreement dated as of July 5, 2007 (the “First Lien Credit Agreement”) and the provider of cash management services

6. On May 15 and 19, 2015, Nelson served motion materials on the Service List (the “**Sale Approval Motion**”), which motion materials were subsequently filed with the Court on July 6, 2015, for an Order *inter alia* approving the sale of substantially all of the property and assets of Nelson as contemplated by an asset purchase agreement (the “**APA**”) to be entered into between Nelson Education Ltd. as Seller and 682534 N.B. Inc. as Purchaser if the Approval and Vesting Order (the “**AVO**”) sought by Nelson is granted. The Monitor understands that the Purchaser is a special purpose vehicle through which the lenders under the First Lien Credit Agreement (the “**First Lien Lenders**”) would acquire the business and assets of Nelson if the AVO is granted and the transaction contemplated by the APA (the “**FLL Transaction**”) closes.

7. 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. The Monitor filed its First Report to the Court on June 4, 2015, in respect of Nelson’s request for an extension of the Stay Period. This report is the Monitor’s second report, the purpose of which is to inform the Court on the following:
 - (a) The receipts and disbursements of Nelson for the period May 30 to June 26, 2015;

 - (b) Nelson’s revised and extended cash flow forecast for the period June 27 to September 25, 2015 (the “**July 6 Forecast**”);

 - (c) The Monitor’s review of and conclusions regarding:
 - (i) The sales and investor solicitation process (the “**SISP**”) carried out by Nelson with the assistance of A&M commencing in September 2014;

 - (ii) Other indicia of the potential value of the Nelson business and assets;

- (iii) Potential alternatives to the sale of the business to the First Lien Lenders pursuant to the APA; and
- (d) The Sale Approval Motion, returnable August 13, 2015, and the Monitor's recommendations with respect to the approval of the FLL Transaction.

TERMS OF REFERENCE

8. 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**").
9. 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.
10. 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.
11. The Monitor has prepared this Report in connection with the Sale Approval Motion. The Report should not be relied on for other purposes.

12. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars. For the purposes of this Report, a US to Canadian dollar exchange rate of \$0.80 has been used for the conversion of US\$ denominated amounts where necessary.
13. Capitalized terms not otherwise defined herein have the meanings defined in the Initial Order, the affidavit of Mr. Greg Nordal sworn May 11, 2015 filed in support of the Initial Application (the “**Nordal May 11 Affidavit**”), in the affidavit of Mr. Dean Mullett of A&M sworn May 11, 2015 and filed in support of the Sale Approval Motion (the “**Mullett Affidavit**”) or in the previous report of the Monitor.

EXECUTIVE SUMMARY

14. In the Monitor’s view:
 - (a) The design of the SISP was typical of such marketing processes and was consistent with processes that have been approved by the courts in many CCAA proceedings;
 - (b) The SISP allowed interested parties adequate opportunity to conduct due diligence, both A&M and management appear to have been responsive to all requests from potentially interested parties and the timelines provided for in the SISP were reasonable in the circumstances;
 - (c) The activities undertaken by A&M were consistent with the activities that any investment banker or sale advisor engaged to assist in the sale of a business would be expected to undertake;
 - (d) The selection of A&M as investment banker would not have had a detrimental effect on the SISP or the value of offers;

- (e) Both key senior management and A&M were incentivised to achieve the best value available and there was no impediment to doing so;
 - (f) The SISP was undertaken in a thorough and professional manner;
 - (g) The results of the SISP clearly demonstrate that none of the interested parties would, or would be likely to, offer a price for the Nelson business that would be sufficient to repay the amounts owing to the First Lien Lenders under the First Lien Credit Agreement (the “**First Lien Debt**”);
 - (h) The SISP was a thorough market test and can be relied on to establish that there is no value beyond the First Lien Debt.
15. Furthermore, the Monitor is of the view that:
- (a) There is no realistic prospect that Nelson could obtain a new source of financing sufficient to repay the First Lien Debt;
 - (b) An alternative debt restructuring that might create value for the Second Lien Lenders is not a viable alternative at this time;
 - (c) There is no reasonable prospect of a new sale process generating a transaction at a value in excess of the First Lien Debt;
 - (d) It does not appear that there are significant operational improvements reasonably available that would materially improve profitability in the short-term such that the value of the Nelson business would increase to the extent necessary to repay the First Lien Debt and, accordingly, there is no apparent benefit from delaying the sale of the business.
16. Accordingly, the Monitor supports Nelson’s request for the approval of the FLL Transaction.

17. The Monitor is still in the process of considering the Ancillary Relief, as defined hereinafter, contained in the Sale Approval Motion and, accordingly, reserves its views with respect thereto. To the extent necessary, the Monitor will file a subsequent report addressing the Ancillary Relief and any other pertinent matters prior to the return of the Sale Approval Motion.

RECEIPTS & DISBURSEMENTS FOR THE PERIOD TO JUNE 26, 2015

18. Nelson’s actual cash flow on a consolidated basis for the period from May 29 to June 26, 2015, was approximately \$4.5 million better than the June 3 Forecast, as summarized below:

	Forecast	Actual	Variance
	\$000	\$000	\$000
Receipts:			
Sales Receipts	3,787	6,692	2,905
Other Receipts	129	152	23
Total Receipts	3,916	6,844	2,928
Disbursements:			
Operating Expenses	1,367	1,110	257
Payroll & Benefits	5,634	5,601	33
KERP	0	0	0
Other Expenses	1,522	1,284	238
Capex and Plate	737	702	35
Professional Fees	1,400	393	1,007
Financing Charges	0	0	0
Total Disbursements	10,660	9,090	1,570
Net Operating Cash Flow	(6,744)	(2,246)	4,498
Beginning Cash Balance	19,830	19,830	0
Net Operating Cash Flow	(6,744)	(2,246)	4,498
Ending Cash Balance	13,086	17,584	4,498

19. Explanations for the key variances in actual receipts and disbursements as compared to the June 3 Forecast are as follows:

- (a) The favourable variance of approximately \$2.9 million in sales receipts is believed to be a timing variance as a result of collections being received earlier than forecast following a concerted effort by Nelson to collect K-12 Business receivables prior to school boards closing for the summer break and is expected to reverse in future weeks;
- (b) The favourable variance of approximately \$257,000 in operating expenses is primarily attributable to a lower spend on paper, print and binding than forecast. Approximately \$140,000 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 \$238,000 in other expenses is comprised of a \$98,000 timing variance in fleet payments that is expected to reverse in future periods and a permanent variance of \$140,000 arising from lower than projected spend on non-restructuring professional fees;
- (d) Approximately \$110,000 of the favourable variance of approximately \$1 million in Professional Fees is a permanent variance with the balance believed to be primarily timing in nature and expected to reverse in future periods.

THE JULY 6 FORECAST

- 20. The July 6 Forecast is attached hereto as Appendix A. The July 6 Forecast shows a net cash inflow of approximately \$7.6 million in the period June 27 to September 25, 2015, and is summarized below:

	\$000
Receipts:	
Sales Receipts	43,971
Other Receipts	962
Total Receipts	44,933
Disbursements:	
Operating Expenses	18,475
Payroll & Benefits	7,991
KERP	332
Other Expenses	5,866
Capex and Plate	2,089
Professional Fees	2,542
Financing Charges	0
Total Disbursements	37,295
Net Operating Cash Flow	7,638
Beginning Cash Balance	17,584
Net Operating Cash Flow	7,638
Ending Cash Balance	25,222

21. There are no significant changes in the key underlying assumptions of the July 6 Forecast as compared to the June 3 Forecast.
22. The Monitor notes that RBC has requested that Nelson file a cash flow forecast to October 31, 2015. Nelson has extended its weekly cash flow forecast to October 30, 2015 (October 31, 2015 being a Saturday) but the Monitor has not yet completed its review of the extended forecast. The extended cash flow forecast will be filed following the completion of the Monitor's review.

THE MONITOR'S REVIEW

BACKGROUND

23. As described in the Mullett Affidavit, the SISP did not produce a transaction that would result in proceeds sufficient to repay the First Lien Debt in full or that would otherwise be supported by the First Lien Lenders.
24. Accordingly, Nelson seeks approval of the FLL Transaction which, as described in greater detail later in this Report, would provide for:

- (a) The transfer of substantially all of Nelson's assets to the Purchaser;
- (b) The assumption by the Purchaser of substantially all of:
 - (i) Nelson's ordinary course liabilities to clients, vendors, suppliers and customers, and other trade payables;
 - (ii) Liabilities incurred in the ordinary course under assigned contracts and cure costs, if any, in respect of assigned contracts;
 - (iii) Liabilities in respect of Transferred Employees (as defined in the APA); and
 - (iv) Liabilities of Nelson that rank senior in priority to the obligations owing to the First Lien Lenders, other than the court-ordered charges granted in these CCAA Proceedings, and in each case subject to the exceptions described in the APA;
- (c) An offer of employment by the Purchaser to all of Nelson's employees; and
- (d) An exchange and release by the First Lien Lenders of all of the indebtedness owing under the First Lien Credit Agreement for:
 - (i) 100% of the common shares of a newly incorporated entity ("Purchaser Holdco") that will own 100% of the common shares of the Purchaser; and
 - (ii) A new US\$200 million first lien term facility to be entered into by the Purchaser.

25. At paragraph 31 of his endorsement in respect of the Comeback Motion, the Honourable Mr. Justice Newbould stated:

“[31] Nelson intends to request Court approval of the proposed transaction. An issue that will be front and centre will be whether the SISP process prior to this CCAA proceeding can be relied on to establish that there is no value in the security of the second lien lenders and whether other steps could have been taken to obtain financing to assist Nelson in continuing in business other than a credit bid by the first lien lenders. ...”

26. Mr. Justice Newbould went on to reiterate that the conduct of the SISP was a key issue in the CCAA Proceedings, stating at paragraph 36 of his endorsement:

“[36] ... the very issue in this case, namely the reliability of the SISP program in determining whether the second lien lenders’ security has any value.”

27. Accordingly, the Monitor has undertaken an extensive review of the following matters:

- (a) The conduct of the SISP;
- (b) Other indicia of potential value; and
- (c) Potential alternatives to proceeding with the FLL Transaction.

AMOUNTS OWING TO THE FIRST LIEN LENDERS

28. The Monitor has been informed by the First Lien Lenders that the amount of the First Lien Debt is currently approximately US\$268.8 million of principal plus accrued interest of approximately \$4.7 million plus legal and professional fees.

29. The Monitor understands that RBC disputes the amount of the First Lien Debt on the basis that the consent fees paid to the Consenting First Lien Lenders are not allowable and must be treated as a payment of obligations under the First Lien Credit Agreement. The Monitor is informed that approximately US\$12.6 million in consent fees has to date been paid to the Consenting First Lien Lenders.
30. The Monitor takes no position on the issue of how the amounts paid as consent fees should be treated. The amount of the First Lien Debt has not been proven, but for the purposes of this Report, the Monitor has assumed the First Lien Debt to be in the range US\$260.9 million to US\$273.5 million or \$326.1 million to \$341.9 million converted at \$0.80, being the approximate exchange rate at the date of this Report. Any outstanding accrued interest and legal or professional fees would be in addition to those amounts.

THE SISP

The First Lien Support Agreement

31. As described in the Mullet Affidavit, Nelson and the Consenting First Lien Lenders entered into the First Lien Support Agreement on September 10, 2014. The First Lien Support Agreement provided for, *inter alia*:
 - (a) A marketing process to be conducted by Nelson to identify one or more potential purchasers of, or investors in, the Nelson business; and

- (b) If a transaction that would provide for net sale or investment proceeds sufficient for full payment in cash of all obligations under the First Lien Credit Agreement or that is otherwise acceptable to First Lien Lenders holding at least 66 2/3% of the outstanding obligations under the First Lien Credit Agreement (a "**Superior Offer**") was not identified pursuant to the process, a credit bid by the First Lien Lenders of all of the debt owing to them under the First Lien Credit Agreement to effectuate a conversion of the First Lien Lenders' claims for a new first lien term facility and for common shares of the Purchaser.

The Design of the SISP Process

- 32. A description of the SISP and events leading up to the implementation of the SISP, including Nelson's efforts to achieve a consensual transaction with the First Lien Lenders and the Second Lien Lenders, is included in the Mullett Affidavit and the Nordal May 11 Affidavit.
- 33. As described in the Mullett Affidavit, the SISP was a two-phase process. In the first phase ("**Phase 1**"), parties were contacted to solicit potential interest, a teaser was provided and interested parties that signed a non-disclosure agreement were invited to undertake initial due diligence and to submit a non-binding expression of interest (an "**EOI**") by 5:00 pm on November 7, 2014 (the "**EOI Deadline**"). Interested parties were informed that EOIs received would be evaluated to determine which parties, if any, would be invited to advance to the second phase of the SISP.
- 34. In the second phase of the SISP ("**Phase 2**"), qualified parties were given management presentations and provided the opportunity to complete detailed due diligence. Binding offers were required to be submitted by December 19, 2014 (the "**Bid Deadline**").

35. The SISP provided that interested parties could propose a purchase of the whole or parts of the business or an investment in Nelson.

The Implementation of the SISP Process

36. Part of A&M's mandate was to assist Nelson in the implementation of the SISP. In that regard, A&M:

- (a) Assisted Nelson with the development of a teaser and confidential information memorandum ("CIM") describing the Company and its financial results and projections to potentially interested parties;
- (b) Compiled a list of potential buyers, investors and providers of acquisition financing;
- (c) Contacted and communicated with potentially interested parties in respect of the opportunity;
- (d) Assisted with the preparation of a data room that was made available to interested parties that signed an appropriate non-disclosure agreement;
- (e) Assisted with the development of management presentations to be presented to interested parties;
- (f) Made itself available to answer questions and address diligence requests from the interested parties; and
- (g) Participated in discussions with and provided updates to management, the Board of Directors of Nelson and the First Lien Lenders.

The Results of the SISP Process

37. The initial list of potentially interested parties to be contacted to introduce the opportunity of an acquisition of, or investment in, the Nelson business comprised of 168 Canadian, U.S. and overseas financial sponsors and strategic purchasers. Of the total of 168 potentially interested parties, 65 parties executed a non-disclosure agreement and were provided copies of the CIM.
38. In addition, 11 potential lenders were contacted with respect to potentially providing acquisition financing should it be required by purchasers. Three potential lenders provided non-binding financing guidance that they consented to being shared with prospective purchasers.
39. EOIs for the entire Nelson business were submitted by six interested parties by the EOI deadline, only two of which indicated a potential purchase price in the region of the amount owing to the First Lien Lenders. Two of the interested parties were not invited to participate in Phase 2 of the SISP due to the quantum of the potential purchase price indicated in the EOI they submitted. Each of the remaining four interested parties was advanced to Phase 2 of the SISP in the hope that further due diligence and negotiation would result in a Superior Offer.
40. In addition to the EOIs for the entire business, a seventh interested party submitted an EOI for only the K-12 Business. That party was also invited to participate in Phase 2 of the SISP.
41. On or about December 5, 2014, the parties were provided with a form of asset purchase agreement which they were invited to mark-up and provide with their offer by the Bid Deadline of December 19, 2014.

42. On or before December 19, 2014, two offers were received. One offer was for the purchase of substantially all of the Nelson business and one was for the acquisition of the K-12 Business. Both offers were non-binding, subject to further due diligence and reflected prices that were less than 55% of the First Lien Debt. In addition, a third interested party informed A&M that they continued to have interest but would not be prepared to move forward at a price in excess of \$200 million.
43. On December 19, 2014, one interested party requested, and was granted, additional time to submit an offer. That party submitted a non-binding proposal on December 23, 2014, which was subject to due diligence and financing. That party had apparently done no additional due diligence during Phase 2 and did not respond to enquiries from A&M with respect to continued interest in the opportunity following submission of the proposal.
44. The fifth party that had submitted an expression of interest and was invited to participate in Phase 2 declined to submit an offer.
45. An additional interested party that had not been identified for the original list of potentially interested parties contacted A&M in January 2015 with respect to the opportunity to acquire the Nelson business. That party was provided with the teaser and the form of non-disclosure agreement but subsequently informed A&M that, after internal discussions, it had decided not to pursue the opportunity.

Cengage

46. As described in the Nordal May 11 Affidavit, Cengage is a major supplier to Nelson. Cengage was included in the list of potentially interested parties for the SISP but they declined to participate.

47. When the SISP elicited no Superior Offers, Cengage was approached to determine whether there was an interest in submitting an offer to acquire the Higher Ed Business which could potentially be combined with the offer received for the K-12 Business.
48. Cengage submitted an expression of interest for the Higher Ed Business on February 23, 2015, but the combination of the offers for the Higher Ed Business and the K-12 Business was substantially lower than the amount owing to the First Lien Lenders.

Conduct of the SISP

49. The list of potentially interested parties contacted in the SISP was reviewed by the Monitor with the assistance of members of the media industry team of FTI Consulting, Inc., the Monitor's US parent. In the Monitor's view the list of potentially interested parties compiled by A&M and Nelson was extensive and thorough and provided for wide market coverage.
50. The Monitor reviewed the materials utilized in the SISP, including the teaser, CIM and process letter provided to interested parties. The Monitor did not identify any areas of concern with respect to the materials.
51. RBC has noted that in contrast to information presented by certain companies in the industry, the teaser and the CIM did not reference Nelson's deferred revenue. The Monitor is of the view that this would have had no impact on the SISP, or the results attained therefrom, as the interested parties were all sophisticated commercial parties and the deferred revenue information was available in the due diligence process.

52. The Monitor discussed the conduct of the SISP with Mr. Greg Nordal, Chief Executive Officer of Nelson, and with Mr. Ron Dunn, Chair of the Board of Nelson. Both Messrs. Nordal and Dunn expressed the view that A&M were thorough and professional in the conduct of the SISP and were complimentary of the work undertaken by A&M.
53. As discussed later in this Report, the Monitor also discussed the conduct of the SISP with a number of the interested parties. The interested parties were also complimentary of the work done by A&M in marketing the business, informed the Monitor that both A&M and Nelson management were helpful and responsive in all instances and identified no concerns with respect to their conduct or the administration of the SISP.

Selection of A&M as Investment Banker

54. The Monitor was informed that in discussions prior to the implementation of the SISP, the First Lien Lenders had indicated a preference for Nelson to engage either Houlihan Lokey Inc. or Moelis & Company to conduct the SISP. Houlihan Lokey Inc. and A&M were interviewed by Nelson, which ultimately selected A&M to run the SISP as the Board and management believed that A&M had the requisite expertise and that the significant knowledge of the business gained from A&M's role as financial advisor would be beneficial to the process.
55. Amongst its concerns, RBC has expressed a view that given that A&M has a well-known restructuring practice, the selection of A&M as investment banker could have led to a perception that a CCAA proceeding was inevitable, potentially resulting either in parties believing that they did not have to participate in the SISP as a further opportunity would be available in a CCAA proceeding or depressed values.

56. A&M has advised the Monitor that its corporate finance division, headed by Mr. Mullett, is separate from its restructuring practice and operates primarily in non-distressed situations, with approximately 95% of its corporate finance revenues from transactions outside any formal restructuring process since the firm's inception in 2010.
57. In the Monitor's view, the selection of A&M as investment banker to run the SISP would, in and of itself, not have had any adverse impact on the outcome of the SISP or the ability for the SISP to maximize value.

Incentives of A&M and Management

58. Pursuant to its engagement letter dated September 5, 2014 (the "**September 5 Engagement Letter**"), A&M's compensation for undertaking the SISP was a fixed fee for Phase 1 and hourly rates for Phase 2. A&M is not entitled to any success based fee, completion fee or other consideration related to the completion of the FLL Transaction.
59. Pursuant to the September 5 Engagement Letter, A&M would earn an additional transaction completion fee of 2% of the aggregate sale consideration in excess of US\$275 million in the event that a transaction with proceeds in excess of US\$275 million was completed. Accordingly, the September 5 Engagement Letter provided an incentive for A&M to obtain a transaction with a value in excess of the First Lien Debt and achieve the maximum sale price possible in the circumstances.

60. A key employee transaction incentive program (the “**KETIP**”) was approved by the Nelson Board on October 21, 2014. The KETIP was designed to incentivize those members of senior management considered integral to the SISP to both continue in their employment until at least 30 days following the completion of a transaction and to complete a transaction at a value sufficient to repay the First Lien Debt. No amounts are payable under the KETIP in connection with the FLL Transaction. Accordingly, the KETIP provided an incentive for the members of senior management that are parties to the KETIP to obtain a transaction with a value in excess of the First Lien Debt and achieve the maximum sale price possible in the circumstances.

Influence of the First Lien Lenders on the SISP

61. In addition to its other avenues of review, the Monitor has considered whether the First Lien Lenders may have had an adverse influence on the conduct of the SISP or its chances of obtaining an offer in excess of the First Lien Debt.
62. Based on its review, including discussions with Nelson and its advisors, discussions with the Chair of the Board of Directors of Nelson, discussions with members of the steering committee of the First Lien Lenders and their advisors and review of Board minutes and other documents, the Monitor has no reason to believe that the SISP, or its prospects of success, were adversely influenced by the First Lien Lenders or that there was any intention or motive on the part of the First Lien Lenders, Nelson or its advisors to achieve any result other than the highest and best offer for the business.

Heritage Canada Considerations

63. The Department of Canadian Heritage (“**Heritage Canada**”) was established by the Federal Government of Canada with a mandate to promote culture, the arts, heritage, official languages, citizenship and participation as well as Aboriginal, youth and sport initiatives.

64. Nelson, as a Canadian publisher, falls under the Heritage Canada mandate and is subject to the *Revised Foreign Investment Policy in Book Publishing and Distribution, 1992* (the “**Policy**”). The Policy sets out guidelines aimed at ensuring that foreign investment in Canada’s book industry is of net benefit to Canada. Factors to be considered in establishing net benefit to Canada are set out in section 20 of the *Investment Canada Act* (the “**ICA**”).
65. Heritage Canada states on its website that:

“Under the Act, the determination of net benefit in the cultural sector is made on a case-by-case basis by the Minister of Canadian Heritage through the review of proposals for controlling foreign investments. An investment may proceed if it receives the Minister’s approval.”
66. Nelson is currently owned by entities owned by OMERS Administration Corporation, a pension investment fund for Ontario municipal employees and Apax Partners, a foreign global private equity investment fund. A change in the ownership of Nelson would require the approval of Heritage Canada if a non-Canadian entity was to acquire the controlling interest.
67. The Monitor has been advised that Nelson and the First Lien Lenders have been in communication with Heritage Canada with respect to the issue of whether the FLL Transaction is subject to review under the ICA.
68. The Monitor has been informed by counsel to Nelson that Heritage Canada has verbally confirmed that it agrees that the FLL Transaction would be exempt from review. The Monitor has been informed that it is not Heritage Canada’s practice to issue written confirmation regarding the applicability of exemptions from review.

69. The Monitor has considered whether the Heritage Canada requirements, or the way they may have been presented to interested parties, could have had an adverse influence on the SISP.
70. While neither the CIM nor the management presentation provided to potentially interested parties included specific commentary on the Heritage Canada issues, the Monitor was informed by both Nelson and A&M that the matter was discussed during meetings with potential purchasers. Nelson also informed the Monitor that, during such discussions, it highlighted that a number of transactions had been reviewed and approved by Heritage Canada in the past and that, in Nelson's view, obtaining Heritage Canada approval would be achievable in the circumstances.
71. It is not feasible for the Monitor to canvass all of the 168 potentially interested parties that were invited to participate in the SISP to enquire whether there were any significant concerns in respect of Heritage Canada approval or the way it was presented by Nelson. However, as discussed later in this report, the Monitor did make such enquiries of each of the parties interested in the entire Nelson business that was invited to participate in Phase 2 of the SISP and it appears that:
- (a) The interested parties were aware of the approval requirement;
 - (b) The approval requirement was not considered an insurmountable concern, but was viewed simply as a necessary step in the process to acquiring Nelson to the extent that the purchaser was a non-Canadian;
 - (c) Nelson and its advisors appear to have been open in their discussions in respect of Heritage Canada and it was not presented as an insurmountable hurdle to concluding a transaction; and
 - (d) The Heritage Canada approval requirement was not the reason that the interested parties did not pursue an acquisition of Nelson at a price in excess of the First Lien Debt.

72. While the Monitor has not had discussions with representatives of Heritage Canada, the Monitor does not consider it likely that any kind of pre-approval or “comfort letter” from Heritage Canada, even if it was possible for such pre-approval or comfort letter to be obtained, would have had any material impact on the level of interest in the Nelson business or the value interested parties would have been willing to pay.

Discussions with Interested Parties

73. The Monitor contacted each of the parties interested in the entire Nelson business that had been invited to participate in Phase 2 of the SISP, including the party that declined to submit a Phase 2 proposal, to discuss the conduct of the SISP and matters related thereto, in particular the following:

- (a) Was there any concern or issue with respect to the sales process and how it was run?
- (b) Was there any concern with the conduct of A&M or their administration of the SISP?
- (c) Was A&M attentive and responsive in conducting the sales process?
- (d) Was Nelson management attentive and responsive in conducting the sales process?
- (e) Whether the interested party considered a Heritage Canada approval requirement a significant impediment to a transaction?
- (f) What were the primary reasons that they did not further pursue a transaction?

74. The discussions with the interested parties are summarized as follows:

- (a) No issues or concerns were identified with respect to the SISP or how it was conducted;

- (b) The interested parties were complimentary of the work done by A&M in marketing the business;
- (c) A&M was helpful and responsive in all instances and no concerns were identified with respect to their conduct;
- (d) Management was helpful and responsive in all instances and no concerns were identified with respect to their conduct;
- (e) Each party was aware of the Heritage Canada requirement for approval of a transaction as it was either identified through discussions with A&M and management or their own diligence process, but no party considered the requirement for Heritage Canada approval of a transaction to be a material impediment or factor affecting value;
- (f) The primary reasons given for not further pursuing a transaction were that:
 - (i) A value at levels approaching the amount of the First Lien Debt was not supportable; and
 - (ii) Uncertainty with respect to the K-12 Business which had been in decline and when, or if, there might be growth in the segment.

Unsolicited Interest Arising since the Commencement of the CCAA Proceedings

75. Since its appointment, the Monitor has received two unsolicited enquiries from parties expressing an interest in the acquisition of Nelson. One of the parties had been contacted during the SISP and had passed on the opportunity. The other is the party that had contacted A&M in January 2015 but decided not to proceed.

76. As discussed later in this Report, the Monitor is of the view that reopening the SISP at this time is not likely to result in a transaction at a value sufficient to repay the First Lien Debt and that parties reconsidering their decision to not participate in the SISP does not, in and of itself, justify reopening the process.
77. Notwithstanding, Nelson has agreed to provide the two parties the opportunity to conduct due diligence while preparing for the Sale Approval Motion.

The Monitor's Assessment of the SISP Process

78. In the Monitor's view:
- (a) The design of the SISP was typical of such marketing processes and was consistent with processes that have been approved by the courts in many CCAA proceedings;
 - (b) The SISP allowed interested parties adequate opportunity to conduct due diligence, both A&M and management appear to have been responsive to all requests from potentially interested parties and the timelines provided for in the SISP were reasonable in the circumstances;
 - (c) The activities undertaken by A&M were consistent with the activities that any investment banker or sale advisor engaged to assist in the sale of a business would be expected to undertake;
 - (d) The selection of A&M as investment banker would not have had a detrimental effect on the SISP or the value of offers;
 - (e) Both key senior management and A&M were incentivised to achieve the best value available and there was no impediment to doing so;
 - (f) The SISP was undertaken in a thorough and professional manner;

- (g) The results of the SISP clearly demonstrate that none of the interested parties would, or would be likely to, offer a price for the Nelson business that would be sufficient to repay the First Lien Debt.

79. Accordingly, it is the Monitor's view that the SISP was a thorough market test and can be relied on to establish that there is no value beyond the First Lien Debt.

OTHER INDICIA OF THE POTENTIAL VALUE OF THE NELSON BUSINESS AND ASSETS

80. As described above, the Monitor is of the view that the SISP provided a thorough market test of the value of the Nelson business. The Monitor is also of the view that a market test is a true indicator of value and more relevant in the circumstances of this case than a theoretical or "desk-top" valuation. Accordingly, the Monitor has not obtained a valuation by a Chartered Business Valuator, nor does this report purport to be a valuation of the Nelson business. However, for illustrative purposes, the Monitor has considered the following other indicia of value:

- (a) Discounted cash flow ("**DCF**");
- (b) Multiples of earnings before interest, tax, depreciation and amortization ("**EBITDA**");
- (c) Comparable market transactions; and
- (d) Liquidation value.

DCF

81. DCF is a calculation utilizing a discount rate to calculate forecast cash flow to a net present value. In carrying out a DCF assessment, Chartered Business Valuators will use a variety of factors to determine an appropriate discount rate to be used in the calculation.

82. For the purposes of considering DCF, the Monitor has utilized Nelson’s five-year projections as provided to interested parties during the SISP. The projections end at fiscal year 2019, and 2019 has been used as a proxy for an additional five years of projection.
83. The Monitor understands that the publishing industry typically presents earnings on a “pre-plate” and a “post-plate” basis. “Plate” refers to the pre-publication and development costs associated with products. Such costs are typically capitalized and amortized over a specified period of time. Plate costs are incurred to refresh existing products and to bring new products to market and are a necessary expense as without investment in plate, the product pipeline would diminish and the business performance would decline. Accordingly, post-plate earnings could be viewed as a better indicator of business performance.
84. For the purposes of this Report, the Monitor has calculated DCF based on Nelson’s projected post-plate EBITDA using a range of discount rates from 10% to 20%. The results of that calculation are as follows:

Discount Rate	Indicative DCF \$M
10%	258.8
12%	241.3
14%	225.9
16%	212.1
18%	199.9
20%	188.9

85. As noted earlier in this Report, there is a potential dispute over the amount of the First Lien Debt, but the Monitor has assumed for the purposes of this Report that the First Lien Debt is in the range of approximately US\$260.9 million to US\$273.5 million or \$326.1 million to \$341.9 million converted at \$0.80. Utilizing the same methodology described above, a discount rate in the range 2.9% to 4.0% would be required for the indicative DCF to be at the level of the First Lien Debt excluding cash on hand.

EBITDA Multiples

86. EBITDA multiples may also be used to calculate the potential value of a business based on historic or projected profitability. Indicative values calculated based on Nelson's 2014 post-plate EBITDA, 2015 estimated post-plate EBITDA and 2016 forecast post-plate EBITDA using a range of EBITDA multiples are as follows:

EBITDA Multiple	2014 Actual \$M	2015 Estimated \$M	2016 Forecast \$M
4	121.6	131.2	136.4
5	152.0	164.0	170.5
6	182.4	196.8	204.6
7	212.8	229.6	238.7
8	243.2	262.4	272.8
9	273.6	295.2	306.9
10	304.0	328.0	341.0
11	334.4	360.8	375.1
12	364.8	393.6	409.2

87. A number of companies that are potentially comparable to Nelson are publicly traded. A&M and CDG Group, the financial advisor to the Second Lien Lenders, have each provided the Monitor some analysis of public company multiples. The Monitor makes no comment on the degree of comparability of the companies used in the analysis but has summarized the information provided for indicative purposes² as follows:

² Only a small set of potential comparables was identified and there is a high degree of variability in the data set which may impact the utility of these multiples for comparison purposes.

A&M Data	EV/Pre-Plate EBITDA			EV/Post-Plate EBITDA		
	30/9/14	31/12/14	2/6/15	30/9/14	31/12/14	2/6/15
Pearson plc	11.4	11	10.7	15.9	15.4	14.8
John Wiley & Sons Inc.	9.4	9.7	9	10.6	10.9	10.1
Cengage Learning	6.9	6.3	7.1	9.1	8.5	9.9
Houghton Mifflin Harcourt Company	10	9.2	14.3	18.2	16.7	28.1
Scholastic Corporation	5.9	5.8	7.1	8.4	8.2	10.1

CDG Data	Date	EV/Pre-Plate EBITDA	EV/Post-Plate EBITDA
Pearson plc	31/12/14	14.25	24.83
Cengage Learning	31/3/15	6.67	8.93
Houghton Mifflin Harcourt Company	31/3/15	13.7	19.51

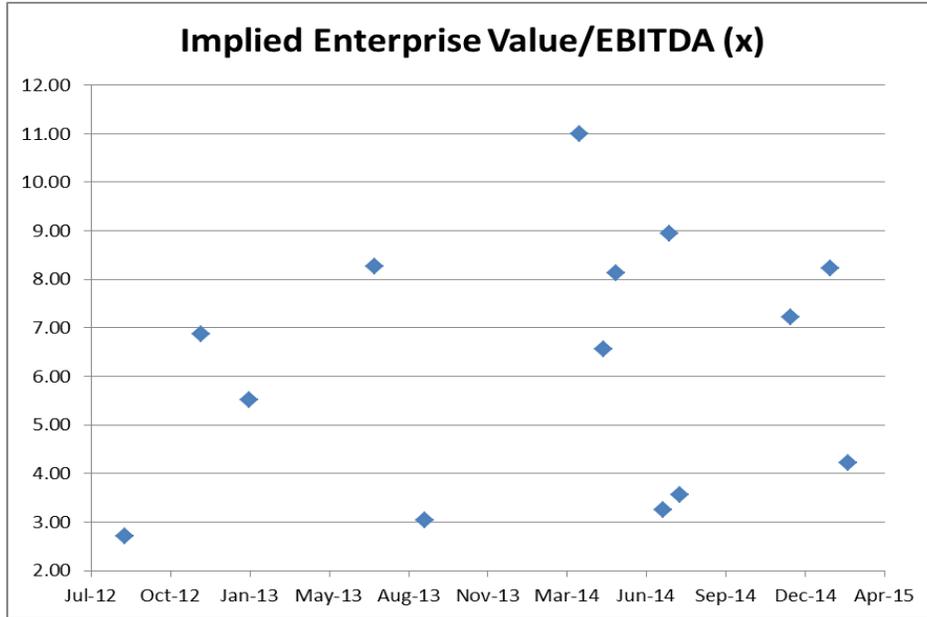
Comparable Market Transactions

88. The Monitor obtained data³ on potentially comparable recent market transactions based on the following search criteria:

- (a) Transactions in the three years from June 2012 to May 2015;
- (b) Transactions with the SIC Code 2700 “printing, publishing and allied industries” or under the industry classification “printed media publishing”;
- (c) Within the geographic regions of United States and Canada or European Developed Markets; and
- (d) A total transaction value greater than US\$25 million.

³ Source: Capital IQ

89. The search returned 69 transactions, of which 18 transactions had reported data for Enterprise Value to pre-plate EBITDA ratio (“EV/EBITDA”). Excluding four transactions in the commercial printing sector, the EV/EBITDA data for the transactions ranged from 2.71 to 10.99 with a mean of 6.25 and is summarized in the following chart:



90. The implied EV/EBITDA for a transaction at a value sufficient to repay the First Lien Debt would be in the range 7.6 to 8.0 times based on Nelson’s estimated 2015 pre-plate EBITDA and in the range 9.9 to 10.4 times based on Nelson’s estimated post-plate EBITDA.

Liquidation Value

91. The Monitor has considered the potential liquidation value of the assets of Nelson in a shut-down scenario. The asset information from Nelson’s March 2015 balance sheet is summarized below:

Assets	Book Value
	\$M
Cash and restricted cash	32.2
Accounts receivable	1.3
Inventory	11.4
Prepays and other current assets	19.8
Total Current Assets	64.7
Pre-publication cost	17.2
Property and equipment	13.7
Identifiable intangible assets	116.3
Goodwill	34.4
Total Assets	246.3

92. In the Monitor's judgment there is no reasonable possibility that the liquidation value of the Nelson assets is greater than the First Lien Debt.

POTENTIAL ALTERNATIVES TO THE FLL TRANSACTION

93. The Monitor has considered whether there are viable alternatives to the sale of the business pursuant to the FLL Transaction, in particular, the following:

- (a) Whether a refinancing sufficient to repay the First Lien Debt would be possible;
- (b) Whether an alternative restructuring of debt acceptable to the First Lien Lenders and the Second Lien Lenders might be achievable;
- (c) Whether re-opening the sale process at this time would likely result in a sale at a value in excess of the First Lien Debt; and
- (d) Whether a delay in proceeding with a sale would enable steps to be taken by Nelson to improve profitability to such a degree that value might be available to the Second Lien Lenders at a later date.

Possibility of Refinancing

94. The Monitor obtained data⁴ on senior secured loan leverage ratios⁵ covering the period 2003 to March 2015, which is summarized below:

Year	Senior Debt/EBITDA	Sub-Debt/EBITDA	Total Debt/EBITDA
2003	2.87	1.99	4.87
2004	3.17	2.30	5.46
2005	3.31	2.35	5.66
2006	3.79	2.48	6.27
2007	4.40	2.65	7.05
2008	3.64	1.83	5.48
2009	3.55	1.27	4.82
2010	3.83	1.82	5.65
2011	3.99	1.59	5.57
2012	3.80	2.07	5.86
2013	4.28	1.89	6.18
2014	4.66	1.90	6.56
Q1 2015	4.47	1.51	5.99

95. The First Lien Lender debt equates to a leverage ratio of between approximately 9.9 and 10.5 based on estimated 2015 post-plate EBITDA, a level that the data shown above would suggest is significantly higher than market norms.

96. The Monitor also notes that the Second Lien Lenders were apparently not prepared to provide Nelson with the financing necessary to repay the First Lien Debt.

97. Accordingly, the Monitor is of the view that there is no realistic prospect that Nelson could obtain a new source of financing sufficient to repay the First Lien Debt.

⁴ Source: Thomson Reuters

⁵ Debt/EBITDA

Alternative Debt Restructuring

98. Based on the Nordal May 11 Affidavit and discussions with various parties, the Monitor understands that significant efforts were made over a considerable period of time prior to the execution of the First Lien Support Agreement to endeavour to negotiate a debt restructuring that would be acceptable to both the First Lien Lenders and the Second Lien Lenders but without success.
99. As noted earlier in this Report, the Monitor is of the view that the SISP has fairly demonstrated that there is no value beyond the First Lien Debt. Accordingly, there would appear to be little incentive for the First Lien Lenders to agree to a debt restructuring in preference to proceeding with the acquisition of the business and the consequent de-levering of the balance sheet. Consequently, the Monitor does not consider that an alternative debt restructuring that might create value for the Second Lien Lenders is a viable alternative at this time.

Re-Opening of Sale Process at This Time

100. The Monitor has considered whether reopening the sales process in the CCAA Proceedings might reasonably be expected to generate a result that would repay the First Lien Debt and provide some recovery for the Second Lien Lenders.
101. As previously noted, the Monitor is of the view that the SISP was a thorough canvassing of the market and fairly demonstrated that there is no value beyond the First Lien Debt.
102. Since December 2014 when the SISP was substantially completed, there has been no material improvement in the business or market conditions that would suggest that a different result could be achieved if the sales process was reopened at this time.

103. Furthermore, the decline in the Canadian dollar as compared to the US dollar is an important factor as Nelson's revenues and profits are denominated in Canadian dollars and the First Lien Debt is denominated in US dollars. The Canadian dollar has dropped from approximately \$0.89 at September 30, 2014 to approximately \$0.86 at December 31, 2014 to approximately \$0.80 currently, resulting in the amount required to repay the First Lien Debt increasing by approximately 7.5% since December 31, 2014 and 11.25% since September 30, 2014.
104. Accordingly, the Monitor does not believe that there is any reasonable prospect of a new sale process generating a transaction at a value in excess of the First Lien Debt.

Delay to Improve Profitability

105. Pursuant to the provisions of the CCAA, a debtor company must, in order to continue to benefit from a stay of proceedings, proceed with good faith and due diligence. The Monitor does not believe that a strategy of simply waiting in the hope that market conditions improve is a reasonable or appropriate approach. The Monitor has, however, considered whether it is reasonable to believe that steps could be taken to materially improve the profitability of Nelson such that additional value could be obtained for the business.

FTI US Report

106. Pursuant to an engagement letter dated October 23, 2014, between FTI Consulting, Inc. ("**FTI US**") and Nelson Education Ltd., FTI US was engaged to perform an independent operational assessment, process review, benchmarking and preliminary estimate of potential savings or revenue opportunities for Nelson. The Monitor understands that FTI US completed its mandate in January 2015 with a delivery of a report on its findings (the "**FTI US Report**").
107. The FTI US Report concludes that Nelson:

- (a) Is well run with EBITDA margins and cost metrics at the top end of the peer range;
 - (b) Has adapted well to the declining revenue environment in both the Higher Ed and K-12 Business segments; and
 - (c) Has a slightly weaker revenue trend than some peers, which may indicate that costs reductions have been too severe in some places.
108. The FTI US report identified a number of potential opportunities to potentially improve future profitability, of which the following were identified as the key opportunities:
- (a) Amending the sales incentive compensation plan;
 - (b) Improving inventory management and reducing inventory production;
 - (c) Eliminating unprofitable titles; and
 - (d) Replacing the information technology and back office systems.
109. The Monitor discussed the findings of FTI US with Mr. Nordal who concurs that some opportunities are available, particularly the replacement of the back office systems, though that would require a significant capital outlay. Mr. Nordal was also of the view that certain of the suggestions of FTI US were not entirely feasible or would not generate the improvements suggested, particularly in the short-term.

Additional Opportunities Arising from the CCAA Proceedings

110. The Monitor also discussed with Mr. Nordal whether additional restructuring opportunities might be available as a result of the commencement of the CCAA Proceedings, for example, disclaiming onerous contracts. It does not appear that there are any additional material opportunities.

Potential Renegotiation of the Cengage Contract

111. Nelson's relationship with Cengage and the current contract to adapt and distribute Cengage materials in the Canadian market is a significant value driver for Nelson's Higher Education business segment. The contract currently expires on January 1, 2018 (the "**Initial Term**"), subject to automatic one-year renewal periods. The Monitor has considered whether it would be possible to renegotiate or extend that contract to potentially make Nelson more attractive to potential buyers.
112. While Nelson made efforts to renegotiate or extend the Cengage contract in the period between approximately June 2013 and September 2014, Cengage declined to do so.
113. With more than three years remaining on the Initial Term of the Cengage contract, it is not surprising to the Monitor that Cengage was not willing to commence negotiations with respect to extending the contract. Given the SISF, it is also likely that Cengage would rather have any such discussions following the completion of a sale. Furthermore, in the Monitor's view it is not reasonable to believe that Nelson could successfully negotiate revised terms that would increase Nelson's profitability to such an extent that the value of the Nelson business would increase to a level in excess of the First Lien Debt.

Potential Detrimental Impact of Delay

114. Nelson's management has expressed to the Monitor that it is concerned that further delay in completing the FLL Transaction could have a detrimental impact on the Nelson business and relationships with employees, customers, vendors and authors.

Conclusion

115. Overall, it does not appear to the Monitor that there are significant operational improvements reasonably available that would materially improve profitability in the short-term such that the value of the Nelson business would increase to the extent necessary to repay the First Lien Debt. Accordingly, there is no apparent benefit from delaying the sale of the business.

THE SALE APPROVAL MOTION

116. Capitalized terms used in this section of this Report not otherwise defined are as defined in the APA.

117. In addition to the approval of the FLL Transaction and other common provisions, the AVO provides for certain ancillary relief (the “**Ancillary Relief**”), including:

- (a) Releases of claims between Nelson, the Purchaser, the First Lien Agent, the Supplemental Agent, the First Lien Lenders and their respective present and former direct and indirect shareholders, officers, directors, employees, auditors, advisors, legal counsel and agents, relating to matters occurring prior to Closing in connection with Nelson, the APA, the Transaction, the CCAA Proceedings, the Support Agreement, the First Lien Credit Agreement and other matters ancillary to the foregoing; and
- (b) A provision deeming the Stockholders and Registration Rights Agreement to be effective and binding on all holders of common shares of Purchaser Holdco and any person entitled to receive common shares of Purchaser Holdco in connection with the Transaction. The Stockholders and Registration Rights Agreement contains terms relating to:

- (i) The composition of the board of directors of Purchaser Holdco and the designation of rights of certain shareholders to appoint directors of Purchaser Holdco;
- (ii) Certain drag along, tag along and pre-emptive rights with respect to transfers and issuances of shares of Purchaser Holdco;
- (iii) Provisions for access to information by shareholders; and
- (iv) Procedures by which shareholders may cause the registration of Purchaser Holdco's securities for Canadian and US securities law purposes.

118. The Monitor is still in the process of considering the Ancillary Relief and, accordingly, the Ancillary Relief is not addressed in this Report. To the extent necessary, the Monitor will file a subsequent report addressing the Ancillary Relief prior to the return of the Sale Approval Motion.

THE APA

119. On May 11, 2015, Nelson entered into a supplemental support agreement (the "**Supplemental Support Agreement**") among the Nelson Education Ltd., Nelson Education Holdings Ltd., the First Lien Agent, Cortland Capital Market Services LLC, as sub-agent and supplemental administrative agent appointed in connection with the implementation of the FLL Transaction (the "**Supplemental Agent**") and Consenting First Lien Lenders party thereto pursuant to which, upon entry of an Approval and Vesting Order approving the FLL Transaction, in the form attached to the APA, Nelson agreed to enter into the APA 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 APA with Nelson. A copy of the APA is attached as Exhibit B to the Mullett Affidavit filed in support of the Sale Approval Motion.

120. The key provisions of the APA are as follows:

- (a) The Purchaser shall acquire the Purchased Assets for the Purchase Price, being US\$216 million plus the amount of the Closing Date Assumed Liabilities;
- (b) The Purchase Price will be satisfied by the Purchaser:
 - (i) Assuming the Closing Date Assumed Liabilities;
 - (ii) Entering into the Newco First Lien Credit Agreement and issuing the Term Note to the Seller in the principal amount of US\$200 million; and
 - (iii) Issuing to the Seller the Purchaser Preferred Shares with an aggregate redemption amount equal to US\$16 million;
- (c) The Purchaser shall not acquire the Excluded Assets or assume the Excluded Liabilities; and
- (d) Closing shall take place on the third Business Day following the date on which all of the conditions of the APA have been satisfied or waived, other than those conditions that can only be satisfied on Closing.

121. The obligation of the Purchaser and of the Seller to complete the Transaction is subject to a number of customary conditions in favour of the Purchaser and the Seller respectively.

THE MONITOR'S COMMENTS AND RECOMMENDATION

122. Section 36(1) of the CCAA states:

“36(1) Restriction on disposition of business assets - A
debtor company in respect of which an order has been

made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.”

123. Section 36(3) of the CCAA states:

“(3) **Factors to be considered** - In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.”

Reasonableness of the Process Leading to the Proposed Sale

124. As described earlier in this Report, the Monitor has investigated the design, implementation and conduct of the SISP. The Monitor has considered the SISP in light of the principles of leading decisions regarding Court-approved sales of assets⁶ and is satisfied that the marketing process was fair, transparent and reasonable in the circumstances. Furthermore, the Monitor is of the view that further canvassing of the market is unnecessary in the circumstances.

Monitor's Approval of the Process

125. As the Court is aware, the SISP was carried out well in advance of the commencement of the CCAA Proceedings and the Monitor had no involvement in the process. However, since its appointment, the Monitor has been provided with all the information it has requested in respect of the SISP, including the expressions of interest and letters of intent obtained. Nelson and its advisors, the First Lien Lenders representatives and RBC and its advisors have all provided their full cooperation with the Monitor's review as described in this Report.

Consultation with Creditors

126. The Monitor understands that the Steering Committee of the First Lien Lenders was consulted with respect to the development of the SISP and was also provided periodic updates throughout the process including details of the expressions of interest received.

127. The Monitor understands that there was no consultation with the Second Lien Lenders. The Monitor has been informed that RBC received a copy of the SISP on September 19, 2014 and certain limited verbal updates during the SISP.

⁶ Decisions in the following cases: *Royal Bank of Canada v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (Ont. C.A.); *Re. Aveos Fleet Performance Inc.* [2012] Q.J. No. 8077 (QC .S.C.); *Re. White Birch Paper Holding Company* [2010] Q.J. No. 10469 (QC S.C.); *Re. AbitibiBowater* , [2010] 71 C.B.R. (5th) 220. (QC S.C.)

128. The Monitor would expect that a secured lender that is also a bidder in a sale process would not be given access to competing bid information unless such lender had confirmed that they would not bid in excess of their indebtedness, in which case they would have no competitive advantage from the receipt of such information.
129. The Monitor has been informed that Nelson and its counsel are of the view that based on dialogue with the First Lien Lenders, their conduct and the terms of the First Lien Support Agreement, there was sufficient assurance that the First Lien Lenders would not participate in the SISP as a competitive bidder and that the First Lien Support Agreement was a “backstop” in case the SISP failed to provide a Superior Offer. As described earlier in this Report, there were no bids in excess of the First Lien Debt.
130. Accordingly, there was no apparent or unfair advantage provided to the First Lien Lenders by the Steering Committee having access to the expressions of interest.
131. The Monitor does not believe that the SISP was adversely impacted by any lack of consultation with the Second Lien Lenders or that any material change in the outcome of the SISP would have resulted from such consultation.

The Effect of the Proposed Sale on Creditors and Other Interested Parties

132. The FLL Transaction, if approved, would result in:
 - (a) The transfer of substantially all of Nelson's assets to the Purchaser, subject to the rights of the Purchaser to elect not to acquire any particular asset provided that such election is made on or prior to the date that is three business days before closing;
 - (b) The assumption by the Purchaser, in each case subject to the exceptions described in the APA, of:

- (i) Nelson's ordinary course liabilities to clients, vendors, suppliers and customers, and other trade payables;
 - (ii) Liabilities incurred in the ordinary course under assigned contracts and cure costs, if any, in respect of assigned contracts;
 - (iii) Liabilities in respect of Transferred Employees; and
 - (iv) Liabilities of Nelson that rank senior in priority to the obligations owing to the First Lien Lenders, other than the court-ordered charges granted in these CCAA Proceedings;
- (c) An offer of employment by the Purchaser to all of Nelson's employees;
- (d) Ongoing service for Nelson's customers and ongoing business opportunities for Nelson's suppliers; and
- (e) An exchange and release by the First Lien Lenders of all of the indebtedness owing under the First Lien Credit Agreement for:
- (i) 100% of the common shares of a newly incorporated entity ("Purchaser Holdco") that will own 100% of the common shares of the Purchaser; and
 - (ii) A new US\$200 million first lien term facility to be entered into by the Purchaser.
133. Liabilities (the "**Excluded Liabilities**") that would not be assumed by the Purchaser include:
- (a) Amounts owed to the Second Lien Lenders;

- (b) Severance amounts owing to a small number of former employees (the “**Terminated Former Employees**”), which amounts would total approximately \$180,000 at July 31, 2015;
 - (c) Liabilities under Excluded Contracts;
 - (d) Pre-closing liabilities under Assumed Contracts other than liabilities incurred in the ordinary course or cure costs, if any;
 - (e) Pre-closing tax liabilities on purchased assets;
 - (f) Environmental liabilities and liabilities for hazardous substances to the extent these can be excluded under applicable laws.
134. While creditors owed Excluded Liabilities, including the Second Lien Lenders and the Terminated Former Employees, will receive no recovery on the amounts owing if the FLL Transaction is completed, in the Monitor’s view there is no reasonable prospect of any alternative solution that would provide a recovery for those creditors, all of whom rank subordinate to the First Lien Lenders.
135. Substantially all other creditors ranking subordinate to the First Lien Lenders would be assumed by the Purchaser, providing a recovery that may not be available in other circumstances.
136. Accordingly, in the Monitor’s view, the FLL Transaction represents the best available outcome for all stakeholders and is not prejudicial to the creditors owed Excluded Liabilities.

Fairness of Consideration

137. The Monitor is of the view that results of the SISIP indicate that the consideration is fair and reasonable in the circumstances and that the SISIP can, and should, be relied on for the purposes of such a determination.

Monitor's Recommendation

138. Based on the foregoing, the Monitor supports Nelson's request for approval of the FLL Transaction.
139. As noted earlier in this Report, the Monitor is still in the process of considering the Ancillary Relief contained in the Sale Approval Motion and, accordingly, reserves its views with respect thereto. To the extent necessary, the Monitor will file a subsequent report addressing the Ancillary Relief and any other pertinent matters prior to the return of the Sale Approval Motion.

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

Dated this 8th day of July, 2015.

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



Nigel D. Meakin
Senior Managing Director



Toni Vanderlaan
Senior Managing Director

Appendix A

The July 6 Forecast

Nelson Education Ltd.

Cash flow forecast for the 13-week period June 29, 2015 to September 25, 2015

(Unaudited, in '000s CAD)

Week Ending, Friday:	Week 1 7/3/2015 Forecast	Week 2 7/10/2015 Forecast	Week 3 7/17/2015 Forecast	Week 4 7/24/2015 Forecast	Week 5 7/31/2015 Forecast	Week 6 8/7/2015 Forecast	Week 7 8/14/2015 Forecast	Week 8 8/21/2015 Forecast	Week 9 8/28/2015 Forecast	Week 10 9/4/2015 Forecast	Week 11 9/11/2015 Forecast	Week 12 9/18/2015 Forecast	Week 13 9/25/2015 Forecast	Total
Receipts														
Sales receipts	1,037	1,156	1,263	1,940	3,988	2,350	2,545	4,126	6,048	6,029	6,507	4,878	2,105	43,971
Other receipts	332	-	330	-	-	-	-	150	-	-	-	150	-	962
Total Receipts	1,369	1,156	1,594	1,940	3,988	2,350	2,545	4,276	6,048	6,029	6,507	5,028	2,105	44,933
Disbursements														
Operating expenses	240	917	1,950	996	372	374	377	6,426	377	466	535	4,107	1,338	18,475
Payroll & benefits	5	1,430	10	1,225	14	1,425	5	1,220	5	1,420	5	1,220	5	7,991
KERP	332	-	-	-	-	-	-	-	-	-	-	-	-	332
Other expenses	257	212	343	401	825	122	101	422	1,167	176	158	394	1,287	5,866
Capital expenditures and plate spend	313	133	74	182	113	281	86	144	288	128	112	108	128	2,089
Professional fees	41	811	65	330	140	165	200	165	140	140	115	115	115	2,542
Financing charges	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Disbursements	1,188	3,504	2,442	3,134	1,463	2,367	770	8,377	1,978	2,331	924	5,945	2,874	37,296
Net Operating Cash Flow	181	(2,348)	(849)	(1,194)	2,524	(18)	1,775	(4,101)	4,070	3,698	5,583	(917)	(769)	7,637
Beginning Cash Balance	17,584	17,766	15,418	14,569	13,376	15,900	15,882	17,657	13,556	17,626	21,324	26,907	25,990	17,584
Net Cash Flow	181	(2,348)	(849)	(1,194)	2,524	(18)	1,775	(4,101)	4,070	3,698	5,583	(917)	(769)	7,637
Ending Cash Balance	17,766	15,418	14,569	13,376	15,900	15,882	17,657	13,556	17,626	21,324	26,907	25,990	25,221	25,221

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

Nelson Education Ltd.
Cash Flow Forecast
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 disbursements are made in accordance with the normal payment terms for the Companies' creditors and consistent with the Companies' historical practice. 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 opening cash balance as at June 29, 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 Forecast excludes the KERP monies that are being held in a separate account with Valiant Trust Company. The Forecast reflects the receipt of those monies and corresponding payment of the KERP in Week 1.

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 and the Monitor and its legal counsel. The Forecast also includes the payment of costs awarded to RBC in connection with the endorsement of Justice Newbould issued on June 30, 2015. The Forecast does not include payment of ordinary course professional fees of First or Second Lien Lenders' 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 or Second Lien Lenders.

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.

Court File No. CV-15-10961-OOCL

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

Proceeding commenced at Toronto

SECOND REPORT OF THE MONITOR

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