CAMBIUM LEARNING GROUP, INC.
Form 10-Q
November 06, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2014

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission File Number: 001-34575

Cambium Learning Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	27-0587428 (I.R.S. Employer Identification No.)
17855 North Dallas Parkway, Suite 400, Dallas, Texas (Address of Principal Executive Offices)	75287 (Zip Code)

Registrant’s telephone number, including area code: (888) 399-1995

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares of the registrant’s common stock, $0.001 par value per share, outstanding as of October 31, 2014 was 44,916,856.

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Item 1. Financial Statements.

Cambium Learning Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net revenues	$41,144	$42,957	$108,467	$117,172
Cost of revenues:				
Cost of revenues	11,045	12,950	29,986	37,000
Amortization expense	4,695	4,692	13,213	12,680
Total cost of revenues	15,740	17,642	43,199	49,680
Research and development expense	2,745	2,486	8,090	7,345
Sales and marketing expense	11,015	10,943	31,680	32,991
General and administrative expense	5,039	5,122	14,676	16,795
Shipping and handling costs	666	721	1,266	1,419
Depreciation and amortization expense	1,050	1,227	3,150	3,663
Embezzlement-related expense	—	3	—	118
Total costs and expenses	36,255	38,144	102,061	112,011
Income before interest, other income (expense) and income taxes	4,889	4,813	6,406	5,161
Net interest expense	(4,377)	(4,773)	(13,535)	(14,028)
Loss on extinguishment of debt	—	—	(570)	—
Other income, net	535	215	965	645
Income (loss) before income taxes	1,047	255	(6,734)	(8,222)
Income tax expense	(52)	(127)	(146)	(297)
Net income (loss)	$995	$128	$(6,880)	$(8,519)
Other comprehensive income (loss):				
Amortization of net pension loss	22	30	65	90
Comprehensive income (loss)	$1,017	$158	$(6,815)	$(8,429)
Net income (loss) per common share:				
Basic	$0.02	$0.00	$(0.15)	$(0.18)
Diluted	$0.02	$0.00	$(0.15)	$(0.18)
Average number of common shares and equivalents outstanding:				
Basic	45,664	47,563	45,663	47,439

Diluted	45,753	47,657	45,663	47,439

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

Cambium Learning Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(In thousands, except per share data)

	As of September 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$44,403	$67,993
Accounts receivable, net	28,561	15,767
Inventory	6,311	9,221
Restricted assets, current	1,463	1,343
Other current assets	8,872	6,873
Total current assets	89,610	101,197
Property, equipment and software at cost	49,576	43,224
Accumulated depreciation and amortization	(29,148)	(22,909)
Property, equipment and software, net	20,428	20,315
Goodwill	47,842	47,842
Acquired curriculum and technology intangibles, net	6,038	8,719
Acquired publishing rights, net	3,248	4,705
Other intangible assets, net	4,871	6,251
Pre-publication costs, net	15,081	13,401
Restricted assets, less current portion	4,451	5,492
Other assets	8,578	8,288
Total assets	$200,147	$216,210

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

Cambium Learning Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(In thousands, except per share data)

	As of September 30, 2014 (Unaudited)	December 31, 2013
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Capital lease obligations, current	$ 1,061	$ 995
Accounts payable	3,723	1,301
Accrued expenses	15,943	25,279
Deferred revenue, current	60,416	53,532
Total current liabilities	81,143	81,107
Long-term liabilities:		
Long-term debt	164,635	174,491
Capital lease obligations, less current portion	1,217	2,019
Deferred revenue, less current portion	10,204	7,829
Other liabilities	12,818	13,954
Total long-term liabilities	188,874	198,293
Commitments and contingencies (See Note 12)		
Stockholders' equity (deficit):		
Preferred stock ($.001 par value, 15,000 shares authorized, zero shares issued and outstanding at September 30, 2014 and December 31, 2013)	—	—
Common stock ($.001 par value, 150,000 shares authorized, 51,251 and 51,208 shares issued, and 44,917 and 45,042 shares outstanding at September 30, 2014 and December 31, 2013, respectively)	51	51
Capital surplus	284,109	283,673
Accumulated deficit	(339,575)	(332,695)
Treasury stock at cost (6,334 and 6,166 shares at September 30, 2014 and December 31, 2013, respectively)	(12,448)	(12,147)
Accumulated other comprehensive loss:		

Pension and postretirement plans	(2,007)	(2,072)
Accumulated other comprehensive loss	(2,007)	(2,072)
Total stockholders' equity (deficit)	(69,870)	(63,190)
Total liabilities and stockholders' equity (deficit)	$200,147	$216,210

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

Cambium Learning Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Operating activities:		
Net loss	$(6,880)	$(8,519)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization expense	16,363	16,343
Loss on extinguishment of debt	570	—
Loss from recovery of property held for sale	—	122
Gain on sale of IntelliTools product line	(289)	—
Amortization of note discount and deferred financing costs	1,164	1,304
Change in fair value of contingent value rights obligation	—	74
Loss on disposal of assets	91	104
Stock-based compensation and expense	383	788
Proceeds from recovered properties	—	258
Michigan tax refund received	—	12,342
Other	5	—
Changes in operating assets and liabilities:		
Accounts receivable, net	(12,794)	(13,738)
Inventory	2,649	6,029
Other current assets	(1,964)	(408)
Other assets	(1,734)	(875)
Restricted assets	921	3,995
Accounts payable	2,422	(1,355)
Accrued expenses	(5,336)	60
Deferred revenue	9,300	7,556
Other long-term liabilities	(1,511)	(830)
Net cash provided by operating activities	3,360	23,250
Investing activities:		
Cash paid for acquisitions	(3,600)	—
Cash paid for contingent value rights obligation related to acquisition	—	(7,673)
Expenditures for property, equipment, software and	(13,027)	(12,383)

pre-publication costs		
Proceeds from sale of IntelliTools product line	806	—
Net cash used in investing activities	(15,821)	(20,056)
Financing activities:		
Principal payments under capital lease obligations	(736)	(1,061)
Repayment of debt	(10,145)	—
Proceeds from exercise of stock options	53	—
Share repurchases	(301)	(244)
Net cash used in financing activities	(11,129)	(1,305)
Change in cash and cash equivalents	(23,590)	1,889
Cash and cash equivalents, beginning of period	67,993	51,904
Cash and cash equivalents, end of period	$44,403	$53,793

The accompanying Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

Cambium Learning Group, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

Note 1 — Basis of Presentation

Presentation. The Condensed Consolidated Financial Statements include the accounts of Cambium Learning Group, Inc. and its subsidiaries (the "Company") and are unaudited. The condensed consolidated balance sheets as of December 31, 2013 have been derived from audited financial statements. All intercompany transactions have been eliminated.

As permitted under the Securities and Exchange Commission ("SEC") requirements for interim reporting, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") have been omitted. The Company believes that these financial statements include all necessary and recurring adjustments for the fair presentation of the interim period results. These financial statements should be read in conjunction with the Consolidated Financial Statements and related notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013. Due to seasonality, the results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results to be expected for any future interim period or for the year ending December 31, 2014.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Subsequent actual results may differ from those estimates.

Nature of Operations. The Company is a leading educational solutions and services company that is committed to helping all students reach their full potential by providing evidence-based solutions and expert professional services to empower educators and raise the achievement levels of all students. The Company's brands include: Voyager Sopris Learning, Learning A–Z, ExploreLearning and Kurzweil Education. Together, these business units provide best-in-class intervention and supplemental instructional materials; gold-standard professional development and school-improvement services; breakthrough technology solutions for online learning and professional support; valid and reliable assessments; and proven materials to support a positive and safe school environment.

These brands comprise four reportable segments with separate management teams and infrastructures that offer various products and services. Prior to the sale of the IntelliTools product line in the second quarter of 2014, the Company referred to its Kurzweil Education segment as Kurzweil/IntelliTools. See Note 14 – Segment Reporting for further information on the Company's segment reporting structure.

Note 2 — Accounts Receivable

Accounts receivable are stated net of allowances for doubtful accounts and estimated sales returns. The allowance for doubtful accounts and estimated sales returns totaled $0.6 million at September 30, 2014 and $0.7 million at

December 31, 2013. The allowance for doubtful accounts is based on a review of outstanding balances and historical collection experience. The reserve for sales returns is based on historical rates of return as well as other factors that in the Company's judgment, could reasonably be expected to cause sales returns to differ from historical experience.

Note 3 — Stock-Based Compensation and Expense

The stock-based compensation and expense recorded was allocated as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2014	2013	2014	2013
Cost of revenues	$10	$33	$28	$57
Research and development expense	27	60	76	112
Sales and marketing expense	35	61	96	105
General and administrative expense	63	192	183	514
Total	$135	$346	$383	$788

2014 Grants

On March 14, 2014, the Company granted 559,000 options under the Cambium Learning Group, Inc. 2009 Equity Incentive Plan ("Plan") with a total grant date fair value, net of forecasted forfeitures, of $0.7 million. Each of these options have a per-share exercise price of $2.14 and vest in equal monthly installments on the last day of each month of the four year period beginning on the first day of the month of grant. The term of each of the options is ten years from the date of grant.

On March 26, 2014, the Company granted 35,000 options under the Plan with a total grant date fair value, net of forecasted forfeitures, of $41 thousand. Each of these options have a per-share exercise price of $2.06 and vest in equal monthly installments on the last day of each month of the four year period beginning on the first day of the month of grant. The term of each of the options is ten years from the date of grant.

On July 21, 2014, the Company granted 10,000 options under the Plan with a total grant date fair value, net of forecasted forfeitures, of $10 thousand. Each of these options have a per-share exercise price of $1.84 and vest in equal monthly installments on the last day of each month of the four year period beginning on the first day of the month of grant. The term of each of the options is ten years from the date of grant.

On August 25, 2014, the Company granted 15,000 options under the Plan with a total grant date fair value, net of forecasted forfeitures, of $14 thousand. Each of these options have a per-share exercise price of $1.66 and vest in equal monthly installments on the last day of each month of the four year period beginning on the first day of the month of grant. The term of each of the options is ten years from the date of grant.

Valuation assumptions

The following assumptions were used in the Black-Scholes option-pricing model to estimate the fair value of the awards granted during the nine month period ended September 30, 2014:

	Nine Months Ended September 30, 2014	
Expected stock volatility	64.00	%
Risk-free interest rate	1.91% - 2.05%	
Expected years until exercise	6.25	
Dividend yield	0.00	%

Due to a lack of exercise history or other means to reasonably estimate future exercise behavior, the Company used the simplified method as described in applicable accounting guidance for stock-based compensation to estimate the expected years until exercise on new awards.

Award activity

The following tables detail changes in the Company's outstanding stock options during the three and nine month periods ended September 30, 2014.

	Three Months Ended September 30, 2014				
Grant Date	Beginning Outstanding	Granted	Exercised	Cancelled and Forfeited	Ending Outstanding
January 27, 2010	5,000	—	—	—	5,000
July 30, 2013	1,997,083	—	7,083	—	1,990,000
September 19, 2013	30,000	—	—	—	30,000
October 28, 2013	40,000	—	—	—	40,000
November 18, 2013	15,000	—	—	—	15,000
March 14, 2014	544,730	—	—	4,479	540,251
March 26, 2014	35,000	—	—	—	35,000
July 21, 2014	—	10,000	—	—	10,000
August 25, 2014	—	15,000	—	—	15,000
Total	2,666,813	25,000	7,083	4,479	2,680,251

	Nine Months Ended September 30, 2014				
Grant Date	Beginning Outstanding	Granted	Exercised	Cancelled and Forfeited	Ending Outstanding
January 27, 2010	5,000	—	—	—	5,000
November 21, 2011	79,158	—	—	79,158	—
May 14, 2012	10,198	—	—	10,198	—
July 30, 2013	2,187,344	—	40,416	156,928	1,990,000
September 19, 2013	30,000	—	—	—	30,000
October 28, 2013	40,000	—	—	—	40,000
November 18, 2013	15,000	—	—	—	15,000
March 14, 2014	—	559,000	—	18,749	540,251
March 26, 2014	—	35,000	—	—	35,000
July 21, 2014	—	10,000	—	—	10,000
August 25, 2014	—	15,000	—	—	15,000
Total	2,366,700	619,000	40,416	265,033	2,680,251

During the nine months ended September 30, 2014, restricted common stock awards of 2,000 shares were issued. The restriction on the common stock awards lapse equally over a four-year period on the anniversary of the grant date or upon a change in control of the Company. The awards were valued based on the Company's closing stock price on the date of grant of $1.96. During the nine months ended September 30, 2014, the related restrictions lapsed on restricted common stock awards of 1,500 shares.

Note 4 — Net Income (Loss) per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period including a warrant for shares issuable for little or no cash consideration, which is considered a common share equivalent. Diluted net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period; including potential dilutive shares of common stock assuming the dilutive effect of outstanding stock options, restricted stock awards and warrants using the treasury stock method. Weighted average shares from common share equivalents in the amount of 803,944 and 2,423,319 for the three months ended September 30, 2014 and 2013, respectively, and 2,638,533 and 3,243,154 for the nine months ended September 30, 2014 and 2013, respectively, were excluded from the respective dilutive shares outstanding because their effect was anti-dilutive.

The following table presents the calculation of basic and diluted net income (loss) per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	2014	2013	2014	2013

Numerator:				
Net income (loss)	$995	$128	$(6,880)	$(8,519)
Denominator:				
Basic:				
Weighted-average common shares used in computing basic net income (loss) per share	45,664	47,563	45,663	47,439
Diluted:				
Add weighted average effect of dilutive securities:				
Stock options, restricted stock awards and warrant	89	94	—	—
Weighted-average common shares used in computing diluted net income (loss) per share	45,753	47,657	45,663	47,439
Net income (loss) per common share:				
Basic	$0.02	$0.00	$(0.15)	$(0.18)
Diluted	$0.02	$0.00	$(0.15)	$(0.18)

During the first quarter of 2014, the Company repurchased 167,961 shares of its outstanding common stock for $0.3 million. After these transactions, the Company had $0.3 million remaining under its previously disclosed share repurchase authorization. The share repurchase program expired in July 2014.

Note 5 — Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability (exit price), in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques are based on observable or unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 — Quoted prices for identical instruments in active markets.
- Level 2 — Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant value drivers are observable.
- Level 3 — Valuations derived from valuation techniques in which significant value drivers are unobservable.

Applicable guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

As of September 30, 2014, financial instruments include $44.4 million of cash and cash equivalents, restricted assets of $5.9 million, collateral investments of $3.6 million, and $164.6 million of senior secured notes. As of December 31, 2013, financial instruments include $68.0 million of cash and cash equivalents, restricted assets of $6.8 million, collateral investments of $2.0 million, and $174.5 million of senior secured notes. The fair market values of cash equivalents, restricted assets and collateral investments are equal to their carrying value, as these investments are recorded based on quoted market prices and/or other market data for the same or comparable instruments and transactions as of the end of the reporting period.

As of September 30, 2014, the senior secured notes, with aggregate outstanding principal amount of $165.0 million, had a fair value of $165.4 million, based on quoted market prices in active markets for these debt instruments when traded as assets. As of December 31, 2013, the senior secured notes, with aggregate outstanding principal amount of $175.0 million, had a fair value of $166.5 million, based on quoted market prices in active markets for these debt instruments when traded as assets.

Assets and liabilities measured at fair value on a recurring basis are as follows:

(in thousands)		Fair Value at Reporting Date Using		
Description	As of September 30, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Restricted Assets:				
Money Market	$ 5,914	$5,914	$ —	$ —
Collateral Investments:				
Money Market	904	904	—	—
Certificates of Deposit	2,717	2,717	—	—

(in thousands)		Fair Value at Reporting Date Using		
Description	As of December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Restricted Assets:				
Money Market	$ 6,835	$6,835	$ —	$ —
Collateral Investments:				
Money Market	903	903	—	—
Certificates of Deposit	1,068	1,068	—	—

(in thousands) Description	Total Gains (Losses) for the Nine Months Ended September 30, 2014	2013
Restricted Assets:		
Money Market	$ —	$ —
Collateral Investments:		
Money Market	—	—
Certificates of Deposit	—	—
Warrant	—	(53)
Assets held for sale:		
Recovered Properties	—	(122)
CVRs	—	(74)

The warrant was valued using the Black-Scholes pricing model which is considered level 3. Due to the low exercise price of the warrants, the model assumptions do not significantly impact the valuation.

Contingent Value Rights

As part of the 2009 merger with Voyager Learning Company ("VLCY"), each former VLCY shareholder received contingent value rights ("CVR") to receive cash in an amount equal to the aggregate amount of specified tax refunds received after the closing of the mergers and various other amounts deposited in escrow on or after the closing date, reduced by any payments to be made under the escrow agreement entered into in connection with the mergers, with respect to agreed contingencies, a potential working capital adjustment and allowed expenses, divided by the total number of shares of VLCY common stock outstanding immediately prior to the effective time of the mergers.

The CVR payment dates were in September 2010, June 2011, and June 2013, with $1.1 million, $2.0 million, and $7.7 million, respectively, distributed to the escrow agent at those times for distribution to holders of the CVRs. The final payment comprised $5.8 million related to a Michigan state tax matter and $1.9 million related to a potential tax indemnity obligation. Restricted cash in an escrow account for the benefit of the CVRs was $3.0 million for the potential tax indemnity obligation. As the potential tax indemnity obligation was not triggered, the remaining $1.1 million in the escrow account reverted back to the general cash of the Company in the second quarter of 2013.

Assets and liabilities measured at fair value on a non-recurring basis are listed below at their carrying values as of each reporting date:

(in thousands) Description	As of	Value at Reporting Date Using Significant	Significant

	September 30, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Goodwill	$ 47,842	$—	$ —	$ 47,842
Property, equipment and software, net	20,428	—	—	20,428
Pre-publication costs, net	15,081	—	—	15,081
Acquired curriculum and technology intangibles, net	6,038	—	—	6,038
Acquired publishing rights, net	3,248	—	—	3,248
Other intangible assets, net	4,871	—	—	4,871

(in thousands)		Value at Reporting Date Using		
Description	As of December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Goodwill	$ 47,842	$ —	$ —	$ 47,842
Property, equipment and software, net	20,315	—	—	20,315
Pre-publication costs, net	13,401	—	—	13,401
Acquired curriculum and technology intangibles, net	8,719	—	—	8,719
Acquired publishing rights, net	4,705	—	—	4,705
Other intangible assets, net	6,251	—	—	6,251

(in thousands)	Total Gains (Losses) for the Nine Months Ended September 30,	
Description	2014	2013
Goodwill	$ —	$ —
Property, equipment and software, net	—	—
Pre-publication costs, net	—	—
Acquired curriculum and technology intangibles, net	—	—
Acquired publishing rights, net	—	—
Other intangible assets, net	—	—

There were no significant remeasurements of these assets during the nine months ended September 30, of 2014 or 2013.

Note 6 — Other Current Assets

Other current assets at September 30, 2014 and December 31, 2013 consisted of the following:

	As of September 30,	December 31,
(in thousands)	2014	2013
Deferred costs	$6,014	$ 4,968
Prepaid expenses	2,287	1,369
Deferred taxes	571	536
Total	$8,872	$ 6,873

Note 7 — Other Assets

Other assets at September 30, 2014 and December 31, 2013 consisted of the following:

	As of September 30,	December 31,
(in thousands)	2014	2013
Collateral investments	$3,621	$ 1,971
Deferred financing costs	3,097	4,541
Deferred costs, less current portion	901	765
Other	959	1,011
Total	$8,578	$ 8,288

The deferred financing costs represent costs incurred in connection with the issuance of the 9.75% senior secured notes as described in Note 13 – Long-Term Debt.

Collateral Investments

The Company maintains certificates of deposit to collateralize its outstanding letters of credit associated with the build-to-suit lease, credit collections, performance bonds for certain contracts and workers' compensation activity. At December 31, 2013, the Company had certificates of deposit of $1.1 million to collateralize certain letters of credit outstanding at that date. During the first

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quarter of 2014, the Company purchased additional certificates of deposit of $2.1 million to serve as collateral for outstanding letters of credit previously collateralized by the ABL Facility that was terminated on March 26, 2014 as described in Note 13 – Long-Term Debt. During the third quarter of 2014, an outstanding certificate of deposit of $0.5 million was redeemed as the associated letter of credit was terminated during the period. At September 30, 2014, the Company had $2.7 million in certificates of deposit serving as collateral for its outstanding letters of credit. See Note 12 – Commitments and Contingencies for additional information regarding the Company's outstanding letters of credit.

Additionally, the Company maintains a money market fund investment to serve as collateral for a travel card program. The balance of the money market fund investment was $0.9 million at September 30, 2014 and December 31, 2013.

Note 8 — Accrued Expenses

Accrued expenses at September 30, 2014 and December 31, 2013 consisted of the following:

	As of September 30,	December 31,
(in thousands)	2014	2013
Salaries, bonuses and benefits	$7,567	$ 9,687
Accrued interest	2,011	6,471
Pension and post-retirement medical benefits	1,172	1,214
Accrued royalties	1,279	1,649
Headsprout acquisition accrual	400	3,600
Other	3,514	2,658
Total	$15,943	$ 25,279

Accrued interest primarily relates to the 9.75% senior secured notes. The notes require semi-annual interest payments in arrears on each February 15 and August 15 over the life of the notes.

In December 2013, LAZEL, Inc., a wholly owned subsidiary of the Company, completed the acquisition of certain assets of Headsprout for $4.0 million. Of the total purchase price, $3.6 million was paid in January 2014 with the remaining $0.4 million to be paid 18 months after the closing date, subject to the holdback provisions of the purchase agreement. The remaining accrual of $0.4 million is included in Accrued Expenses.

Note 9 — Other Liabilities

Other liabilities at September 30, 2014 and December 31, 2013 consisted of the following:

(in thousands)	As of September 30, 2014	December 31, 2013
Pension and post-retirement medical benefits, long-term portion	$9,693	$ 10,241
Deferred rent	1,068	1,201
Long-term income tax payable	938	902
Long-term deferred tax liability	610	570
Long-term deferred compensation	358	491
Headsprout acquisition accrual	—	400
Other	151	149
Total	$12,818	$ 13,954

Note 10 — Pension Plan

The net pension costs of the Company's defined benefit pension plan were comprised primarily of interest costs and totaled $0.1 million and $0.1 million, respectively, for the three months ended September 30, 2014 and 2013 and $0.4 million and $0.4 million for the nine months ended September 30, 2014 and 2013. The net pension costs for the three and nine months ended September 30, 2014 and 2013 also included immaterial accumulated net loss amortization.

Note 11 — Uncertain Tax Positions

The Company recognizes the financial statement impacts of a tax return position when it is more likely than not, based on technical merits, that the position will ultimately be sustained. For tax positions that meet this recognition threshold, the Company applies judgment, taking into account applicable tax laws, experience managing tax audits and relevant GAAP, to determine the amount of tax benefits to recognize in its financial statements. For each position, the difference between the benefit realized on the Company's tax return and the benefit reflected in its financial statements is recorded on the Condensed Consolidated Balance Sheet as an unrecognized tax benefit ("UTB"). The Company updates its UTBs at each financial statement date to reflect the impacts of audit settlements and other resolution of audit issues, expiration of statutes of limitation, developments in tax law and ongoing discussions with tax authorities. The balance of UTBs was $6.4 million at September 30, 2014 and December 31, 2013.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. All U.S. tax years prior to 2008 related to the VLCY acquired entities have been audited by the Internal Revenue Service. Cambium and its subsidiaries have been examined by the Internal Revenue Service through the end of 2006. The Company has been audited by the various state tax authorities through 2007.

Note 12 — Commitments and Contingencies

The Company is involved in various legal proceedings incidental to its business. Management believes that the outcome of these proceedings will not have a material adverse effect upon the Company's consolidated operations or financial condition and the Company has recognized appropriate liabilities as necessary based on facts and circumstances known to management. The Company expenses legal costs related to legal contingencies as incurred.

From time to time, the Company may enter into firm purchase commitments for printed materials included in inventory which the Company expects to use in the ordinary course of business. These commitments are typically for terms less than one year and require the Company to buy minimum quantities of materials with specific delivery dates at a fixed price over the term. These open purchase commitments totaled $0.1 million as of September 30, 2014.

The Company has letters of credit outstanding as of September 30, 2014 in the amount of $2.0 million to support the build-to-suit lease, credit collections, performance bonds for certain contracts and workers' compensation activity. The Company maintains certificates of deposit as collateral for the letters of credit. The Company also maintains a $0.9 million money market fund investment as collateral for a travel card program. The certificates of deposit and money market fund investment are recorded in Other Assets.

Note 13 — Long-Term Debt

Long-term debt at September 30, 2014 and December 31, 2013 consisted of the following:

(in thousands)	As of September 30, 2014	December 31, 2013
9.75% senior secured notes due February 15, 2017, interest payable semiannually	$165,000	$175,000
Less: Unamortized discount	(365)	(509)
Total long-term debt	$164,635	$174,491

In February 2011, the Company closed an offering of $175 million aggregate principal amount of 9.75% senior secured notes due 2017 (the "Notes"). Deferred financing costs are capitalized in Other Assets in the Condensed Consolidated Balance Sheets, net of accumulated amortization, and are to be amortized over the term of the related debt using the effective interest method. Unamortized capitalized deferred financing costs at September 30, 2014 and December 31, 2013 were $3.1 million and $4.5 million, respectively, related to the Notes and an asset-based revolving credit facility, which was terminated in the first quarter of 2014.

Interest on the Notes accrues at a rate of 9.75% per annum from the date of original issuance and is payable semi-annually in arrears on each February 15 and August 15 to the holders of record of the Notes on the immediately preceding February 1 and August 1. No principal repayments are due until the maturity date of the Notes.

The Notes are secured by (i) a first priority lien on substantially all of the Company's assets including capital stock of the guarantors (which are certain of the Company's subsidiaries), and (ii) a second-priority lien, prior to the termination of the ABL Facility (as defined and described below), on substantially all of the inventory and accounts receivable and related assets of the ABL Credit Parties, in each case, subject to certain permitted liens. The Notes also contain customary covenants, including limitations on the Company's ability to incur debt, and events of default as defined by the agreement. The Company may, at its option, redeem the Notes prior to their maturity based on the terms included in the agreement.

During the quarter ended March 31, 2014, the Company repurchased $2.0 million aggregate principal amount of Notes for approximately $2.0 million, plus accrued and unpaid interest. During the quarter ended June 30, 2014, the Company repurchased an additional $8.0 million aggregate principal amount of Notes for $8.1 million, plus accrued and unpaid interest. During the nine months ended September 30, 2014, a Loss on Extinguishment of Debt of $0.4 million was recorded in connection with these repurchases, which was primarily due to the write-off of unamortized deferred financing costs. In October 2014, the Company repurchased an additional $10.0 million principal amount of Notes for $9.9 million plus accrued and unpaid interest. See Note 16 – Subsequent Events.

ABL Facility. In February 2011, the Company's wholly owned subsidiary, Cambium Learning, Inc. (together with its wholly owned subsidiaries, the "ABL Credit Parties"), entered into a credit facility (the "ABL Facility") pursuant to a Loan and Security Agreement (the "ABL Loan Agreement"), by and among the ABL Credit Parties, Harris N.A., individually and as Agent (the "Agent") for any ABL Lender (as hereinafter defined) which is or becomes a party to said ABL Loan Agreement, certain other lenders party thereto (together with Harris N.A. in its capacity as a lender, the "ABL Lenders"), Barclays Bank PLC, individually and as Collateral Agent, and BMO Capital Markets and Barclays Capital, as Joint Lead Arrangers and Joint Book Runners. The ABL Facility consisted of a four-year $40.0 million revolving credit facility, which included a $5.0 million subfacility for swing line loans and a $5.0 million subfacility for letters of credit.

The ABL Facility was, subject to certain exceptions, secured by a first-priority lien on the ABL Credit Parties' inventory and accounts receivable and related assets and a second-priority lien (junior to the lien securing the ABL Credit Parties' obligations with respect to the Notes) on substantially all of the ABL Credit Parties' other assets.

The ABL Credit Parties were required to pay, quarterly in arrears, an unused line fee equal to the product of (x) either 0.375% or 0.50% (depending upon the ABL Credit Parties' fixed charge coverage ratio at the time) and (y) the average daily unused amount of the revolver. The ABL Facility contained a financial covenant that generally required the ABL Credit Parties to maintain, on a consolidated basis, either (i) excess availability of at least the greater of $8 million and 15% of the revolver commitment or (ii) a fixed charge coverage ratio of 1.1 to 1.0.

During the first quarter of 2014, the Company's excess availability and fixed charge coverage ratios fell below the required thresholds, which put the Company in a Trigger Period as defined under the ABL Facility agreement. On March 26, 2014, the Company had no borrowings outstanding under the agreement and terminated the ABL Facility. A Loss on Extinguishment of Debt of $0.2 million was recorded in connection with the termination related to the write-off of unamortized deferred financing costs.

Note 14 — Segment Reporting

The Company operates in four reportable segments with separate management teams and infrastructures that offer various products and services:

Voyager Sopris Learning:

Voyager Sopris Learning is committed to partnering with school districts to overcome obstacles that students, teachers, and school leaders face every day. The suite of instructional and service solutions that Voyager Sopris Learning provides are not only research based, but also evidence based—proven to increase student achievement and educator effectiveness. Voyager Sopris Learning solutions have been fully tested in the classroom, ensuring that they are easy to implement and teacher friendly. They are innovative, both in overall instructional approach and in the strategic use of technology in blended and 100% online solutions and they are supported by an unparalleled commitment to build local capacity for sustained success. With a comprehensive suite of instructional resources, Voyager Sopris Learning provides assessments, professional development and school-improvement services, literacy and math instructional tools—both comprehensive intervention and supplemental—and resources to build a positive school climate. Voyager Sopris Learning's products include the work of world-renowned researchers and education leaders.

Learning A-Z:

Learning A-Z is a preK-6 educational resource company specializing in online delivery of leveled readers and other supplementary curriculum. Founded in 2002 to help teachers differentiate instruction and meet the unique needs of all students, Learning A-Z's resources are currently used in more than half of the districts in the United States, Canada and in over 165 countries worldwide. Serving a wide range of student needs, including English language learners, intervention, special education, and daily instruction Learning A-Z's value proposition focuses on three key things:

- Saving teachers time, giving them all the resources they need, all online, all accessible at the click of a mouse
- Saving teachers money, delivering thousands of resources for a fraction of the cost of print and other online providers
- Supporting student achievement through differentiated instruction, ensuring the right high-quality resources for every PreK-6 student

Learning A-Z's subscription-based websites include: Reading A-Z, Raz-Kids, Science A-Z, Writing A-Z, Vocabulary A-Z, ReadyTest A-Z and Headsprout®.

ExploreLearning:

ExploreLearning develops online solutions to improve student learning in math and science. ExploreLearning currently has two products: Gizmos, the world's largest library of interactive, online simulations for math and science in grades 3-12; and Reflex, a powerful solution available for math fact fluency development. Gizmos and Reflex bring research-proven instructional strategies to classrooms around the world.

Kurzweil Education:

Kurzweil Education develops literacy-boosting solutions that directly enhance opportunities to learn and achieve, offering learners a way up and a path forward. Using the principals of Universal Design for Learning, the segment's products deliver content and tools that enable all learners to read, understand and demonstrate their learning using technology-based tools and resources.

In April 2014, the Company completed the sale of its IntelliTools product line for $0.8 million. Net revenues associated with the IntelliTools product line were $0.3 million during 2014 through the date of sale and $1.0 million for the year ended December 31, 2013. Prior to the sale of the IntelliTools product line, the Company referred to the Kurzweil Education segment as Kurzweil/IntelliTools.

Other:

This consists of unallocated shared services, such as accounting, legal, human resources and corporate related items. Depreciation and amortization expense, interest income and expense, other income and expense, and income taxes are also included in Other, as the Company and its chief operating decision maker evaluate the performance of operating segments excluding these captions.

The following table represents the net revenues, operating expenses, income (loss) from operations, and capital expenditures which are used by the Company's chief operating decision maker to measure the segments' operating performance. The Company does not track assets directly by segment and the chief operating decision maker does not use assets to measure a segment's operating performance, and therefore this information is not presented.

(in thousands)	Voyager Sopris Learning	Learning A-Z	ExploreLearning	Kurzweil Education	Other	Consolidated
Three Months Ended September 30, 2014						
Net revenues	$23,951	$11,116	$ 4,098	$ 1,979	$—	$ 41,144
Cost of revenues	9,631	300	733	381	—	11,045
Amortization expense	—	—	—	—	4,695	4,695
Total cost of revenues	9,631	300	733	381	4,695	15,740
Other operating expenses	7,212	4,992	2,452	1,153	3,656	19,465
Depreciation and amortization expense	—	—	—	—	1,050	1,050
Total costs and expenses	16,843	5,292	3,185	1,534	9,401	36,255
Income (loss) before interest, other income (expense) and income taxes	7,108	5,824	913	445	(9,401)	4,889
Net interest expense	—	—	—	—	(4,377)	(4,377)
Other income, net	—	—	—	—	535	535
Income tax expense	—	—	—	—	(52)	(52)
Segment net income (loss)	$7,108	$5,824	$ 913	$ 445	$(13,295)	$ 995
Expenditures for property, equipment, software and pre-publication costs	$1,767	$1,667	$ 468	$ 139	$626	$ 4,667

(in thousands)	Voyager Sopris Learning	Learning A-Z	ExploreLearning	Kurzweil Education	Other	Consolidated
Three Months Ended September 30, 2013						
Net revenues	$28,212	$ 8,362	$ 3,700	$ 2,683	$—	$ 42,957
Cost of revenues	11,434	167	670	679	—	12,950
Amortization expense	—	—	—	—	4,692	4,692

Total cost of revenues	11,434	167	670	679	4,692	17,642
Other operating expenses	8,589	3,512	2,322	1,038	3,811	19,272
Depreciation and amortization expense	—	—	—	—	1,227	1,227
Embezzlement-related expense	—	—	—	—	3	3
Total costs and expenses	20,023	3,679	2,992	1,717	9,733	38,144
Income (loss) before interest, other income (expense) and income taxes	8,189	4,683	708	966	(9,733)	4,813
Net interest expense	—	—	—	—	(4,773)	(4,773)
Other income, net	—	—	—	—	215	215
Income tax expense	—	—	—	—	(127)	(127)
Segment net income (loss)	$ 8,189	$ 4,683	$ 708	$ 966	$ (14,418)	$ 128
Expenditures for property, equipment, software and pre-publication costs	$ 2,007	$ 1,112	$ 382	$ 154	$ 754	$ 4,409

(in thousands)	Voyager Sopris Learning	Learning A-Z	ExploreLearning	Kurzweil Education	Other	Consolidated
Nine Months Ended September 30, 2014						
Net revenues	$ 57,628	$ 31,846	$ 13,119	$ 5,874	$—	$ 108,467
Cost of revenues	25,308	1,194	2,186	1,298	—	29,986
Amortization expense	—	—	—	—	13,213	13,213
Total cost of revenues	25,308	1,194	2,186	1,298	13,213	43,199
Other operating expenses	20,035	13,687	7,668	3,383	10,939	55,712
Depreciation and amortization expense	—	—	—	—	3,150	3,150
Total costs and expenses	45,343	14,881	9,854	4,681	27,302	102,061
Income (loss) before interest, other income (expense) and income taxes	12,285	16,965	3,265	1,193	(27,302)	6,406
Net interest expense	—	—	—	—	(13,535)	(13,535)
Loss on extinguishment of debt	—	—	—	—	(570)	(570)
Other income, net	—	—	—	—	965	965
Income tax expense	—	—	—	—	(146)	(146)
Segment net income (loss)	$ 12,285	$ 16,965	$ 3,265	$ 1,193	$ (40,588)	$ (6,880)
Expenditures for property, equipment, software and pre-publication costs	$ 5,008	$ 4,403	$ 1,200	$ 422	$ 1,994	$ 13,027

(in thousands)	Voyager Sopris Learning	Learning A-Z	ExploreLearning	Kurzweil Education	Other	Consolidated
Nine Months Ended September 30, 2013						
Net revenues	$ 74,032	$ 24,047	$ 11,497	$ 7,596	$—	$ 117,172
Cost of revenues	32,934	646	1,693	1,727	—	37,000
Amortization expense	—	—	—	—	12,680	12,680
Total cost of revenues	32,934	646	1,693	1,727	12,680	49,680
Other operating expenses	25,032	10,211	6,662	3,348	13,297	58,550
Depreciation and amortization expense	—	—	—	—	3,663	3,663
Embezzlement-related expense	—	—	—	—	118	118
Total costs and expenses	57,966	10,857	8,355	5,075	29,758	112,011

Income (loss) before interest, other income (expense) and income taxes	16,066	13,190	3,142	2,521	(29,758)	5,161
Net interest expense	—	—	—	—	(14,028)	(14,028)
Other income, net	—	—	—	—	645	645
Income tax expense	—	—	—	—	(297)	(297)
Segment net income (loss)	$16,066	$13,190	$ 3,142	$ 2,521	$(43,438)	$ (8,519)
Expenditures for property, equipment, software and pre-publication costs	$5,627	$3,320	$ 1,070	$ 279	$2,087	$ 12,383

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Note 15 — Related Party Transactions

As previously disclosed, the Company is party to a consulting fee agreement with VSS Fund Management LLC ("VSS") entitling VSS to the following fees: (i) a fee equal to 1% of the gross proceeds of any debt or equity financing by the Company, and (ii) a fee equal to 1% of the enterprise value of any entities acquired or disposed of by the Company. During the first quarter of 2014, the Company accrued $40 thousand under this agreement as a result of the Headsprout acquisition.

Note 16 — Subsequent Events

On October 15, 2014, the Company entered into a note repurchase agreement with an investor. The transaction settled on October 20, 2014, with the Company repurchasing $10.0 million aggregate principal amount of Notes for $9.9 million plus accrued and unpaid interest. The Company expects to record a Loss on Extinguishment of Debt of approximately $0.1 million in connection with this repurchase, primarily related to the write-off of unamortized deferred financing costs. After completion of this transaction, total principal outstanding under the Company's Notes is $155.0 million.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

This section should be read in conjunction with the audited Consolidated Financial Statements of Cambium Learning Group, Inc. and its subsidiaries (the "Company," "we," "us," or "our") and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013.

Cautionary Note Regarding Forward-looking Statements.

This report contains forward-looking statements within the meaning of the federal securities laws that involve risks and uncertainties, and which are based on beliefs, expectations, estimates, projections, forecasts, plans, anticipations, targets, outlooks, initiatives, visions, objectives, strategies, opportunities, drivers and intents of our management. Such statements are made in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact included in this report, including statements regarding our future financial position, economic performance and results of operations, as well as our business strategy, objectives of management for future operations, and the information set forth under "Management's Discussion and Analysis of Financial Condition and Results of Operations," are forward-looking statements.

Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements can be identified by, among other things, the use of forward-looking language, such as "believes," "expects," "estimates," "projects," "forecasts," "plans," "anticipates," "targets," "outlooks," "init "visions," "objectives," "strategies," "opportunities," "drivers," "intends," "scheduled to," "seeks," "may," "will," or "should," of those terms, or other variations of those terms or comparable language, or by discussions of strategy, plans, targets, models or intentions. Forward-looking statements speak only as of the date they are made, and except for our ongoing obligations under the federal securities laws, we undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events, or otherwise, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements. Accordingly, you are cautioned that any such forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Although we believe that the expectations reflected in such forward-looking statements are reasonable as of the date made, expectations may prove to have been materially different from the results expressed or implied by such forward-looking statements, as it is impossible for us to anticipate all factors that could affect our actual results. These risks and uncertainties include, but are not limited to, those described in "Risk Factors" in Part II, Item 1A and elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2013, and those described from time to time in our future reports filed with the SEC. Unless otherwise required by law, we also disclaim any obligation to update our view of any such risks or uncertainties or to announce publicly the results of any revisions to the forward-looking statements made in this report.

Our Company

We are a leading educational solutions and services company that is committed to helping all students reach their full potential by providing evidence-based solutions and expert professional services to empower educators and raise the achievement levels of all students. Our brands include: Voyager Sopris Learning ™ (www.voyagersopris.com), Learning A–Z™ (www.learninga-z.com), ExploreLearning® (www.explorelearning.com and www.reflexmath.com) and Kurzweil Education™ (www.kurzweiledu.com). Together, these business units provide best-in-class intervention and supplemental instructional materials; gold-standard professional development and school-improvement services; breakthrough technology solutions for online learning and professional support; valid and reliable assessments; and proven materials to support a positive and safe school environment.

Our products have continued to receive awards and accolades from industry publications including the Best Educational Software (BESSIE) awards from the ComputED Gazette, the CODiE awards from the Software and Information Industry Association and the Education Software Review Awards (EDDIES) by The ComputED Gazette.

The following products were named winners of the 20th annual BESSIE awards:

- ExploreLearning – Reflex
- ExploreLearning – Gizmos
- Kurzweil Education– firefly
- Learning A-Z – Raz-Kids.com
- Learning A-Z – ScienceA-Z.com

The following products were named winners of the 19th annual EDDIE awards:

- ExploreLearning – Reflex
- ExploreLearning – Gizmos
- Kurzweil Education – firefly
- Learning A-Z – Reading A-Z.com
- Learning A-Z – Raz-Kids.com

ExploreLearning – Reflex won a 2014 CODiE Award for Best Learning Game.

Additionally, ExploreLearning – Gizmos and Learning A-Z – Raz-Kids.com won 2014 REVERE Awards, presented by the PreK-12 Learning Group of the Association of American Publishers. The annual awards, established by the Association of Educational Publishers (AEP) and formerly known as the AEP Awards program, recognize exemplary learning resources for preK–12 students, educators, and administrators, as well as adult learners.

Overview

Order volumes are an internal metric that measure the total dollar value of customer orders in a period, regardless of the timing of the related revenue recognition. Management considers order volumes a leading indicator of revenues. Our first half results were sluggish in three of our four segments and we were impacted by some instability with respect to support of Common Core State Standards. Many customers shifted purchases of our products into the latter half of the year and, and as a result, our third quarter 2014 order volumes were 6% better than the third quarter of 2013. For the nine months ended September 30, 2014, company-wide order volumes were down 5% compared with the same period of 2013, with changes by segment as follows:

- Learning A-Z increased 33%
- ExploreLearning increased 7%
- Voyager Sopris Learning decreased 21%
- Kurzweil Education decreased 21%

We continue to execute our strategy to shift resources to subscription and technology-enabled products. Order volumes for technology-enabled products grew 31% year to date in 2014 over the same period of 2013. For the nine months ended September 30, 2014, 57% of order volumes were generated by technology-enabled products versus 41% for the same period of 2013. For purposes of this metric, technology-enabled products are defined as those products that are sold primarily as a technology-based solution or that could be used solely using a digital platform. For the Voyager Sopris Learning segment, several products classified as technology-enabled include supplemental print materials.

Learning A–Z delivered another historically high period of order volumes during the third quarter of 2014, continuing its trend of double-digit growth rates due to quality content, award-winning technology, and ongoing strategic investments within the segment. Within ExploreLearning, the unfavorable impact of the timing of deals began to reverse during the third quarter of 2014 and as a result, ExploreLearning achieved strong year over year growth in the third quarter of 2014, bringing the year to date 2014 growth versus prior year to 7%. Both Voyager Sopris Learning and Kurzweil Education showed some improvement in order volumes during the third quarter of 2014 compared to 2013, with Voyager Sopris Learning down 14% quarter over quarter and Kurzweil Education approximately flat quarter over quarter. These segments continue to experience declines in legacy products, which are outpacing gains from newer technology-enabled solutions.

Most of our public school district customers are largely dependent on federal, state and local funding to purchase our products. The education market is changing in response to the adoption of the Common Core State Standards by a majority of the states. Common Core State Standards define the knowledge and skills students should have within their K-12 education careers so that they will graduate high school able to succeed in entry-level, credit-bearing academic college courses and in workforce training programs. These standards are the product of a state-led effort to establish a single set of clear educational standards for grades K-12. Most states that have adopted the Common Core State Standards also belong to one of two multistate testing consortia that are developing common state assessments in English language arts and mathematics, aligned to the new standards. These assessments, which will be designed to replace existing statewide tests, are expected to be administered beginning in the 2014-15 school year. Schools in these states may need to augment or replace instructional materials to align to the Common Core State Standards and to prepare students for the new state assessments. Additionally, the digitalization of education content and delivery is driving a substantial shift in the education market. The demand for these products has developed rapidly over the past several years and has led to changes in the way that providers develop, produce, market and distribute products. We believe our current product development strategy is aligned to these market trends.

Generally accepted accounting principles ("GAAP") net revenues for the nine months ended September 30, 2014 decreased 7% to $108.5 million compared to $117.2 million for the nine months ended September 30, 2013. GAAP net revenues by segment for the nine months ended September 30, 2014, and the change from the same period in 2013, were as follows:

- Learning A–Z: $31.8 million, increased $7.8 million or 32%
- ExploreLearning: $13.1 million, increased $1.6 million or 14%
- Voyager Sopris Learning: $57.6 million, decreased $16.4 million or 22%
- Kurzweil Education: $5.9 million, decreased $1.7 million or 23%

The following strategic initiatives have also impacted results of operations and cash flows:

- To facilitate expected growth in our Learning A-Z and ExploreLearning segments, we have made investments in 2013 and continuing into 2014 in our sales force and product development efforts, which are expected to increase costs as a percentage of net revenues within these segments for the full year 2014.
- Right-sizing cost structure efforts completed by Voyager Sopris Learning have helped offset the top-line declines.
- Capital expenditures have increased as we continue to invest in the development of technology-enabled products that meet the needs of the market.

Segment Results of Operations

Our brands comprise four reportable segments with separate management teams and infrastructures that offer various products and services.

Learning A-Z

Learning A-Z is a preK-6 educational resource company specializing in online delivery of leveled readers and other supplementary curriculum. Founded in 2002 to help teachers differentiate instruction and meet the unique needs of all students, Learning A-Z's resources are currently used in more than half of the districts in the United States, Canada and in over 165 countries worldwide. Serving a wide range of student needs, including English language learners, intervention, special education, and daily instruction, Learning A-Z's value proposition focuses on three key things:

- Saving teachers time, giving them all the resources they need, all online, all accessible at the click of a mouse
- Saving teachers money, delivering thousands of resources for a fraction of the cost of print and other online providers
- Supporting student achievement through differentiated instruction, ensuring the right high-quality resources for every preK-6 student

Learning A-Z's subscription-based websites provide online supplemental books, lessons, assessments, and other instructional resources for individual classrooms, schools, and districts. These solutions include: Reading A-Z, Raz-Kids, Science A-Z, Writing A-Z, Vocabulary A-Z, ReadyTest A-Z and Headsprout®.

In October 2014, Learning A-Z launched a new website, ReadyTest A-Z. The website delivers downloadable resources teachers need to provide effective high-stakes English Language Arts assessment practice and instruction, as well as a student-centric environment where kids log in to develop their test-taking skills online. Kids are able to access ReadyTest A-Z 24/7 to develop real high-stakes testing skills, while teachers can monitor student progress and then provide customized instruction to help students maximize their learning.

Results of Operations

For the nine months ended September 30, 2014, Learning A-Z order volumes exceeded the same period in 2013 by 33%. GAAP net revenues for Learning A-Z were higher by $7.8 million, or 32%, for the nine months ended September 30, 2014 from

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the same period in 2013, which was consistent with its order volume trends. Learning A-Z revenues are recognized pro rata over their subscription periods, which are generally for one year but can be for longer periods.

Learning A-Z has realized double-digit order volume growth for several years and we believe this unit will continue to deliver strong growth. We believe that the value proposition offered by the Learning A-Z products will continue to be compelling due to quality content and award-winning technology. To facilitate the expected growth, we have made significant investments in our sales force and product development efforts. Learning A-Z products are aligned with the Common Core State Standards and this will continue to be a focus in future development. Total costs and expenses as a percentage of net revenues were higher in the nine months ended September 30, 2014 compared to the same period in 2013 as a result of these investments.

ExploreLearning

ExploreLearning develops online solutions to improve student learning in math and science. ExploreLearning currently has two products: Gizmos, the world's largest library of interactive, online simulations for math and science in grades 3-12; and Reflex, a powerful solution available for math fact fluency development. Gizmos and Reflex bring research-proven instructional strategies to classrooms around the world.

In August 2014, ExploreLearning launched Reflex Student, an iPad® app available for download in the iTunes store. The new app features the Reflex student experience, which helps students gain quick and effortless recall of basic math facts in all four operations through game-based instruction and practice. With expanded access on the iPad®, even more students can build fluency anytime and anywhere with Reflex.

Results of Operations

Order volumes in the ExploreLearning segment increased 7% in the nine months ended September 30, 2014 from the same period in 2013. GAAP net revenues for ExploreLearning were higher by $1.6 million, or 14%, for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. Year to date growth in revenues exceeded growth in order volumes due to the recognition of prior period sales which are recorded pro rata over their subscription periods, which are generally for one year but can be for longer periods.

Order volumes for the first half of 2014 were unfavorably impacted by the timing of deals, but ExploreLearning was able to achieve strong year over year growth in the third quarter of 2014, bringing the year to date 2014 growth versus prior year to 7%. We currently expect ExploreLearning to have slight order volume growth for the full year 2014. This a lower percentage growth than the 27% growth experienced from 2012 to 2013 because 2013 order volumes included several large multi-year deals, which impact comparability.

We believe that the value proposition offered by the ExploreLearning products will continue to be compelling due to quality content and award-winning technology and we expect strong growth in the coming years. To ensure ExploreLearning is well positioned for expected future growth, we have made significant investments in 2014 in this segment for the enhancement of existing products, the development of new products, and the expansion of the sales force. Total costs and expenses as a percentage of net revenues were higher in the nine months ended September 30, 2014 compared to the same period in 2013 as a result of these investments.

Voyager Sopris Learning

Voyager Sopris Learning is committed to partnering with school districts to overcome obstacles that students, teachers, and school leaders face every day. The suite of instructional and service solutions we provide is not only research based, but also evidence based—proven to increase student achievement and educator effectiveness. Our solutions have been fully tested in the classroom, ensuring that they are easy to implement and teacher friendly. They are innovative, both in overall instructional approach and in the strategic use of technology in blended and 100% online solutions and they are supported by an unparalleled commitment to build local capacity for sustained success. With a comprehensive suite of instructional resources, we provide assessments, professional development and school-improvement services, literacy and math instructional tools—both comprehensive intervention and supplemental—and resources to build a positive school climate.

In August 2014, Voyager Sopris Learning released the following technology-enabled products:

· A major update to Passport Reading Journeys® was released. Passport Reading Journeys is a literacy intervention that combines high-interest reading, multimedia teaching tools and evidence-based instruction for students in grades 6-12. With this release, the product offers support for teaching the skills needed for college and career with innovative technology components.

- LANGUAGE!® Live Level 2 was released, significantly expanding the scope and reach of LANGUAGE! Live. Level 2 continues the powerful combination of teacher-led instruction and student-directed technology, while moving students to more advanced literacy levels and providing additional entry points to meet the needs of a larger population of learners.
- Vmath® Third Edition was released for classroom implementation for students in grades 2-8. Vmath was completely rebuilt to respond to the rigor of mathematics standards and to build the foundation for more advanced math, using innovative technology components to increase efficiency and engagement of both teachers and students.
- LANGUAGE!® with Focus on English Language Learning and Everyday English Plus were released in an online format. LANGUAGE! with Focus on English Language Learning is an intensive literacy intervention that integrates reading, writing, spelling, vocabulary, grammar, foundational skills and spoken English to raise the achievement of students, including newcomers to English, in grades 4-12.

Results of Operations

We expect sales of purely print-based products to continue to decline. Therefore, to stabilize order volumes and enable growth in future years, Voyager Sopris Learning is focusing its development efforts on technology based solutions, especially those opportunities that help school districts implement the new Common Core State Standards or other State-based curriculum or assessment standards. We believe that the efficacy of our products and the transition of our existing content to technology-based learning solutions will eventually offset the weakness in our legacy print-based offerings and return the segment to growth. However, these products take a significant amount of time to develop and gain customer acceptance.

For the nine months ended September 30, 2014, Voyager Sopris Learning order volumes were down 21% compared to prior year, and GAAP net revenues declined $16.4 million, or 22%, from prior year. Costs benefitted from right-sizing efforts completed in 2013 and continued vigilance throughout 2014.

We expect the segment to have full year order volume declines at or slightly better than the 21% experienced during the nine months ended September 30, 2014. Due to ongoing efforts to right-size the business and transition to more profitable technology-enabled products, margins are expected to improve year over year. However, due to the magnitude of the top line declines, earnings are expected to be lower in 2014 versus 2013.

Kurzweil Education

Kurzweil Education™ develops literacy-boosting solutions that directly enhance opportunities to learn and achieve, offering learners a way up and a path forward. Using the principals of Universal Design for Learning, the segment's products deliver content and tools that enable all learners to read, understand and demonstrate their learning using technology-based tools and resources.

In March 2014, Alex Saltonstall, President of Kurzweil Education, resigned from the Company. John Campbell, Chief Executive Officer of the Company, is currently performing management oversight for this segment.

In April 2014, the Company completed the sale of its IntelliTools product line for $0.8 million. Net revenues associated with the IntelliTools product line were $0.3 million during 2014 through the date of sale and $1.0 million for the year ended December 31, 2013. Prior to the sale of the IntelliTools product line, we referred to the Kurzweil Education segment as Kurzweil/IntelliTools.

Results of Operations

Order volumes in the Kurzweil Education segment declined 21% in the nine months ended September 30, 2014 from the same period in 2013. Declines are attributable to the segment's transition to a subscription model rather than its historical perpetual model. Additionally, management believes that customers are increasingly meeting their special education and text-to-speech needs with free and low-priced, but less comprehensive, solutions. GAAP net revenues for Kurzweil Education declined $1.7 million, or 23%, for the nine months ended September 30, 2014 from the same period in 2013.

Going forward, the Company plans to continue to invest in firefly which brings many of the capabilities of the Kurzweil 3000 product to the web. This subscription solution has shown strong year over year growth and high renewal rates and will continue to be the focus of the segment. We believe that the strength of the firefly solution and potentially the development of other subscription-based products will eventually return the segment to growth, but we expect Kurzweil Education order volumes to continue to decline in 2014. We currently expect that Kurzweil Education will have full year order volume declines at approximately the same rate as the 21% experienced in the nine months ended September 30, 2014. Additionally, the transition to subscription-based products, where revenues are recognized pro rata over the subscription life, will likely result in a decline in GAAP net revenues greater than the decline in order volumes. We expect any decline in order volumes or GAAP net revenues to reduce segment earnings.

Shared Services and Other

Shared Services and Other include accounting, legal, human resources and corporate related items, as well as depreciation and amortization expense, interest income and expense, other income and expense, and income taxes. The Company does not allocate any of these costs to its segments, and our chief operating decision maker evaluates the performance of operating segments excluding these items.

Three Months Ended September 30, 2014 Compared to the Three Months Ended September 30, 2013:

	Three Months Ended September 30, 2014		September 30, 2013		Year Over Year Change Favorable/(Unfavorable)	
(in thousands)	Amount	% of Net Revenues	Amount	% of Net Revenues	$	%
Net revenues:						
Voyager Sopris Learning	$23,951	58.2 %	$28,212	65.7 %	$ (4,261)	(15.1)%
Learning A-Z	11,116	27.0 %	8,362	19.5 %	2,754	32.9 %
ExploreLearning	4,098	10.0 %	3,700	8.6 %	398	10.8 %
Kurzweil Education	1,979	4.8 %	2,683	6.2 %	(704)	(26.2)%
Total net revenues	41,144	100.0 %	42,957	100.0 %	(1,813)	(4.2)%
Cost of revenues:						
Voyager Sopris Learning	9,631	23.4 %	11,434	26.6 %	1,803	15.8 %
Learning A-Z	300	0.7 %	167	0.4 %	(133)	(79.6)%
ExploreLearning	733	1.8 %	670	1.6 %	(63)	(9.4)%
Kurzweil Education	381	0.9 %	679	1.6 %	298	43.9 %
Amortization expense	4,695	11.4 %	4,692	10.9 %	(3)	(0.1)%
Total cost of revenues	15,740	38.3 %	17,642	41.1 %	1,902	10.8 %
Research and development expense	2,745	6.7 %	2,486	5.8 %	(259)	(10.4)%
Sales and marketing expense	11,015	26.8 %	10,943	25.5 %	(72)	(0.7)%
General and administrative expense	5,039	12.2 %	5,122	11.9 %	83	1.6 %
Shipping and handling costs	666	1.6 %	721	1.7 %	55	7.6 %
Depreciation and amortization expense	1,050	2.6 %	1,227	2.9 %	177	14.4 %
Embezzlement-related expense	—	0.0 %	3	0.0 %	3	100.0 %
Income before interest, other income (expense) and income taxes	4,889	11.9 %	4,813	11.2 %	76	1.6 %
Net interest expense	(4,377)	(10.6)%	(4,773)	(11.1)%	396	8.3 %
Other income, net	535	1.3 %	215	0.5 %	320	148.8 %
Income tax expense	(52)	(0.1)%	(127)	(0.3)%	75	59.1 %
Net income	$995	2.4 %	$128	0.3 %	$ 867	677.3 %

Net Revenues.

During the three months ended September 30, 2014, our overall order volumes increased 6% from the same period of 2013, which was largely due to increased sales of our technology-enabled products that typically result in pro rata revenue recognition over the life of the applicable contract. Given the shift in order mix towards technology-enabled products, our total net revenues decreased $1.8 million, or 4.2%, to $41.1 million in the third quarter of 2014 compared to the same period in 2013 as a larger portion of our third quarter 2014 order volumes were deferred for revenue recognition purposes relative to prior year.

Cost of Revenues.

Cost of revenues includes expenses to print, purchase, handle and warehouse our products, as well as order processing and royalty costs, and to provide services and support to customers. Cost of revenues, excluding amortization, decreased $1.9 million, or 14.7%, to $11.0 million in the third quarter of 2014 compared to the same period in 2013. This decline was primarily due to lower order volumes in our Voyager Sopris Learning segment.

Amortization Expense.

Amortization expense in cost of revenues includes amortization for acquired pre-publication costs and technology, acquired publishing rights, and developed pre-publication and technology. Amortization for the third quarter of 2014 was flat compared to the third quarter of 2013 at $4.7 million.

Research and Development Expense.

Research and development expense includes costs to research, evaluate and develop educational products, net of capitalization. Research and development expense for the third quarter of 2014 increased $0.3 million, or 10.4%, to $2.7 million compared to the third quarter of 2013 as we continue to invest in our product offerings.

Sales and Marketing Expense.

Sales and marketing expense includes all costs to maintain our various sales channels, including the salaries and commissions paid to our sales force, and costs related to our advertising and marketing efforts. Sales and marketing expense for the third quarter of 2014 was up slightly at $11.0 million for the three months ended September 30, 2014 compared to $10.9 million for the same period in 2013, primarily due to planned investments in our Learning A-Z and ExploreLearning segments.

General and Administrative Expense.

General and administrative expense for the third quarter of 2014 decreased $0.1 million, or 1.6%, from the third quarter of 2013 to $5.0 million.

Shipping and Handling Costs.

Shipping and handling costs decreased $0.1 million or 7.6% in the third quarter of 2014 compared to the same period in 2013. This decline was primarily due to lower order volumes in our Voyager Sopris Learning segment. As a percentage of total net revenues, shipping and handling costs remained approximately flat at 1.6% during the third quarter of 2014 compared to 1.7 % during the third quarter of 2013.

Net Interest Expense.

Net interest expense decreased by $0.4 million, or 8.3%, to $4.4 million in the third quarter of 2014 compared to the same period in 2013 primarily due to the repurchase of $10.0 million aggregate principal amount of debt that occurred in the first half of 2014.

Other Income, Net

Other income, net increased $0.3 million to $0.5 million in the third quarter of 2014 compared to the same period in 2013 primarily due to a settlement associated with an internet domain name.

Income Tax Expense.

During the third quarter of 2014 and 2013, we recorded state income tax expense of $0.1 million. We continue to maintain a valuation allowance against our deferred tax assets, which eliminated any deferred tax benefit generated.

Nine Months Ended September 30, 2014 Compared to the Nine Months Ended September 30, 2013: