Houghton Mifflin Harcourt Co
Form 10-K
February 25, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934, or**

For the fiscal year ended December 31, 2015

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

Commission file number 001-36166

Houghton Mifflin Harcourt Company

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**27-1566372** **(I.R.S. Employer Identification No.)**

222 Berkeley Street

Boston, MA 02116

(617) 351-5000

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $0.01 par value	**The NASDAQ Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨

Non-accelerated filer ¨ Smaller reporting company ¨
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 aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 30, 2015, was approximately $3.4 billion.

The number of shares of common stock, par value $0.01 per share, outstanding as of February 4, 2016 was 123,521,151.

Documents incorporated by reference and made a part of this Form 10-K:

The information required by Part III of this Form 10-K, to the extent not set forth herein, is incorporated herein by reference from the Registrant s Definitive Proxy Statement for its 2016 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2015.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained herein include forward-looking statements, which involve risks and uncertainties. These forward-looking statements can be identified by the use of forward-looking terminology, including the terms believes, estimates, projects, anticipates, expects, could, intends, may, will or should, forecast, intend, target or, in each case, their negative, or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. They include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies, the industry in which we operate and potential business decisions. We derive many of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the impact of known factors, and, of course, it is impossible for us to anticipate all factors that could affect our actual results. All forward-looking statements are based upon information available to us on the date of this report.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. We caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and the development of the industry in which we operate may differ materially from those made in or suggested by the forward-looking statements contained herein. In addition, even if our results of operations, financial condition and liquidity and the development of the industry in which we operate are consistent with the forward looking statements contained herein, those results or developments may not be indicative of results or developments in subsequent periods.

Important factors that could cause our results to vary from expectations include, but are not limited to: changes in state and local education funding and/or related programs, legislation and procurement processes; industry cycles and trends; the rate and state of technological change; changes in product distribution channels and concentration of retailer power; changes in our competitive environment; periods of operating and net losses; our ability to enforce our intellectual property and proprietary rights; risks based on information technology systems; dependence on a small number of print and paper vendors; third-party software and technology development; our ability to identify, complete, or achieve the expected benefits of, acquisitions; increases in our operating costs; exposure to litigation; major disasters or other external threats; contingent liabilities; risks related to our indebtedness; future impairment charges; changes in school district payment practices; a potential increase in the portion of our sales coming from digital sales; risks related to doing business abroad; and other factors discussed in the Risk Factors section of this Annual Report on Form 10-K (this Annual Report). In light of these risks, uncertainties and assumptions, the forward-looking events described herein may not occur.

We undertake no obligation, and do not expect, to publicly update or publicly revise any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law. All subsequent written and oral forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained herein.

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Item 1. Business

As used in this Annual Report, the terms we, us, our, HMH and the Company refer to Houghton Mifflin Harcou
Company, formerly known as HMH Holdings (Delaware), Inc., and its consolidated subsidiaries, unless otherwise expressly stated or the context otherwise requires.

Our Company

Overview of Houghton Mifflin Harcourt

We are a global learning company, specializing in education solutions across a variety of media. We deliver content, services and technology to both educational institutions and consumers, reaching over 50 million students in more than 150 countries worldwide. In the United States, we are the leading provider of kindergarten through 12th grade (K-12) educational content by market share. We believe our long-standing reputation and trusted brand enable us to capitalize on consumer and digital trends in the education market through our existing and developing channels. Furthermore, our trade, general interest, young readers and reference material include adult and children s fiction and non-fiction books that have won industry awards such as the Pulitzer Prize, Newbery and Caldecott medals and National Book Award.

We believe our leadership position in the K-12 market, our primary market, provides us with strong competitive advantages. We have established relationships with educators, institutions, parents, students and life-long learners that are founded on our education expertise, content and services. Our portfolio of intellectual property spans educational, general interest, children s and reference works, and has been developed by leading educators and award-winning authors including 10 Nobel Prize winners, 48 Pulitzer Prize winners and 15 National Book Award winners. Our content includes national education programs such as Collections, GO! Math, READ 180 and Channel One News, as well as characters and titles such as Curious George, Carmen Sandiego, The Little Prince, The Lord of the Rings, Life of Pi, Webster s New World Dictionary and Cliffs Notes.

We sell our products and services across multiple media and distribution channels and are expanding our customer base beyond educational institutions, with an increasing focus on consumers and early learners. Leveraging our portfolio of content, including some of our best-known children s brands and titles, such as Carmen Sandiego and Curious George, we create interactive digital content, mobile applications and educational games, build websites and provide technology-based educational solutions for the home.

Our digital products portfolio, combined with our content development or distribution agreements with recognized technology leaders, such as Apple, Google, Intel and Microsoft, enable us to bring our next-generation educational solutions and content to learners across virtually all platforms and devices. Additionally, we believe our technology and development capabilities allow us to enhance content engagement and effectiveness with embedded assessment, interactivity and personalized adaptable content as well as increased accessibility.

Market Opportunity

U.S. K-12 Market is Large and Growing

In the United States, which is our primary market in which we sell educational content for both public and private schools, the K-12 education market represents one of the largest industry segments accounting for over $632 billion of expenditures, or about 4.4% of the 2011 U.S. gross domestic product as measured by the U.S Education s National Center for Education Statistics (NCES) for the 2010-2011 school year. The instructional supplies and services

component of this market was estimated to be approximately $30 billion in 2011 and is expected to continue growing as a result of several secular and cyclical factors. From 2000-01 to 2010-11, current expenditures per student in public elementary and secondary schools increased by 14%, after adjusting for inflation. However, there can be no assurance that the U.S. K-12 market will grow.

In addition to its size, the U.S. K-12 education market is highly decentralized and is characterized by complex content adoption processes. It is comprised of approximately 16,600 public school districts across the 50 states and 129,000 public and private elementary and secondary schools. We believe this market structure underscores the importance of scale and industry relationships and the need for broad, diverse coverage across states, districts and schools. While we believe certain initiatives in the education sector such as the Common Core State Standards, a set of mathematics and English language arts standards, and Next Generation Science Standards, a set of science standards, each benchmarked to international standards, have increased standardization in K-12 education content, we also believe significant state standard specific customization still exists, and we believe the need to address customization provides an ongoing need for companies in the industry to maintain relationships with individual state and district policymakers and expertise in state-varying academic standards.

Growth in the U.S. K-12 market for educational content and services is driven by several factors. In the near term, total spend by institutions, which is largely dependent upon state and local funding, is rebounding in the wake of the U.S. economic recovery. While the market has historically grown above the pace of inflation, averaging 7.2% growth annually since 1969, the difficult operating environment stemming from the 2008-2009 recession caused many states and school districts to defer spending on educational materials. Following the recovery, and as tax revenues collected through income, sales and property taxes continue to rebound, institutional customers benefit from improved funding cycles. Total state tax revenues in FY 2015 increased by 5.6% over the prior year, although revenue growth is expected to slow somewhat in FY 2016 according to the Nelson A. Rockefeller Institute of Government, there can be no assurance of any further improvement or that it will be significant.

State adoptions of instructional materials, which were often deferred during the recession, have for the most part returned to regular, pre-recession cyclical patterns. California adopted English language arts materials this year for purchase in 2016 and subsequent years; Texas is scheduled to adopt materials in world languages in 2016 (for purchase in 2017 and subsequent years) and English language arts in 2017 (for purchase in 2018 and subsequent years); and Florida is slated to adopt new social studies programs in 2016 (for purchase in 2017 and subsequent years), and science programs in 2017 (for purchase in 2018 and subsequent years). We expect modest growth in open territories.

Long-term growth in the U.S. K-12 education market is positively correlated with student enrollments. Compared to 54.7 million students in 2010, total U.S. public school enrollments are expected to increase to approximately 57.0 million by the 2022 school year, according to NCES and the U.S. Census Bureau.

In addition, increased investment in areas of government policy focus is expected to further drive market growth. We believe the adoption of new academic standards in many states, including states that have adopted the Common Core State Standards in mathematics and English language arts and states adopting or contemplating adoption of the Next Generation Science Standards, is also expanding the market for teacher professional development and school improvement services.

We estimate that our U.S. K-12 educational addressable market is expected to be approximately in the range of $2.6 billion to $3.2 billion from 2015 through 2019. We define our addressable market as the market that we primarily compete in with our products, with the exception of our trade products, our cognitive and summative assessment products, professional development products and products sold internationally.

Expansion of Market Opportunities

Other U.S. educational market segments, such as early learning (pre-K) and direct-to-consumer have demonstrated growth in recent years. For example, according to a January 2015 report from the Education Commission of the

States, state funding for pre-K programs totaled $6.3 billion in fiscal 2014-15, a 12% increase from the prior fiscal year. This growing emphasis on early childhood education is further evidenced by language

in recently enacted legislation to reauthorize the Elementary and Secondary Education Act (**ESEA**), that authorizes continued funding for Preschool Development Grants, with an increased focus on coordinating programs, ensuring quality, and broadening access to early childhood education. The direct-to-consumer market performed strongly in 2014, with sales growth of 8% from just over $3 billion in 2013. The direct-to-consumer educational content market is fragmented, with many providers staking a claim in commercializing learning as families increasingly seek supplemental resources to help their children succeed in school and to set up young learners for success in the classroom.

Increasing Focus on Accountability and Student Outcomes

U.S. K-12 education has come under significant political scrutiny in recent years, due to recognition of its importance to the U.S. society at large and concern over the perceived decline in U.S. students competitiveness relative to their international peers. An independent task force report published in March of 2012 by the Council on Foreign Relations, a non-partisan membership organization and think tank, observed that American students rank far behind global leaders in international tests of literacy, math and science, and concluded that the current state of U.S. education severely impairs the United States economic, military and diplomatic security as well as broader components of America s global leadership.

These concerns helped lead to the passage in 2002 of the No Child Left Behind Act (NCLB), which ushered in an era of stricter accountability, higher standards and increased transparency in education. Since the enactment of NCLB, states have been required to measure progress towards these standards through annual student testing and make results, disaggregated by demographic sub-group, publicly available. 46 states and the District of Columbia initially adopted the new academic standards in mathematics and English language arts, based on the Common Core State Standards, developed under the auspices of governors and state chief school officers. Congress recently enacted the Every Student Succeeds Act (ESSA), which reauthorizes and overhauls the ESEA and replaces NCLB. The ESSA allows states greater flexibility in how to carry out federal mandates but retain NCLB s focus on accountability, standards and transparency, including NCLB s requirements for annual student testing and disaggregated score reporting.

This heightened focus on accountability and international competitiveness and the adoption of new, more rigorous standards has elevated the importance of, and helped drive demand for, high-quality, proven content that is aligned with these standards and empowers educators to meet new requirements. Schools have also increased their expenditures on services and professional development for educators that support teachers in implementing new programs effectively and provide district and school leaders with data management and assessment capabilities to measure progress. Although this trend may lead to increases in spending by schools and districts, educational mandates and expenditures can also be affected by other factors.

Growing Shift Towards Digital Materials

In the U.S. K-12 education market, an increasing number of schools are utilizing digital content in their classrooms and implementing online or blended learning environments, which mix the use of print and digital educational materials in the classroom. Technologies are also being adapted for educational uses via digital platforms, which permit the sharing of digital files and programs among multiple computers, mobile, or other devices in real time through a virtual network.

While the speed of technology adoption within the U.S. K-12 education market differs across districts and states due to varying resources and infrastructure, most schools are implementing more technology and are seeking partners to help them create effective digital learning environments. In some cases, districts are requiring providers of

instructional materials to include flexible digital components in their offerings, and are exploring subscription-based models for acquiring content. Many educators also believe that the increased implementation of digital learning environments will enable the widespread use of learning analytics, which enhance the ability to monitor effectiveness and learning outcomes to ultimately help schools build better pedagogical methods, personalize learning, identify and support at-risk students and improve student retention.

Rising Global Demand for Education

The global education market, especially in Asia and the Middle East, is experiencing rising enrollments and increasing government and consumer spending driven by the close connection between levels of educational attainment, evolving standards, personal career prospects and economic growth that will increase the demand for English language products. As of 2013, there were approximately 1.4 billion students out of a world population of approximately 7.2 billion people. Population growth is a leading indicator for pre-primary school enrollments, which have a subsequent impact on secondary and higher education enrollments. Globally, according to United Nations Educational, Scientific and Cultural Organization (UNESCO), rapid population growth has caused pre-primary enrollments to grow by 44.5% worldwide over the 10-year period from 2003 to 2013. Additionally, according to the United Nations, the world population of 7.2 billion in 2013 is projected to increase by 1 billion by 2025 and reach 9.6 billion by 2050, as countries develop and improvements in medical conditions increase the birth rate.

Currently, we focus our offerings in international markets on English language education and instructional products.

Our Industry

K-12 Comprehensive Curriculum, or Basal, Market

The U.S. K-12 comprehensive curriculum or basal market provides educational programs and assessments to approximately 55.0 million students across approximately 129,000 elementary and secondary schools. Basal programs cover curriculum standards in a particular subject and include a comprehensive offering of teacher and student materials necessary to conduct the class throughout the year. Products and services in basal programs include students print and digital offerings and a variety of supporting materials such as teacher s editions, formative assessments, whole group instruction materials, practice aids, educational games and services.

Comprehensive curriculum programs are the primary resource for classroom instruction in most K-12 academic subjects, and as a result, enrollment trends are a major driver of industry growth. Although economic cycles may affect short-term buying patterns, school enrollments, a driver of growth in the educational content industry, are highly predictable and are expected to trend upward over the longer term.

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

The majority of states are in the process of implementing or transitioning to new curriculum standards in two of the most important subject areas, mathematics and English language arts. For the most part, these new standards are based on the Common Core State Standards, the product of a multi-state effort to establish a single set of content standards in mathematics and English language arts for grades K-12. Forty-six states and the District of Columbia initially adopted the Common Core State Standards, and, while some states have nominally moved away from the standards, a majority of the original adopting states continue to use Common Core State Standards or curriculum standards closely based on them. Many states also have recently adopted or are in the process of developing new science standards, including 15 states that have adopted the multi-state Next Generation Science Standards. Most of these states are administering new student assessments aligned to the new standards.

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Instructional Material Adoption Process

The process through which materials and curricula are selected and procured for classroom use varies throughout the United States. In nineteen states, known as adoption states, new basal programs are evaluated at the state level, usually every six to eight years, for alignment to standards and other criteria. Individual school districts then purchase instructional materials for local use, typically from the state-approved list, although in some adoption states districts are permitted to use materials not on the state list. In all remaining states, known as open states or open territories, each individual school or school district evaluates and purchases materials independently and at any time, typically according to a five to ten year cycle.

The following chart illustrates the current adoption and open states:

The student population in adoption states represents over 50% of the U.S. elementary and secondary school-age population. A number of adoption states, and a few open territory states, provide categorical state funding for instructional materials; that is, funds that cannot be used for any purpose other than to purchase instructional content or, in some cases, technology equipment used to deliver instruction. In some states, categorical instructional materials funds can be used only for the purchase of materials on the state-approved list. In states that do not provide categorical state instructional materials funding, districts pay for materials primarily out of general state formula aid and/or local funds.

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

In open territory states, the procurement process is typically characterized by a presentation and the provision of sample materials to district-level instructional materials selection committees, which subsequently evaluate and recommend a particular program to district officials and school boards. Products are generally customized to meet the states curriculum standards with similar research methods as in adoption states.

We believe that a content provider s ultimate success in a given state will depend on a variety of factors, including the quality of its programs and materials, the strength of its relationships with key decision-makers and the magnitude of its marketing and sales efforts. As a result, educational content providers often implement formal market research efforts that include educator focus groups, prototypes of student and ancillary materials

and comparisons against competing products. At the same time, marketing and editorial staffs work closely together to incorporate the results of research into products, while developing the most up-to-date, research- and needs-based curricula.

Intervention and Supplemental Materials Market Segments

The intervention and supplemental materials market segments include a wide range of product offerings targeted at addressing specific needs generally not addressed through a comprehensive curriculum solution. These products include intervention programs in key subject areas, such as literacy and mathematics, that provide students in need of targeted support with additional instruction, knowledge and practice as well as supplemental materials and solutions that educators can use in addition to core curriculum to tailor education programs for their classrooms. Intervention solutions are generally purchased by individual schools or districts, while supplemental materials are generally purchased by individual teachers whose purchases are not tied to adoption schedules. The intervention market segment is a significant and growing segment in the United States. More than 60 percent of students enrolled in the public school environment perform below their grade level and are strong candidates for intervention programs both in literacy and mathematics.

Intervention and supplemental products and services are funded through state and local funding as well as federal funding allocations pursuant to the Elementary and Secondary Education Act (ESEA) and the Individuals with Disabilities Education Act (IDEA). Title I, the largest program within ESEA, provides funding to schools and school districts with high concentrations of students from low income families. Title I and other ESEA programs also provide targeted funding for specific activities, such as early childhood education, school improvement, response to intervention, dropout prevention, and before- and after-school programs. IDEA governs how states and public agencies provide early intervention, special education and related services to children with disabilities.

Professional Services Market Segment

The Professional Services market segment includes consulting and support services to assist individual schools and school districts in raising student achievement, implementing new programs and technology effectively, developing effective teachers, principals and leaders, as well as school and school-district turnaround and improvement solutions. We believe all districts and schools contract for some level of professional services. These services may include support for up-front training, in-classroom coaching, institutes, author workshops, professional learning communities, leadership development, technical support and maintenance, and program management. Historically, it has been challenging to measure the success of these investments or sustain their effects owing to the fragmented nature of initiatives and providers in a single district as well as the lack of sustained plans.

Professional development is directly addressed in the Every Student Succeeds Act (ESSA), the reauthorization of the Elementary and Secondary Education Act. ESSA restructures Title II, the section of the law addressing teacher quality, and authorizes $2.3 billion in grants to support activities that promote teacher and principal effectiveness. ESSA also eliminates federal highly qualified teacher requirements and prohibits U.S. Department of Education mandates and incentives to evaluate teachers on the basis of student test scores, which in recent years have channeled resources and attention to the development of educator evaluation systems, measurement tools, and related training. Title II now focuses instead on the role of the profession in improving student achievement, including new requirements to ensure professional development is not only sustained (no one-day workshops), but also job-embedded , data-driven, and personalized. It is expected that school districts will need to focus their applications for teacher training to ensure teacher alignment with high quality standards as well as priorities for funds to low-performing schools where comprehensive support and improvement plans are in place. There are also significant funding opportunities for professional development as part of state programs, especially in states where they have

consolidated program funding and want solutions that are evidence-based.

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The market for professional development services, which has no single dominant player in the United States, is expected to grow as the transition to digital learning in classrooms increases the need for technology training and implementation support for educators. We believe that the use of interim data, differentiation, teacher content knowledge (in mathematics) and the use of technology in the classroom are the areas in which teachers and leaders are most seeking support. Also, demand for teacher training and professional development opportunities tied to the implementation of new or revised standards at the state level is expected to continue. In addition, there is expected to be a need to develop new teachers as the next several years are expected to continue to see the greening of the teaching force, with approximately 200,000 new teachers entering the work force every year and a 50% attrition rate among beginning teachers.

Assessment Market Segment

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

Many states and districts are currently utilizing teacher evaluation systems that measure teacher performance based on standardized test scores and other elements required to meet certain benchmarks set by policymakers. Certain federal agencies are shifting the focus to children at even younger ages to provide intervention before significant achievement gaps are realized. As a result, this has led to additional opportunities in the early childhood assessment and intervention market.

Legislation to reauthorize ESEA, known as the Every Student Succeeds Act (ESSA), was signed into law in December 2015. ESSA requires annual summative testing in reading and mathematics at grades 3 through 8 and one grade level of high school, as well as testing in science at a minimum of three grade levels. Under ESSA, states have greater flexibility than under NCLB in choosing their assessment approach and how they intervene with the lowest performing schools. In addition, the law prohibits federal incentives for states to adopt any particular set of standards, including the Common Core State Standards, and assessments. Several states that had initially participated in the Common Core-based Smarter Balanced Assessment Consortium (SBAC) and the Partnership Assessment of Readiness for College and Careers (PARCC) have since dropped out of the consortia and decided to use other assessments to measure student achievement. Major challenges facing the future of the consortia are testing time, cost, and dependency for online assessment delivery.

As states plan for and implement new assessments and districts continue to transition to new standards, demand for quality measures and reporting systems that help educators prepare students for the content coverage and item types anticipated on the new assessments should continue to increase.

International Market

Internationally, we predominantly export and sell K-12 English language education products to premium private schools that utilize the U.S. curriculum, which are located primarily in Asia, the Pacific, the Middle East, Latin America, the Caribbean and Africa. Our international sales team utilizes a global network of distributors in local markets around the world.

Our immediate international strategy is to expand our addressable market through offering private schools in targeted international markets educational solutions comprising print and digital content, professional development services and a wide array of supplemental, intervention and assessment products, which are aimed at improving learning outcomes.

Early Learning Market Segment

Over the last decade, the early childhood market has seen significant growth in enrollments and increases in state and federal funding. These increases are driven by increased awareness of the value of quality pre-K experiences to educational achievement, its economic benefits, as well as the growth in breadth and depth of state early learning standards. For example, ESSA, while eliminating and consolidating programs in other areas, created a new national program for early childhood education. The Preschool Development Grants program, with authorized annual funding of $250 million, provides grants to support the expansion of quality pre-K programs serving low-income and disadvantaged children. The program builds upon and codifies a similar grant program currently administered by the U.S. Department of Education. We believe the key to the overall success of pre-K is the quality of the experience, from environments to teachers, with a special focus on instructional materials, an area in which we believe we are well-positioned to grow.

Direct-to-Consumer Market Segment

While the direct-to-consumer educational content market exceeded $3.3 billion in 2014, the market lacks a clear system to help families and educators navigate and evaluate the vast menu of offerings available, whether through application stores, webpages focused on children s content, streaming websites such as YouTube or similar sources. We believe our long history and trusted reputation for delivering educational content with strong learning outcomes positions us well to become the learning partner of choice for parents and families looking for learning solutions that support their children s school experiences. Pressure has continued to increase around student performance and its impact on college and career readiness, shaped by policy, new educational standards, new research on developmental growth, testing and more. We expect this will drive demand for direct-to-consumer educational content. Our immediate strategy in this market segment is to leverage our deep learning and pedagogical expertise to provide effective products rooted in the science of learning directly to parents and families of pre K-12 students.

Trade Publishing Market

The Trade Publishing market includes works of fiction and non-fiction in the General Interest and Young Reader s categories, dictionaries and other reference works. While print remains the primary format in which trade books are produced and distributed, the market for trade titles in digital format, primarily e-books, has developed rapidly over the past several years, as the industry evolves to embrace new technologies for developing, producing, marketing and distributing trade works.

Our Products and Services

We are organized along two reportable segments: Education and Trade Publishing. Our primary segment measures are net sales and Adjusted EBITDA. The Education segment is our largest business, representing approximately 88% of our total net sales for each of the years ended December 31, 2015, 2014 and 2013.

Education

Our Education segment provides educational content, services, and technology solutions to meet the diverse needs of today s classrooms. The principal markets for our Education products are K-12 school systems, which purchase core curriculum materials, intervention and supplemental materials, professional development and school turnaround services, and an array of highly regarded assessment products. Additionally, we believe our increasing portfolio of educational content in the early learning and direct-to-consumer spaces puts us in a strong position for growth in these areas.

The Education segment net sales and Adjusted EBITDA were $1,251.1 million and $269.4 million, $1,209.1 million and $298.5 million, and $1,207.9 million and $343.2 million, for the years ended December 31, 2015, 2014 and 2013, respectively.

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Our Education products consist of the following offerings:

Comprehensive Curriculum: Our comprehensive curriculum offerings include educational programs intended to provide a complete course of study in a subject, either at a single grade level or across multiple grade levels, and serve as the primary source of classroom instruction. We develop and market comprehensive curriculum programs for the pre-K-12 market utilizing the Houghton Mifflin Harcourt brands and focusing our content portfolio on the subjects that have consistently received the highest priority from educators and educational policy makers, namely reading, literature and language arts, mathematics, science, world languages and social studies. Within each subject, comprehensive learning programs are designed and then marketed with a variety of proprietary products to maximize teaching effectiveness, including digital and print program editions, workbooks, teachers guides and resources, audio and visual aids and technology-based products.

Intervention Products and Supplemental Materials: We develop products targeted at addressing struggling learners through comprehensive intervention solutions, products targeted at assisting English language learners and products providing incremental instruction in a particular subject area. Included with this group of products are: flagship intervention programs such as *MATH 180, READ 180, System 44* and *iRead*, which were obtained as part of the acquisition of EdTech; professional books and developmental resources aimed at empowering pre-K-12 teachers; our Benchmark Assessment System, which allows teachers to evaluate students reading levels three times a year; and our Leveled Literacy Intervention System, which is a supplementary intervention program for children struggling with reading and writing. The intervention and supplemental materials group generates net sales and earnings that do not vary greatly with the adoption cycle. In addition, the development of intervention and supplemental materials tends to require significantly less capital investment than the development of a comprehensive curriculum program.

Professional Services. To extend our value proposition, we provide consulting services to assist school districts in increasing accountability for improvement and offering professional development training, comprehensive services and school turnaround solutions. We believe our educational services offer integrated solutions that combine the best learning resources available today. These include learning resources that are supported with professional development in classroom assessment, digital implementation, teacher effectiveness and high-impact leadership, which have a measurable and sustainable impact on student achievement.

*Assessment. Our a*ssessment products provide district and state-level solutions focused on cognitive and formative assessment tools and platform solutions. Cognitive solutions provide psychological and special needs testing to assess intellectual, cognitive and behavioral development. Our group and formative solutions include largely K-12 assessment tools and services relating to academic achievement as well as low-stakes assessment tools that assist in identifying the learning needs and abilities of students.

International. We sell our educational solutions into global education markets predominantly to large English language schools in high growth territories primarily in Asia, the Pacific, the Middle East, Latin America, the Caribbean and Africa.

Early Learning: Our award-winning early learning solutions are designed to support educators, administrators, caregivers, and families as they help to nurture, teach, and raise children from infancy through age seven. Informed by scientific research on how children learn best, our solutions focus on personalizing learning for every child and putting students on the path to school and life readiness. Our solutions include *Big Day for Pre-K*, *Curiosityville* and *iRead*. We sell our solutions to early learning institutions and pre-schools.

Direct-to-Consumer: Our direct-to-consumer educational offerings leverage our deep learning and pedagogical expertise to provide effective products rooted in the science of learning directly to parents

and families of preK-12 students. Our products include Curious World, that features curated videos, games, and content aligned with eight key learning areas and Go Math! Academy, the at-home companion to our leading GO Math! core curriculum.

Trade Publishing

Our Trade Publishing segment, which dates back to 1832, primarily develops, markets and sells consumer books in print and digital formats and licenses book rights to other publishers and electronic businesses in the United States and abroad. The principal markets for Trade Publishing products are retail stores (both physical and online) and wholesalers. Reference materials are also sold to schools, colleges, libraries, office supply distributors and other businesses.

Our Trade Publishing segment offers an extensive library of general interest, young readers and reference works that include well-known characters and brands. Our award-winning general interest titles include literary fiction, culinary, and non-fiction in hardcover, e-book and paperback formats, including the Mariner Books paperback line. Among the general interest properties are the popular J.R.R. Tolkien titles and the prolific The Best American Series. The general interest group also publishes the CliffsNotes series of test prep and study guides, branded field guides, such as the Peterson Field Guides and extensive culinary works. In culinary, our catalog now includes major cookbook brands such as Betty Crocker and Better Homes and Gardens in addition to recent best sellers including the How to Cook Everything series and Whole30. Our catalog features numerous Nobel and Pulitzer Prize winners and Newbery and Caldecott medal winners, including a 2015 Newbery Medal winner, a 2014 and 2013 Caldecott Honor winner and a 2014 Pulitzer Prize winner. In young readers publishing, our list addresses a broad age group and includes an array of products for the preschool/early learning market, including board books, picture books and workbooks. This list includes recognized characters and titles such as Curious George and Martha Speaks, both successful television programs featured on PBS, Five Little Monkeys, Gossie & Friends, Polar Express, Little Blue Truck, and many more. We also publish novels for young adults, a growing genre. In the reference category, we are the publisher of the American Heritage and Webster s New World dictionaries, and related titles.

In addition to traditional conversions of print to digital content, we develop our content digitally in various formats with minimal incremental investment. As such, we have an established and flexible solution for converting, manipulating and distributing trade content to the many digital consumer platforms such as e-readers and tablets. We continue to actively publish into the sizable consumer market for e-books, book or character-based applications and other digital products with net sales from e-books reaching $21.0 million for the year ended December 31, 2015, representing approximately 12.7% of our Trade Publishing segment net sales for the same period. We continue to focus on the development of innovative new digital products which capitalize on our content, our digital expertise, and the growing consumer demand for these products. In addition, we are increasingly leveraging the strength of our Trade Publishing brands and characters, such as Curious George, together with our expertise in developing educational solutions, to further penetrate the large and growing consumer market for at-home educational products and services.

For the years ended December 31, 2015, 2014 and 2013, Trade Publishing net sales and Adjusted EBITDA were approximately $164.9 million and $7.7 million, $163.2 million and $12.7 million, and $170.7 million and $24.4 million, respectively.

Seasonality

Approximately 88% of our net sales for the year ended December 31, 2015 were derived from our Education segment, which is a markedly seasonal business. Schools conduct the majority of their purchases in the second and third quarters of the calendar year in preparation for the beginning of the school year. Thus, over our latest three completed

fiscal years, approximately 68% of consolidated net sales were realized in the second

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and third quarters. Sales of K-12 instructional materials and customized assessment products are also cyclical, with some years offering more sales opportunities than others. The amount of funding available at the state level for educational materials also has a significant effect on year-to-year net sales.

Competition

We sell our products in competitive markets. In these markets, product quality, customer service and perceived stability and longevity are major differentiating factors between companies. Other factors affecting competition include: (i) competitive pricing, sampling and gratis costs; (ii) digitization of educational programs; and (iii) the relationship between the sales force and customer. There are three primary traditional comprehensive curriculum publishers in the K-12 market, which also compete with a variety of specialized or regional publishers that focus on select disciplines and/or geographic regions. There are multiple competitors in the Trade Publishing, supplemental and assessment markets. Our larger competitors in the educational market include Pearson Education, Inc., McGraw Hill Education, Cengage Learning, Inc., Scholastic Corporation and K12 Inc.

Printing and binding; raw materials

We outsource the printing and binding of our products, with approximately 60% of our printing requirements handled by one major supplier. We have procurement agreements that provide volume and scheduling flexibility and price predictability. We have a longstanding relationship with these parties. Approximately 20% of our printed materials (consisting primarily of teacher s editions and other ancillary components) are printed outside of the United States and approximately 80% of our printed materials (including most student editions) are printed within the United States. Paper is one of our principal raw materials. We purchase our paper primarily through one paper merchant and also directly through suppliers for limited product types. We maintain various agreements that protect against supply availability and unbound price increases. We manage our paper supply concentration by having primary and secondary sources and staying ahead of dramatic market changes.

Distribution

We operate three distribution facilities from which we coordinate our own distribution process: one each in Indianapolis, Indiana; Geneva, Illinois; and Troy, Missouri. We also utilize select suppliers to assist us with coordinating the distribution process for a limited number of product types. Additionally, some adoption states require us to use in-state textbook depositories for educational materials sold in that particular state. We utilize delivery firms including United Parcel Service Inc., FedEx Freight, CH Robinson Worldwide Inc., YRC Freight, SAIA and USF Holland, Inc. to facilitate the principally ground transportation of products.

Employees

As of December 31, 2015, we had approximately 4,500 employees, none of which were covered by collective bargaining agreements. These employees are substantially located in the United States with 239 employees located outside of the United States. We believe that relations with employees are generally good.

Intellectual property

Our principal intellectual property assets consist of our trademarks and copyrights in our content. Substantially all of our publications are protected by copyright, whether registered or unregistered, either in our name as the author of a work made for hire or the assignee of copyright, or in the name of an author who has licensed us to publish the work. Ownership of such copyrights secures the exclusive right to publish the work in the United States and in many

countries abroad for specified periods: in the United States in most cases either 95 years from publication or for the author s life plus 70 years, but in any event a minimum of 28 years for works published prior to 1978 and 35 years for works published thereafter. In most cases, the authors who retain

ownership of their copyright have licensed to us exclusive rights for the full term of copyright. Under U.S. copyright law, for licenses granted by an author during or after 1978, such exclusive licenses are subject to termination by the author or certain of the author s heirs for a five year period beginning at the end of 35 years after the date of publication of the work or 40 years after the date of the license grant, whichever term ends earlier.

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

Environmental matters

We generally contract with independent printers and binders for their services, and our operations are generally not otherwise affected by environmental laws and regulations. However, as the owner and lessee of real property, we are subject to environmental laws and regulations, including those relating to the discharge of hazardous materials into the environment, the remediation of contaminated sites and the handling and disposal of wastes. It is possible that we could face liability, regardless of fault, and can be held jointly or severally liable, if contamination were to be discovered on the properties that we own or lease or on properties that we have formerly owned or leased. We are currently unaware of any material environmental liabilities or other material environmental issues relating to our properties or operations and anticipate no material expenditures for compliance with environmental laws or regulations.

Additional information

Houghton Mifflin Harcourt Company was incorporated as a Delaware corporation on March 5, 2010, and was established as the holding company of the current operating group. Houghton Mifflin Harcourt was formed in December 2007 with the acquisition of Harcourt Education Group, then the second-largest K-12 U.S. publisher, by Houghton Mifflin Group. We are headquartered in Boston, Massachusetts. We make available our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, as well as other information, free of charge through our corporate website under the Financial Information link located at: ir.hmhco.com, as soon as reasonably practicable after being filed with or furnished to the Securities and Exchange Commission (the SEC). The information found on our website or any other website we refer to in this Annual Report is not part of this Annual Report or any other report we file with or furnish to the SEC.

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Item 1A. Risk Factors

Our business and results of operations may be adversely affected by many factors outside of our control, including changes in federal, state and local education funding, general economic conditions and/or the loosening of restrictions on the use of state educational funding previously dedicated to instructional material purchases.

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

Federal and/or state legislative changes can also affect the funding available for educational expenditure, which include the impact of education reform, such as the reauthorization of the ESEA and the implementation of Common Core State Standards and new science standards. The recently enacted ESEA reauthorization legislation consolidates funding for a number of existing federal programs into a single block grant and makes other significant changes to the law, including significant changes to state accountability requirements, that could affect demand for our products and services. Moreover, federal educational funding is subject to the Congressional appropriations process and, accordingly, could result in program funding at or below authorized or historical levels, which could adversely affect sources of funding for our products and services. There can be no assurances that states or districts will have sufficient funding to purchase our products and services, that we will win their business in our competitive marketplace or that schools or districts that have historically purchased our products and services will do so again in the future.

Decreases in federal, state and/or local education funding available to school districts, the loosening of restrictions on the use of state educational funding previously dedicated to instructional materials purchases, federal and/or state legislative changes and/or negative trends or changes in general economic conditions could have a material adverse effect on our business, results of operations and financial condition.

State changes to curriculum standards, such as Common Core State Standards, or procurement processes and/or our ability to do well in state adoptions may have a material adverse effect on our business, results of operations and our financial condition.

Changes in state curriculum standards, such as Common Core State Standards and new science standards, may affect our market and sales. There is considerable political controversy in many states surrounding the adoption and implementation of Common Core State Standards. Legislation has been introduced in a number of states to drop Common Core State Standards, and some states are considering revisions to and/or rebranding of the standards. These developments could disrupt local adoptions of instructional materials and require modifications to our programs offered for sale in states that adopt such changes, which may have a material adverse effect on our business and results of operations. Further, the recently enacted ESEA reauthorization legislation consolidates funding for a number of existing federal programs into a single block grant and makes other significant changes to the law, including significant changes to state accountability requirements, which could affect demand for our educational products and services.

Similarly, changes in the state procurement process for instructional, assessment and supplemental materials, particularly in adoption states, can also affect our markets and sales. A significant portion of our net

sales is derived from sales of K-12 instructional materials pursuant to pre-determined adoption schedules. Due to the revolving and staggered nature of state adoption schedules, sales of K-12 instructional materials have traditionally been cyclical, with some years offering more sales opportunities than others. For example, over the next few years adoptions are scheduled in one or more of the primary subjects of reading, language arts and literature, social studies and mathematics in, among others, the states of California, Texas and Florida, the three largest adoption states. The inability to succeed in these states, or reductions in their anticipated funding levels, could materially and adversely affect net sales for the year of adoption and subsequent years. Further, allowing school districts flexibility to use state funds previously dedicated exclusively to the purchase of instructional materials on other items such as technology equipment and training could adversely affect district expenditures on state-adopted instructional materials in the future.

State changes to curriculum standards, such as Common Core State Standards, or procurement process, particularly in adoption states, could materially and adversely affect our markets, business and results of operations. Our failure to do well in state adoptions could have a material adverse effect on our business, results of operations and financial condition.

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

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

Our operating results fluctuate on a seasonal and quarterly basis and our business is dependent on our results of operations for the third quarter.

Our business is seasonal. For the year ended December 31, 2015, we derived approximately 88% of net sales from our Education Segment, which is a markedly seasonal business. Typically, purchases of educational products are made primarily in the second and third quarters of the calendar year in preparation for the beginning of the school year, though assessment net sales are primarily generated in the second and fourth quarters. We typically realize a significant portion of net sales during the third quarter, making third-quarter results material to full-year performance. This sales seasonality affects operating cash flow from quarter to quarter. We typically incur a net cash deficit from all of our activities through the middle of the third quarter of the year. We cannot make assurances that our second and third quarter net sales will continue to be sufficient to fund our business and meet our obligations or that they will be higher than our net sales in prior-year or consecutive quarters. In the event that we do not derive sufficient net sales for the second and third quarter, we may not be able to fund our business and/or meet our debt service requirements and other obligations.

In addition, changes in our customers ordering patterns may impact the comparison of results for a period with the same prior-year or consecutive period and may make it increasingly difficult for us to forecast the timing of their customer purchases and assess our financial performance until later in the year.

Our business is and will continue to be impacted by the rate and state of technological change, including the digital evolution and other disruptive technologies, and the presence and development of open-sourced content could

continue to increase, which could adversely affect our net sales.

Our industry has been impacted by the digitalization of content and proliferation of distribution channels, either over the internet, or via other electronic means, replacing traditional print formats. The digital migration

brings the need for change in product distribution, consumers perception of value and the publisher s position between retailers and authors. Such digitalization increases competitive threats both from large media players and from smaller businesses, online and mobile portals.

Free or relatively inexpensive educational products are becoming increasingly available, particularly in digital formats and through the internet. For example, some governmental and regulatory agencies have increased the amount of information they make publicly available for free. In addition, in recent years, there have been initiatives by non-profit organizations such as the Gates Foundation and the Hewlett Foundation to develop educational content that can be open sourced and made available to educational institutions for free or nominal cost. To the extent that such open sourced content is developed and made available to educational customers and is competitive with our instructional materials, our sales opportunities and net sales could be adversely affected. Technological changes and the availability of free or relatively inexpensive information and materials may also affect changes in customer behavior and expectations. Public and private sources of free or relatively inexpensive information and lower pricing for digital products may reduce demand, and impact the prices we can charge for, our products. To the extent that technological changes and the availability of free or relatively inexpensive information and materials limit demand or the prices we can charge for our products, our business, financial position and results of operations may be materially adversely affected.

Changes in product distribution channels and concentration of retailer power may restrict our ability to grow and affect our profitability in our Trade Publishing segment.

Distribution channels such as online retailers and ecommerce sites, evolving digital delivery platforms, expanding social media, digital discovery and marketing platforms, combined with the increased concentration of retailer power, pose threats and provide opportunities to our traditional consumer publishing models in our Trade Publishing segment, potentially impacting both sales volumes and profitability. The continued reduction in brick and mortar booksellers, the resulting concentration of power held by our largest retailers, and the increased concentration of consumer book spending on best-selling titles could negatively affect our business, financial condition and results of operations.

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

We operate in highly competitive markets with significant established competitors such as Pearson Education, Inc., McGraw Hill Education, Cengage Learning, Inc., Scholastic Corporation, K12 Inc. and John Wiley & Sons, Inc. Some of these established competitors may have greater resources and less debt than us and, therefore, may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or devote greater resources to the development, promotion and sale of their products and services than we can.

The risks of competition are intensified in the current environment where investment in new technology is ongoing and there are rapid changes in the products our competitors are offering, the products our customers are seeking, and sales and distribution channels. As a result, we could experience threats to our existing businesses from the rise of new competitors due to the rapidly changing environment within which we operate.

For example, while our educational content is protected by copyright law, there is nothing to prevent technology companies from developing their own educational digital products and offering educational content to schools. Technology companies are free to distribute materials with and on their technology devices and platforms. Many technology companies have substantial resources that they could devote to expand their business, including the development of educational digital products. Furthermore, while we have entered into digital distribution agreements

with a number of technology companies, our agreements are non-exclusive arrangements and there is nothing to prevent such technology companies from developing and distributing other

educational content to the K-12 market. There is a risk that a technology company with significant resources could license or acquire their own educational content and compete with us, which could negatively affect our business, financial condition and results of operations.

There is also a risk of further disintermediation, which is the occurrence of state, district and other customers contracting directly with technology companies. As a result, there is a risk that technology companies may own direct relationships with our customers, and accordingly, they may have a significant influence over the pricing and distribution strategies for digital and print education materials.

Our history of operations includes periods of operating and net losses, and we may incur operating and net losses in the future. Our significant net losses and our significant amount of indebtedness led us to declare bankruptcy in 2012.

For the years ended December 31, 2015, 2014 and 2013, we generated operating losses of $116.1 million, $85.4 million, and $86.6 million, respectively, and net losses of $133.9 million, $111.5 million, and $111.2 million, respectively. If we continue to suffer operating and net losses, the trading price of our common stock may decline significantly.

In addition, we had a significant amount of indebtedness prior to May 2012. During May 2012, as a result of our financial position, results of operations and significant amount of indebtedness, we filed a voluntary petition for bankruptcy under Chapter 11 of the United States Bankruptcy Code. On June 22, 2012, we emerged from bankruptcy pursuant to a pre-packaged plan of reorganization. Although we have significantly less interest expense as a result of our emergence from bankruptcy, we may not generate sufficient net sales in future periods to pay for all of our operating or other expenses, which could have a material adverse effect on our business, results of operations and financial condition.

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

Our products are largely comprised of intellectual property content delivered through a variety of media, including print, digital and web-based media. We rely on copyright, trademark and other intellectual property laws and rights to establish and protect our proprietary rights in these products. However, our efforts to protect our intellectual property and proprietary rights may not be sufficient and we cannot make assurances that our proprietary rights will not be challenged, invalidated or circumvented. Moreover, we conduct business in certain other countries where the extent of effective legal protection for intellectual property rights is uncertain. We may also be required to initiate expensive and time-consuming litigation to maintain, defend or enforce our intellectual property.

Moreover, despite the existence of copyright and trademark protection under applicable laws, third parties may nonetheless violate our intellectual property rights, and our ability to remedy such violations, including in certain foreign countries where we conduct or seek to conduct business, may be limited. In addition, the copying and distribution of content over the Internet creates additional challenges for us in protecting our proprietary rights.

If we are unable to adequately protect and enforce our intellectual property and proprietary rights, our competitive position may be harmed and our business and financial results could be materially and adversely affected.

We are subject to risks based on Information Technology (IT   ) systems. A major data privacy breach or unanticipated IT system failure could interrupt the availability of our internet-based products and services, result in corruption /and/or loss of data or breach in security and cause liability, reputational damage to our brands and/or financial loss.

Our business is dependent on information technology systems to support our complex operational and logistical arrangements across our businesses. We provide software and/or internet-based products and services to our customers. We also use complex information technology systems and products to support our business activities, particularly in infrastructure and as we move our products and services to an increasingly digital delivery platform.

We face several technological risks associated with software and/or internet-based product and service delivery in our educational businesses, including with respect to information technology capability, reliability and security, enterprise resource planning, system implementations and upgrades. Failures of our information technology systems and products (including as a result of operational failure, natural disaster, computer virus or hacker attacks) could interrupt the availability of our internet-based products and services, result in corruption or loss of data or breach in security and result in liability, reputational damage to our brands and/or adversely impact our operating results.

Across our businesses we hold large volumes of personal data, including that of employees, customers and students, and are subject to privacy laws, rules, regulations and standards in U.S. federal, state and local jurisdictions as well as in foreign jurisdictions where we conduct business, including (i) the Children   s Online Privacy Protection Act and state student data privacy laws in connection with access to, collection of, and use of personally identifiable information of students, (ii) the Health Insurance Portability and Accountability Act in connection with our self-insured health plan and assessment products, (iii) the Payment Card Industry Data Security Standards in connection with collection of credit card information from customers, and (iv) various EU data protection laws resulting from the EU Privacy Directive. Our brands and customer relationships are important assets. Failure to adequately protect such personal data could lead to penalties, significant remediation costs, reputational damage to our brands and customer relationships, potential cancellation of existing business and diminished ability to compete for future business.

While we have policies, processes, internal controls and cybersecurity mechanisms in place intended to ensure the stability of our information technology, provide security from unauthorized access to our systems and maintain business continuity, no mechanisms are entirely free from the risk of failure and we have no guarantee that our security mechanisms will be adequate to prevent all possible security threats. Our operating results may be adversely impacted by unanticipated system failures, corruption or loss of data or breaches in security.

We are dependent on a small number of third-parties to print and bind our products and to supply paper, a principal material for our products. If we were to lose our relationship with our print vendor and/or paper merchant, our business and results of operations may be materially and adversely affected.

We outsource the printing and binding of our products and currently rely on one key third-party print vendor that handles approximately 60% of our printing requirements, and we expect a small number of print vendors will continue to account for a substantial portion of our printing requirements for the foreseeable future. The loss of, or a significant adverse change in our relationship with, our key print vendor could have a material adverse effect on our business and cost of sales. In addition, we purchase paper, a principal raw material for our print products, primarily through one paper merchant. There can be no assurance that our relationships with our print vendor and/or paper merchant will continue or that their business or operations will not be affected by major disasters or other external factors. The loss of our key print vendor and/or paper merchant, a material change in our relationship with them, a material disruption in their business or their failure to otherwise perform in the expected manner could cause disruptions in our business that may materially and adversely affect our results of operations and financial condition.

We rely on third-party software and technology development as part of our digital platform.

We rely on third-parties for some of our software and technology development. For example, some of the technologies and software that compose our instruction and assessment technologies are developed by third parties. We rely on those third parties for the development of future components and modules. Thus, we face risks associated with technology and software product development and the ability of those third parties to meet our needs and their obligations under our contracts with them. In addition, we rely on third-parties for our internet-based product hosting. The loss of one or more of these third-party partners, a material disruption in their business or their failure to otherwise perform in the expected manner could cause disruptions in our business that may materially and adversely affect our results of operations and financial condition.

We may not be able to identify and complete any future acquisitions, or achieve the expected benefits from any previous or future acquisitions, which could materially and adversely affect our business, financial condition and results of operations and/or our growth.

We have at times used acquisitions as a means of expanding our business and technologies, and expect that we will continue to do so as part of our capital allocation strategy. We may be unable to identify suitable acquisition opportunities and, even if we were able to do so, we may not be able to finance or complete any such future acquisition on terms satisfactory to us, if at all. Further, we may not be able to successfully integrate previous or future acquisitions into our existing business, achieve anticipated operating advantages and/or realize anticipated cost savings or other synergies. The acquisition and integration of businesses involve a number of risks, including: use of available cash, incurrence of new or borrowings under our New Revolving Credit Facility to consummate the acquisition and/or integrate the acquired business; diversion of management s attention from existing operations of our existing and the acquired business to the integration; integration of complex systems, technologies and networks into our existing systems; difficulties in the assimilation and retention of employees; unexpected costs, delays or other risks related to transition support services provided under any transition services agreement that may be executed as part of the acquisition; demands on management related to the increase in our size after an acquisition; and potential adverse effects on our operating results.

If we are unable to finance or complete any future acquisition on terms satisfactory to us (or at all) and/or we are unable to successfully integrate any previous or future acquisitions into our existing business, achieve anticipated operating advantages and/or realize anticipated cost savings or other synergies from any such acquired business, it could materially and adversely affect our business, financial condition and results of operations.

For example, we completed the acquisition of EdTech on May 29, 2015. Significant management attention and resources have been and continue to be devoted to integrating the business practices and operations of EdTech with our Company. This integration may prove to be more difficult, costly and time-consuming than expected, which could cause us not to realize some or all of the anticipated benefits from the acquisition. Further, we expect to achieve certain benefits as a result of the acquisition of EdTech, including revenue and cost synergies, and we have made certain projections about the performance of EdTech. There can be no assurances that we will realize the expected benefits currently anticipated from the acquisition or that EdTech will perform according to our projections. A failure to achieve any of the anticipated benefits of the acquisition of EdTech or a failure of EdTech to perform according to our projections could materially and adversely affect our financial condition and results of operations.

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

Our success depends, in part, on our ability to continue to attract and retain key management, information technology, creative, editorial and sales and other personnel and/or key authors. We operate in a number of highly visible industry segments where there is intense competition for successful authors and other experienced

and highly effective individuals. Our successful operations in these segments may increase the market visibility of members of our authors and key management, information technology, creative, editorial and sales and other personnel and result in their recruitment by other businesses. There can be no assurance that we can continue to attract and retain key authors and talented personnel with relevant skills, including executive officers and other key members of management, and, if we fail to do so, it could adversely affect our business.

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

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

Our major expenses include employee compensation and printing, paper and distribution costs for product-related manufacturing.

We offer competitive salary and benefit packages in order to attract and retain the quality employees required to grow and expand our businesses. Compensation costs are influenced by general economic factors, including those affecting the cost of health insurance and post-retirement benefits, and any trends specific to the employee skillsets we require. We could experience changes in pension costs and funding requirements due to poor investment returns and/or changes in pension laws and regulations.

Paper is one of our principal raw materials. As a result, our business may be negatively impacted by an increase in paper prices. Paper prices fluctuate based on the worldwide demand and supply for paper in general and for the specific types of paper used by us. The price of paper may fluctuate significantly in the future, and changes in the market supply of, or demand for paper, could affect delivery times and prices. Paper suppliers may consolidate and as a result, there may be future shortfalls in supplies necessary to meet the demands of the entire marketplace. We may need to find alternative sources for paper from time to time. Our books and workbooks are printed by third parties and we typically have multi-year contracts for the production of books and workbooks. Increases in any of our operating costs and expenses could materially and adversely affect our profitability and our business, financial condition and results of operations.

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

We also have other significant operating costs, and unanticipated increases in these costs could adversely affect our operating margins. Higher energy costs and other factors affecting the cost of publishing, transporting and distributing our products could adversely affect our financial results. Our inability to absorb the impact of increases in paper costs and other costs or any strategic determination not to pass on all or a portion of these increases to customers could adversely affect our business, financial condition and results of operations.

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

In the ordinary course of business, we are involved in legal actions and claims arising from our business operations and face the risk that additional actions and claims will be filed in the future. Litigation alleging infringement of copyrights and other intellectual property rights, particularly with respect to proprietary photographs and images, has

become extensive in the educational publishing industry. At present, there are various suits pending or threatened which claim that we exceeded the print run limitation or other restrictions in licenses granted to us to reproduce photographs and images in our instructional materials. A number of similar

claims against us have already been settled. While management does not expect any of these matters to have a material adverse effect on our results of operations, financial position or cash flows, due to the inherent uncertainty of the litigation process, the resolution of any particular legal proceeding or change in applicable legal standards could have a material effect on our financial position and results of operations.

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

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

Across all our businesses, we manage complex operational and logistical arrangements including distribution centers, data centers and large office facilities. Failure to recover from a major disaster (such as fire, flood or other natural disaster) or other external threat (such as terrorist attacks, strikes, weather or political unrest or other external factors) at a key center or facility could affect our business and employees, disrupt our daily business activities and/or restrict our ability to supply products and services to our customers.

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

In the ordinary course of business, we issue performance-related surety bonds and letters of credit posted as security for our operating activities, some of which obligate us to make payments if we fail to perform under certain contracts in connection with the sale of instructional materials and assessment programs. The surety bonds are partially backstopped by letters of credit. As of December 31, 2015, our contingent liability for all letters of credit was approximately $31.9 million, of which $2.5 million were issued to backstop $9.4 million of surety bonds. The letters of credit reduce the borrowing availability on our Revolving Credit Facility, which could affect liquidity and, therefore, our ability to meet our obligations. We may increase the number and amount of contracts that require the use of letters of credit, which may further restrict liquidity and, therefore, our ability to meet our obligations in the future.

Our substantial level of indebtedness could adversely affect our financial condition and results of operations.

As of December 31, 2015, we had approximately $796.0 million ($792.4 million, net of discount) outstanding under our term loan facility and no amounts outstanding under our revolving credit facility. Our substantial outstanding indebtedness could have important consequences, including the following:

- our high level of indebtedness could make it more difficult for us to satisfy our obligations;

- the restrictions imposed on the operation of our business under the agreements governing such indebtedness may hinder our ability to take advantage of strategic opportunities to grow our business and to make attractive investments;

our ability to obtain additional financing for working capital, capital expenditures, product development, debt service requirements, restructuring, acquisitions or general corporate purposes may be impaired, which could be exacerbated by further volatility in the credit markets;

we must use a substantial portion of our cash flow from operations to pay principal and interest on our indebtedness, which will reduce the funds available to us for operations, working capital, capital expenditures and other purposes;

our high level of indebtedness could place us at a competitive disadvantage compared to our competitors that may have proportionately less debt;

our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate may be limited;

- our failure to satisfy our obligations under the agreements governing our indebtedness could result in an event of default, which could result in all of our debt becoming immediately due and payable and could permit our secured lenders to foreclose on our assets securing such indebtedness;

- our high level of indebtedness makes us more vulnerable to economic downturns and adverse developments in our business and industry; and

- we may be vulnerable to interest rate increases, as certain of our borrowings bear interest at variable rates. A 1% increase or decrease in the interest rate will change our interest expense by approximately $8.0 million on an annual basis for our term loan facility and $2.5 million on an annual basis for our revolving credit facility assuming it is fully drawn.

Any of the foregoing could have a material adverse effect on our business, financial condition, results of operations, prospects and ability to satisfy our obligations. In addition, we may incur substantial additional indebtedness in the future. The terms of the agreements governing our existing indebtedness do not, and any future debt may not, fully prohibit us from doing so. If new indebtedness is added to our current indebtedness levels, the related risks that we now face could substantially intensify.

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

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

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

We may record future goodwill or indefinite-lived intangibles impairment charges related to our reporting units, which could have a material adverse impact on our results of operations.

We test our goodwill and indefinite-lived intangibles asset balances for impairment during the fourth quarter of each year, or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. We assess goodwill for impairment at the reporting unit level and, in evaluating the potential for impairment of goodwill, we make assumptions regarding estimated net sales projections, growth rates, cash flows and discount rates. Although we use consistent methodologies in developing the assumptions and estimates underlying the fair value calculations used in our impairment tests, these estimates are uncertain by nature and can vary from actual results. Declines in the future performance and cash flows of the reporting unit or small changes in other key assumptions may result future goodwill impairment charges, which could have a material adverse impact on our results of operations.

A change from up-front payment by school districts for multi-year programs could adversely affect our cash flow.

In keeping with the past practice of payments, school districts typically pay up-front when buying multi-year programs. If school districts changed their payment practices to spread their payments to us over the term of a program, our cash flow could be adversely affected.

The shift to sales of greater digital content may affect the comparability of our revenue to prior periods and cause increases or decreases in our sales to be reflected in our results of operations on a delayed basis.

As the K-12 comprehensive curriculum market transitions from printed to digital products, an increasing percentage of our revenues are derived from time-based digital products. Our customers typically pay for purchased products up-front; however, we recognize a significant portion of our time-based digital sales over their respective terms, as required by Generally Accepted Accounting Principles in the United States. As a result, an increase in the portion of our sales coming from digital sales may impact the comparison of our revenue results for a period with the same prior-year or consecutive period.

Another effect of recognizing revenue from digital sales over their respective terms is that any increases or decreases in sales during a particular period may not translate into proportional increases or decreases in revenue during that period. Consequently, deteriorating sales activity may be less immediately observable in our results of operations.

We face risks of doing business abroad.

We conduct business in a number of regions outside of the U.S., including emerging markets in South America, Asia and the Middle East. Accordingly, we face exposure to the risks of doing business abroad, including, but not limited to, longer customer payment terms in certain countries; increased credit risk; difficulties in protecting intellectual property, enforcing agreements and collecting receivables under certain foreign legal systems; compliance under local privacy laws, rules, regulations and standards; the need to comply with U.S. Foreign Corrupt Practices Act and local laws, rules and regulations; and in some countries, a higher risk of political instability, economic volatility, terrorism, corruption, and social and ethnic unrest.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

Our principal executive office is located at 222 Berkeley Street, Boston, Massachusetts 02116. The following table describes the approximate building areas in square feet, principal uses and the years of expiration on leased premises of our significant operating properties as of December 31, 2015. We believe that these properties are suitable and adequate for our present and anticipated business needs, satisfactory for the uses to which each is put, and, in general, fully utilized.

Location	Expiration year	Approximate area	Principal use of space	Segment used by
Owned Premises:				
Indianapolis, Indiana	Owned	491,779	Warehouse	All segments
Troy, Missouri	Owned	575,000	Office and warehouse	Education
Leased Premises:				
Orlando, Florida	2019	250,842	Office	Education
Evanston, Illinois	2017	150,050	Office	Education
Itasca, Illinois	2027	105,976	Office	Education
Geneva, Illinois	2019	485,989	Office and warehouse	Education
Boston, Massachusetts (Corporate office)	2017	328,686	Office	All segments
Portsmouth, New Hampshire	2019	25,145	Office	Education
New York, New York	2016	28,704	Office	Trade Publishing
Austin, Texas	2016	195,230	Office	Education
Dublin, Ireland	2025	39,944	Office	Education
Orlando, Florida	2016	25,400	Warehouse	Corporate Records Center
Itasca, Illinois	2016	46,823	Warehouse	Education

In addition, we lease several other offices that are not material to our operations and, in some instances, are partially or fully subleased.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not applicable.

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

Market information. Our common stock has been listed on the NASDAQ Global Select Market (NASDAQ) under the symbol HMHC since November 14, 2013. The following table sets forth, for the periods indicated, the high and low closing sales prices for our common stock as reported by NASDAQ.

2014	**High**	**Low**
First Quarter	$ 20.55	$ 17.07
Second Quarter	20.82	17.66
Third Quarter	20.62	17.26
Fourth Quarter	20.91	18.88
2015		
First Quarter	$ 23.75	$ 18.68
Second Quarter	26.95	22.86
Third Quarter	26.75	20.24
Fourth Quarter	21.78	17.91

The closing price of our common stock on NASDAQ on February 4, 2016, was $17.40 per share.

Holders. As of February 4, 2016, there were approximately 19 stockholders of record of our common stock, one of which was Cede & Co., a nominee for The Depository Trust Company. All of our common stock held by brokerage firms, banks and other financial institutions as nominees for beneficial owners are considered to be held of record by Cede & Co., who is considered to be one stockholder of record. A substantially greater number of holders of our common stock are street name or beneficial holders, whose shares of common stock are held of record by banks, brokers and other financial institutions. Because such shares of common stock are held on behalf of stockholders, and not by the stockholders directly, and because a stockholder can have multiple positions with different brokerage firms, banks and other financial institutions, we are unable to determine the total number of stockholders we have.

Dividends. We have never paid or declared any cash dividends on our common stock. At present, we intend to retain our future earnings, if any, to fund operations, the growth of our business and, as appropriate, execute our share repurchase program. Our future decisions concerning the payment of dividends on our common stock will depend upon our results of operations, financial condition and capital expenditure plans, as well as other factors as our board of directors, in its discretion, may consider relevant, and the extent to which the declaration or payment of dividends may be limited by agreements we have entered or cause us to lose the benefits of certain of our agreements. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Securities authorized for issuance under equity compensation plans. The equity compensation plan information set forth in Part III, Item 12 of this Annual Report is incorporated by reference herein.

Performance Graph. The graph below matches the cumulative return of holders of the Company s common stock with the cumulative returns of the Dow Jones Publishing index, the S&P 500 index, the NASDAQ Composite index, the Russell 2000 index, and our Peer Group index, which is comprised of Pearson PLC, Scholastic Corporation, K-12 Inc., and John Wiley & Sons, Inc. The Russell 2000 index was included as the Company was added to that index

during 2014. The graph assumes that the value of the investment in the Company s common stock, in each index (including reinvestment of dividends) was $100 on November 14, 2013 and tracks it through February 4, 2016. All prices reflect closing prices on the last day of trading at the end of each period. Notwithstanding any general incorporation by reference of this Annual Report into any other document, the information contained in the graph shall not be deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Exchange Act or to the liabilities of Section 18 of

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the Exchange Act, except: (i) as expressly required by applicable law or regulation; or (ii) to the extent that the Company specifically requests that such information be treated as soliciting material or specifically incorporates it by reference into a filing under the Securities Act or the Exchange Act.

The stock price performance shown on the graph is not necessarily indicative of future price performance. Information used in the graph was obtained from a source we believe to be reliable, but we do not assume responsibility for any errors or omissions in such information.

Recent sales of unregistered securities. There have been no sales of unregistered securities by the Company in the three year period ended December 31, 2015.

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Issuer Purchases of Equity Securities

The following table contains the Company s purchases of equity securities in the fourth quarter of 2015 (in thousands, except share and per share information):

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (*)	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
October 1, 2015 to October 31, 2015 to	609,783	$ 20.66	609,783	$ 247,978
November 1, 2015 to November 30, 2015 to	6,245,640	$ 18.91	6,245,640	$ 629,731
December 1, 2015 to December 31, 2015 to	4,594,243	$ 20.16	4,594,243	$ 536,987
Total	11,449,666	$ 19.50	11,449,666	$ 536,987

* On November 3, 2014, our Board of Directors authorized the repurchase of up to $100.0 million in aggregate value of the Company s common stock. Effective April 23, 2015, our Board of Directors authorized an additional $100.0 million under our existing share repurchase program and on May 6, 2015, authorized an incremental $300.0 million and further, on November 3, 2015, authorized an additional $500.0 million under our existing share repurchase program, bringing the total authorization to $1.0 billion. The aggregate share repurchase program may be executed through December 31, 2018.

Repurchases under the program may be made from time to time in open market, including under a trading plan or privately negotiated transactions. The extent and timing of any such repurchases would generally be at our discretion and subject to market conditions, applicable legal requirements and other considerations. Any repurchased shares may be used for general corporate purposes.

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Item 6. Selected Financial Data

The following table summarizes the consolidated historical financial data of Houghton Mifflin Harcourt Company. We derived the consolidated historical financial data as of December 31, 2015 and 2014 and for the years ended December 31, 2015, 2014, and 2013, from our audited consolidated financial statements included in this Annual Report. We derived the consolidated historical financial statement data as of December 31, 2013, 2012 and 2011, and for the years ended December 31, 2012 and 2011 from our audited consolidated financial statements for such years, which are not included in this Annual Report. Historical results for any prior period are not necessarily indicative of results to be expected in any future period. The data set forth in the following table should be read together with the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes thereto.

	Years Ended December 31,				
	2015 (7)	**2014**	**2013**	**2012**	**2011**
Operating Data:					
Net sales	$ 1,416,059	$ 1,372,316	$ 1,378,612	$ 1,285,641	$ 1,295,295
Cost and expenses:					
Cost of sales, excluding publishing rights and pre-publication amortization	622,668	588,726	585,059	515,948	512,612
Publishing rights amortization (1)	81,007	105,624	139,588	177,747	230,624
Pre-publication amortization (2)	120,506	129,693	121,715	137,729	176,829
Cost of sales	824,181	824,043	846,362	831,424	920,065
Selling and administrative	681,124	612,535	580,887	533,462	638,023
Other intangible asset amortization	22,038	12,170	18,968	54,815	67,372
Impairment charge for investment in preferred stock, goodwill, intangible assets, pre-publication costs and fixed assets		1,679	9,000	8,003	1,674,164
Severance and other charges (3)	4,767	7,300	10,040	9,375	32,801
Gain on bargain purchase				(30,751)	
Operating loss	(116,051)	(85,411)	(86,645)	(120,687)	(2,037,130)
Other Income (expense)					
Interest expense	(32,045)	(18,245)	(21,344)	(123,197)	(244,582)
Loss on extinguishment of debt	(3,051)		(598)		
Change in fair value of derivative instruments	(2,362)	(1,593)	(252)	1,688	(811)

Loss before reorganization items and taxes	(153,509)	(105,249)	(108,839)	(242,196)	(2,282,523)
Reorganization items, net (4)				(149,114)	
Income tax expense (benefit)	(19,640)	6,242	2,347	(5,943)	(100,153)
Net loss	$ (133,869)	$ (111,491)	$ (111,186)	$ (87,139)	$ (2,182,370)
Net loss per share basic and diluted	$ (0.98)	$ (0.79)	$ (0.79)	$ (0.26)	$ (3.85)
Net loss per share attributable to common stockholders basic and diluted	$ (0.98)	$ (0.79)	$ (0.79)	$ (0.26)	$ (3.85)
Weighted average number of common shares used in net loss per share attributable to common stockholders basic and diluted	136,760,107	140,594,689	139,928,650	340,918,128	567,272,470
Balance Sheet Data (as of period end):					
Cash, cash equivalents and short-term investments	$ 432,403	$ 743,345	$ 425,349	$ 475,119	$ 413,610
Working capital (5)	376,217	751,009	588,643	556,227	426,692
Total assets (5)	3,137,056	2,990,648	2,880,544	2,986,726	3,249,751
Debt (short-term and long-term)	792,389	243,125	245,625	248,125	3,011,588
Stockholders equity (deficit)	1,198,321	1,759,680	1,850,276	1,943,701	(674,552)
Statement of Cash Flows Data:					
Net cash provided by (used in):					
Operating activities	348,359	491,043	157,203	104,802	132,796
Investing activities	(676,787)	(367,619)	(168,578)	(295,998)	(195,300)
Financing activities	106,104	19,529	(4,075)	106,664	96,041

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	Years Ended December 31,				
	2015 (7)	2014	2013	2012	2011
Other Data:					
Capital expenditures:					
Pre-publication capital expenditures (6)	103,709	115,509	126,718	114,522	122,592
Property, plant, and equipment capital expenditures	82,987	67,145	59,803	50,943	71,817
Pre-publication amortization	120,506	129,693	121,715	137,729	176,829
Depreciation and intangible asset amortization	176,103	190,084	220,264	290,693	356,388

(1) Publishing rights are intangible assets that allow us to publish and republish existing and future works as well as create new works based on previously published materials and are amortized on an accelerated basis over periods estimated to represent the useful life of the content.

(2) We capitalize the art, prepress, manuscript and other costs incurred in the creation of the master copy of a book or other media and amortize such costs from the year of sale typically over five years on an accelerated basis.

(3) Represents severance and real estate charges.

(4) Represents net gain associated with our Chapter 11 reorganization in 2012.

(5) We retrospectively early adopted the Financial Accounting Standards Board s updated accounting guidance related to the balance sheet classification of deferred taxes, which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities be classified as non-current on the balance sheet. We have revised prior years amounts due to the adoption.

(6) Represents capital expenditures for the art, prepress, manuscript and other costs incurred in the creation of the master copy of a book or other media.

(7) Includes the results of our acquisition of the EdTech business from May 29, 2015 through December 31, 2015.

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

The following discussion and analysis is intended to facilitate an understanding of our results of operations and financial condition and should be read in conjunction with our consolidated financial statements and the accompanying notes included elsewhere in this Annual Report. The following discussion and analysis of our financial condition and results of operations contains forward-looking statements about our business, operations and industry that involve risks and uncertainties, such as statements regarding our plans, objectives, expectations and intentions. Actual results and the timing of events may differ materially from those expressed or implied in such forward-looking statements due to a number of factors, including those set forth under Risk Factors and elsewhere in this Annual Report. See Risk Factors and Special Note Regarding Forward-Looking Statements.

Overview

We are a global learning company, specializing in education solutions across a variety of media. We deliver content, services and technology to both educational institutions and consumers, reaching over 50 million students in more than 150 countries worldwide. In the United States, we are the leading provider of K-12 educational content by market share. We believe our long-standing reputation and trusted brand enable us to capitalize on consumer and digital trends in the education market through our existing and developing channels. Furthermore, since 1832, our trade and reference materials, including adult and children s fiction and non-fiction books that have won industry awards such as the Pulitzer Prize, Newbery and Caldecott medals and National Book Award.

Corporate History

Houghton Mifflin Harcourt Company was incorporated as a Delaware corporation on March 5, 2010, and was established as the holding company of the current operating group. Houghton Mifflin Harcourt was formed in December 2007 with the acquisition of Harcourt Education Group, then the second-largest K-12 U.S. publisher, by Houghton Mifflin Group. We are headquartered in Boston, Massachusetts.

Recent Developments

EdTech Acquisition

On April 23, 2015, we entered into a stock and asset purchase agreement with Scholastic Corporation (Scholastic) to acquire certain assets (including the stock of two of Scholastic s subsidiaries) comprising its Educational Technology and Services (EdTech) business. On May 29, 2015, we completed the acquisition and paid an aggregate purchase price of $575.0 million in cash to Scholastic, subject to adjustments for working capital. $34.5 million of the purchase price was deposited into an escrow account to be held for 18 months as security for potential indemnification obligations of Scholastic. Portions of such escrow will be released periodically during the 18-month period.

The EdTech acquisition provided us with a leading position in intervention curriculum and services and extends our product offerings in key growth areas, including educational technology, early learning, and education services, creating a more comprehensive offering for students, teachers and schools. EdTech s consulting and professional development services focus on optimizing the utilization of the products, especially digital solutions, as well as helping teachers and school districts meet professional standards and implement new requirements and standards, including the Common Core State Standards.

The transaction was accounted for under the acquisition method of accounting. Accordingly, the results of operations of the purchased assets of EdTech are included in our consolidated financial statements from the date of acquisition.

We have allocated the purchase price to the EdTech assets acquired and liabilities assumed at estimated fair values as of May 29, 2015. The excess of the purchase price over the net of amounts assigned to the fair value of the assets acquired and the liabilities assumed has been recorded as goodwill, which is allocated to our Education segment. The goodwill recognized is primarily the result of expected synergies. All of the goodwill and identifiable intangibles associated with the acquisition will be deductible for tax purposes.

Stock Repurchase Program

On November 3, 2014, our Board of Directors authorized the repurchase of up to $100.0 million in aggregate value of the Company s common stock. Effective April 23, 2015, our Board of Directors authorized an additional $100.0 million under our existing share repurchase program and on May 6, 2015, authorized an incremental $300.0 million and further, on November 3, 2015, authorized an additional $500.0 million under our existing share repurchase program, bringing the total authorization to $1.0 billion. As of December 31, 2015, approximately $537.0 million of our availability remained under the share repurchase program. The aggregate share repurchase program may be executed through December 31, 2018. Repurchases under the program may be made from time to time in open market, including under a trading plan, or privately negotiated transactions. The extent and timing of any such repurchases would generally be at our discretion and subject to market conditions, applicable legal requirements and other considerations. Any repurchased shares may be used for general corporate purposes.

Key Aspects and Trends of Our Operations

Business Segments

We are organized along two business segments: Education and Trade Publishing. Our Education segment is our largest segment and represented approximately 88% of our total net sales for each of the years ended December 31, 2015, 2014 and 2013. Our Trade Publishing segment represented approximately 12% of our total net sales for each of the years ended December 31, 2015, 2014 and 2013. The Corporate and Other category represents certain general overhead costs not fully allocated to the business segments, such as legal, accounting, treasury, human resources and executive functions.

Net Sales

We derive revenue primarily from the sale of print and digital content and instructional materials, trade books, reference materials, multimedia instructional programs, license fees for book rights, content, software and services, test scoring, consulting and training. We primarily sell to customers in the United States. Our net sales are driven primarily as a function of volume and, to a certain extent, changes in price. Our net sales consist of our billings for products and services, less revenue that will be deferred until future recognition and a provision for product returns. Deferred revenues primarily derive from work-texts, workbooks, online interactive digital content, digital and online learning components. The work-texts and workbooks are deferred until delivered, which often extends over the life of the contract and the online and digital content is typically recognized ratably over the life of the contract. The digitalization of education content and delivery is driving a substantial shift in the education market. An increasing number of schools are utilizing digital content in their classrooms and implementing online or blended learning environments, which is altering the historical mix of print and digital educational materials in the classroom. As a result, our business model has shifted to more digital and online learning components to address the needs of the education marketplace; thus, resulting in an increase in our net sales being deferred.

Basal programs, which represent the most significant portion of our Education segment net sales, cover curriculum standards in a particular K-12 academic subject and include a comprehensive offering of teacher and student materials

required to conduct the class throughout the school year. Products and services in basal programs include print and digital offerings for students and a variety of supporting materials such as teacher s

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editions, formative assessments, whole group instruction materials, practice aids, educational games and professional services. The process through which materials and curricula are selected and procured for classroom use varies throughout the United States. Nineteen states, known as adoption states, approve and procure new basal programs usually every six to eight years on a state-wide basis, before individual schools or school districts are permitted to schedule the purchase of materials. In all remaining states, known as open states or open territories, each individual school or school district can procure materials at any time, though usually according to a five to ten year cycle. The student population in adoption states represents over 50% of the U.S. elementary and secondary school-age population. Many adoption states provide categorical funding for instructional materials, which means that state funds cannot be used for any other purpose. Our basal programs, primarily in adoption states, typically have higher deferred sales than other parts of the business. The higher deferred sales are primarily due to the length of time that our programs are being delivered, along with greater component and digital product offerings. A significant portion of our Education segment net sales is dependent upon our ability to maintain residual sales, which are subsequent sales after the year of the original adoption, and our ability to continue to generate new business. In addition, our market is affected by changes in state curriculum standards, which drive instruction, assessment and accountability in each state. Changes in state curriculum standards require that instructional materials be revised or replaced to align to the new standards, which historically has driven demand for basal programs.

We also derive our Education segment net sales from the sale of summative, formative or in-classroom and cognitive assessments to districts and schools in all 50 states. Summative assessments are concluding or final exams that measure students proficiency in a particular academic subject or group of subjects on an aggregate level or against state standards. Formative assessments are on-going, in-classroom tests that occur throughout the school year and monitor progress in certain subjects or curriculum units. Additionally, our offerings include supplemental products that target struggling learners through comprehensive intervention solutions aimed at raising student achievement by providing solutions that combine technology, content and other educational products, as well as consulting and professional development services. We also offer products targeted at assisting English language learners.

In international markets, we predominantly export and sell K-12 books to premium private schools that utilize the U.S. curriculum, which are located primarily in Asia, the Pacific, the Middle East, Latin America, the Caribbean and Africa. Our international sales team utilizes a global network of distributors in local markets around the world.

Our Trade Publishing segment sells works of fiction and non-fiction in the General Interest and Young Reader s categories, dictionaries and other reference works. While print remains the primary format in which trade books are produced and distributed, the market for trade titles in digital format, primarily e-books, has developed rapidly over the past several years, as the industry evolves to embrace new technologies for developing, producing, marketing and distributing trade works.

Factors affecting our net sales include:

Education

- state or district per student funding levels;
- federal funding levels;

the cyclicality of the purchasing schedule for adoption states;

student enrollments;

adoption of new education standards;

technological advancement and the introduction of new content and products that meet the needs of students, teachers and consumers, including through strategic agreements pertaining to content development and distribution; and

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the amount of net sales subject to deferrals which is impacted by the mix of product offering between digital and non-digital products, the length of programs and the mix of product delivered immediately or over time.

Trade Publishing

consumer spending levels as influenced by various factors, including the U.S. economy and consumer confidence;

the transition to e-books and any resulting impact on market growth;

the publishing of bestsellers along with obtaining recognized authors; and

movie tie-ins to our titles that spur sales of current and backlist titles, which are titles that have been on sale for more than a year.

State or district per-student funding levels, which closely correlate with state and local receipts from income, sales and property taxes, impact our sales as institutional customers are affected by funding cycles. Most public school districts, the primary customers for K-12 products and services, are largely dependent on state and local funding to purchase materials. Recently, total educational materials expenditures by institutions in the United States have been rebounding in the wake of the economic recovery. Globally, education expenditures are projected to grow at 7% through 2018, according to GSV Asset Management.

We monitor the purchasing cycles for specific disciplines in the adoption states in order to manage our product development and to plan sales campaigns. Our sales may be materially impacted during the years that major adoption states, such as Florida, California and Texas, are or are not scheduled to make significant purchases. For example, Florida implemented a language arts adoption in 2014 and is scheduled to adopt social studies materials in 2016, for purchase in 2017. Texas school districts purchased mathematics and science materials in 2014, and adopted social studies and high school math materials for purchase in 2015. California adopted math materials in 2013, with purchases spread over 2014-15, and is scheduled to adopt English language arts materials in 2015 for purchase beginning in 2016. Both Florida and Texas, along with several other adoption states, provide dedicated state funding for instructional materials and classroom technology, with funding typically appropriated by the legislature in the first half of the year in which materials are to be purchased. Texas has a two-year budget cycle and in the 2015 legislative session appropriated funds for purchases in 2015 and 2016. California funds instructional materials in part with a dedicated portion of state lottery proceeds and in part out of general formula funds, with the minimum overall level of school funding determined according to the Proposition 98 funding guarantee. Nationally, total state funding for public schools has been trending upward as state revenues recover from the lows of the 2008-2009 economic recession. While we do not currently have contracts with these states for future instructional materials adoptions and there is no guarantee that we will continue to capture the same market share in the future, we have historically captured approximately 50% of the market share in these states in the years that they adopt educational materials for various subjects.

Long-term growth in the U.S. K-12 market is positively correlated with student enrollments, which is a driver of growth in the educational publishing industry. Although economic cycles may affect short-term buying patterns, school enrollments are highly predictable and are expected to trend upward over the longer term. According to NCES, student enrollments are expected to increase from 54.7 million in 2010, to over 57.0 million by the 2022 school year.

Outside the United States, the global education market continues to demonstrate strong macroeconomic growth characteristics. Population growth is a leading indicator for pre-primary school enrollments, which have a subsequent impact on secondary and higher education enrollments. Globally, according to UNESCO, rapid population growth has caused pre-primary enrollments to grow by 44.5% worldwide over the 10-year period from 2003 to 2013. Additionally, according to the United Nations, the world population of 7.2 billion in 2013 is projected to increase by 1 billion by 2025 and reach 9.6 billion by 2050, as countries develop and improvements in medical conditions increase the birth rate.

The digitalization of education content and delivery is also driving a substantial shift in the education market. As the K-12 educational market transitions to purchasing more digital solutions, we believe our ability to offer embedded assessments, adaptive learning, real-time interaction and student specific personalization in addition to our core educational content in a platform- and device-agnostic manner will provide new opportunities for growth.

Our Trade Publishing segment is heavily influenced by the U.S. and broader global economy, consumer confidence and consumer spending. As the economy continues to recover, both consumer confidence and consumer spending have increased and are at their highest level since 2008.

While print remains the primary format in which trade books are produced and distributed, the market for trade titles in digital format, primarily e-books, has developed over the past several years, as the industry evolves to embrace new technologies for developing, producing, marketing and distributing trade works. We continue to focus on the development of innovative new digital products which capitalize on our strong content, our digital expertise and the growing consumer demand for these products.

In the Trade Publishing segment, annual results can be driven by bestselling trade titles. Furthermore, backlist titles can experience resurgence in sales when made into films. Over the past several years, a number of our backlist titles such as *The Hobbit*, *The Lord of the Rings*, *Life of Pi*, *Extremely Loud and Incredibly Close, The Giver* and *The Time Traveler s Wife* have benefited in popularity due to movie releases and have subsequently resulted in increased trade sales.

We employ several pricing models to serve various customer segments, including institutions, consumers, other government agencies (*e.g.*, penal institutions, community centers, etc.) and other third parties. In addition to traditional pricing models where a customer receives a product in return for a payment at the time of product receipt, we currently use the following pricing models:

- Pay-up-front: Customer makes a fixed payment at time of purchase and we provide a specific product/service in return;

- Pre-pay Subscription: Customer makes a one-time payment at time of purchase, but receives a stream of goods/services over a defined time horizon; for example, we currently provide customers the option to purchase a multi-year subscription to textbooks where for a one-time charge, a new copy of the work text is delivered to the customer each year for a defined time period. Pre-pay subscriptions to online textbooks are another example where the customer receives access to an online book for a specific period of time; and

- Pay-as-you-go Subscription: Similar to the Pre-pay subscription, except that the customer makes periodic payments in a pre-described manner. This pricing model is the least prevalent of the three models.

Cost of sales, excluding publishing rights and pre-publication amortization

Cost of sales, excluding publishing rights and pre-publication amortization, include expenses directly attributable to the production of our products and services, including the non-capitalizable costs associated with our content development group. The expenses within cost of sales include variable costs such as paper, printing and binding costs of our print materials, royalty expenses paid to our authors, gratis costs or products provided at no charge as part of the sales transaction, and inventory obsolescence. Also included in cost of sales are labor costs related to professional

services and the non-capitalized costs associated with our content and platform development group. We also include amortization expense associated with our software platforms. Certain products such as trade books and those products associated with our renowned authors carry higher royalty costs; conversely, digital offerings usually have a lower cost of sales due to lower costs associated with their production. Also, sales to adoption states usually contain higher cost of sales. A change in the sales mix of our products or services can impact consolidated profitability.

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Publishing rights and Pre-publication amortization

A publishing right is an acquired right which allows us to publish and republish existing and future works as well as create new works based on previously published materials. As part of our March 9, 2010 restructuring, we recorded an intangible asset for publishing rights and amortize such asset on an accelerated basis over the useful lives of the various copyrights involved. This amortization will continue to decrease annually. See Note 1 to our consolidated financial statements included elsewhere in this Annual Report.

We capitalize the art, prepress, manuscript and other costs incurred in the creation of the master copy of our content, known as the pre-publication costs. Pre-publication costs are primarily amortized from the year of sale over five years using the sum-of-the-years-digits method, which is an accelerated method for calculating an asset s amortization. Under this method, the amortization expense recorded for a pre-publication cost asset is approximately 33% (year 1), 27% (year 2), 20% (year 3), 13% (year 4) and 7% (year 5). We utilize this policy for all pre-publication costs, except with respect to our Trade Publishing segment s consumer books, which we generally expense such costs as incurred, our assessment products, which we use the straight-line amortization method and the acquired content of the EdTech business, which we amortize over 7 years using an accelerated amortization method. The amortization methods and periods chosen best reflect the pattern of expected sales generated from individual titles or programs. We periodically evaluate the remaining lives and recoverability of capitalized pre-publication costs, which are often dependent upon program acceptance by state adoption authorities.

Selling and administrative expenses

Our selling and administrative expenses include the salaries, benefits and related costs of employees engaged in sales and marketing, fulfillment and administrative functions. Also included within selling and administrative costs are variable costs such as commission expense, outbound transportation costs, sampling and depository fees, which are fees paid to state-mandated depositories that fulfill centralized ordering and warehousing functions for specific states. Additionally, significant fixed and discretionary costs include facilities, telecommunications, professional fees, promotions and advertising. We expect our selling and administrative costs in dollars to increase as we invest in new growth initiatives.

Other intangible asset amortization

Our other intangible asset amortization expense primarily includes the amortization of acquired intangible assets consisting of customer relationships, tradenames, content rights and licenses. The customer relationships, tradenames, content rights and licenses are amortized over varying periods of 6 to 25 years. The expense for the year ending December 31, 2015 was $22.0 million.

Interest expense

Our interest expense includes interest accrued on our term loan facility along with, to a lesser extent, our revolving credit facility, capital leases, the amortization of any deferred financing fees and loan discounts, and payments in connection with interest rate hedging agreements. Our interest expense for the year ended December 31, 2015 was $32.0 million.

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Results of Operations

Consolidated Operating Results for the Years Ended December 31, 2015 and 2014

(dollars in thousands)	Year Ended December 31, 2015	Year Ended December 31, 2014	Dollar change	Percent Change
Net sales	$ 1,416,059	$ 1,372,316	$ 43,743	3.2%
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization	622,668	588,726	33,942	5.8%
Publishing rights amortization	81,007	105,624	(24,617)	(23.3)%
Pre-publication amortization	120,506	129,693	(9,187)	(7.1)%
Cost of sales	824,181	824,043	138	NM
Selling and administrative	681,124	612,535	68,589	11.2%
Other intangible asset amortization	22,038	12,170	9,868	81.1%
Impairment charge for investment in preferred stock and intangible assets		1,679	(1,679)	NM
Severance and other charges	4,767	7,300	(2,533)	(34.7)%
Operating loss	(116,051)	(85,411)	(30,640)	(35.9)%
Other income (expense):				
Interest expense	(32,045)	(18,245)	(13,800)	(75.6)%
Change in fair value of derivative instruments	(2,362)	(1,593)	(769)	(48.3)%
Loss on debt extinguishment	(3,051)		(3,051)	NM
Loss before taxes	(153,509)	(105,249)	(48,260)	(45.9)%
Income tax expense (benefit)	(19,640)	6,242	(25,882)	NM
Net loss	$ (133,869)	$ (111,491)	$ (22,378)	(20.1)%

NM = not meaningful

Net sales for the year ended December 31, 2015 increased $43.7 million, or 3.2%, from $1,372.3 million for the same period in 2014, to $1,416.1 million. The net sales increase was driven by the $148.0 million contribution from the acquired EdTech business. The increase was substantially offset by lower net sales of the domestic education business, which decreased by $98.0 million, due to the comparable prior year Texas math and science adoptions, and to a lesser extent the Florida language arts adoption, all of which contributed to $90.0 million of higher net sales in 2014 compared to the same period in 2015, as the adoption market was substantially lower in 2015. Additionally, international net sales decreased $9.0 million from the prior year period due to the timing of purchases. Offsetting a portion of the lower domestic education sales for the 2015 period was a strong performance in the California math and West Virginia adoptions. There were net sales of $124.0 million during 2015 that were deferred, compared to net sales

of $230.0 million in 2014, primarily due to the previously mentioned large Texas Math and Science adoptions and Florida language arts adoption that existed in 2014. The deferred revenue will be recognized up to seven years rather than immediately as a result of the digital and subscription components within our programs along with the length of our programs. Our billings, which we define as net sales adjusted for the impact of deferred revenue, decreased $61.8 million, or 4%, from 2014 to 2015.

Operating loss for the year ended December 31, 2015 unfavorably changed $30.6 million from a loss of $85.4 million for the same period in 2014 to a loss of $116.1 million, due primarily to the following:

A $68.6 million increase in selling and administrative costs primarily due to $63.0 million of expenses attributed to the EdTech business, $21.0 million of higher professional and legal fees associated with

an equity secondary offering and acquisition and integration related matters, along with higher salary and promotion cost to support growth initiatives, all partially offset by $28.3 million of lower commissions as the 2014 commissions were higher due to over-performance.

As a percentage of net sales, our cost of sales, excluding publishing rights and pre-publication amortization, increased to 44.0% from 42.9%, resulting in an approximate $15.2 million decrease in profitability. The increase in such costs was primarily attributed to product and services mix, shorter print runs with the lack of major adoptions, and technology costs to support our digital products. Additionally there was an $18.8 million increase to our cost of sales, excluding publishing rights and pre-publication amortization, attributed to higher volume.

Partially offsetting the aforementioned, was a $23.9 million net reduction in amortization expense related to publishing rights, pre-publication costs, and other intangible assets, due primarily to our use of accelerated amortization methods, the $43.7 million increase in net sales, and a reduction in severance and other charges of $2.5 million along with a decrease of $1.7 million in an impairment charge.

Interest expense for the year ended December 31, 2015 increased $13.8 million, or 75.6%, to $32.0 million from $18.2 million for the same period in 2014, primarily as a result of the increase to our outstanding term loan facility from $243.1 million to $800.0 million, all of which was drawn at closing of the EdTech acquisition in May of 2015. Further, interest expense increased as a result of expensing deferred financing costs of $2.0 million in 2015 due to the accelerated principal payment of $63.6 million required as of December 31, 2014 by the Excess Cash Flow provision of our previous term loan facility.

Change in fair value of derivative instruments for the year ended December 31, 2015 unfavorably changed by $0.8 million from an expense of $1.6 million in 2014, to an expense of $2.4 million in 2015. The loss on change in fair value of derivative instruments was related to unfavorable foreign exchange forward and option contracts executed on the Euro that were adversely impacted by the stronger U.S. dollar against the Euro during the period compared to the same period last year.

Loss on extinguishment of debt for the year ended December 31, 2015 consisted of a $2.2 million write off of the portion of the unamortized deferred financing fees associated with the portion of our previous term loan facility accounted for as an extinguishment. Further, there was a $0.9 million write off of the portion of the unamortized deferred financing fees associated with the portion of our previous revolving credit facility which was also accounted for as an extinguishment.

Income tax expense for the year ended December 31, 2015 decreased $25.9 million from an expense of $6.2 million for the same period in 2014, to a benefit of $19.6 million in 2015. The 2015 income tax benefit was primarily related to a $34.9 million release of an accrual for uncertain tax positions due to the lapsing of the statute, partially offset by movement in the deferred tax liability associated with tax amortization on indefinite-lived intangibles, and state and foreign taxes. The income tax expense of $6.2 million for the year ended December 31, 2014 was primarily related to movement in the deferred tax liability associated with tax amortization on indefinite-lived intangibles. For both periods, the income tax expense was impacted by certain discrete tax items including the accrual of potential interest and penalties on uncertain tax positions. Including the tax effects of these discrete tax items, the effective tax rate was 12.8% and (5.9)% for the years ended December 31, 2015 and 2014, respectively.

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Consolidated Operating Results for the Years Ended December 31, 2014 and 2013

(dollars in thousands)	Year Ended December 31, 2014	Year Ended December 31, 2013	Dollar change	Percent Change
Net sales	$ 1,372,316	$ 1,378,612	$ (6,296)	(0.5)%
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization	588,726	585,059	3,667	0.6%
Publishing rights amortization	105,624	139,588	(33,964)	(24.3)%
Pre-publication amortization	129,693	121,715	7,978	6.6%
Cost of sales	824,043	846,362	(22,319)	(2.6)%
Selling and administrative	612,535	580,887	31,648	5.4%
Other intangible asset amortization	12,170	18,968	(6,798)	(35.8)%
Impairment charge for investment in preferred stock, intangible assets, pre-publication costs and fixed assets	1,679	9,000	(7,321)	(81.3)%
Severance and other charges	7,300	10,040	(2,740)	(27.3)%
Operating loss	(85,411)	(86,645)	(1,234)	(1.4)%
Other income (expense):				
Interest expense	(18,245)	(21,344)	3,099	14.5%
Change in fair value of derivative instruments	(1,593)	(252)	(1,341)	NM
Loss on debt extinguishment		(598)	598	NM
Loss before taxes	(105,249)	(108,839)	(3,590)	(3.3)%
Income tax expense	6,242	2,347	3,895	NM
Net loss	$ (111,491)	$ (111,186)	$ 305	NM

NM = not meaningful

Net sales for the year ended December 31, 2014 decreased $6.3 million, or 0.5%, from $1,378.6 million for the same period in 2013, to $1,372.3 million. The decrease was largely driven by $18.0 million lower net sales of professional development and professional services, primarily due to the prior year period benefitting $8.0 million from the completion of a contract that led to the recognition of net sales previously deferred, coupled with lower learning management system sales and services as we have exited that business. Further, there was a $9.0 million decrease in net sales of traditional print supplemental products due to an aging product base and a $3.0 million decline in international sales due to a decline in licensing revenue. Additionally, there was a decrease of $8.0 million in Trade Publishing net sales, as 2013 benefitted from strong net sales of backlist titles associated with the theatrical releases of *The Hobbit* and *Life of Pi*, which did not occur in 2014. Partially offsetting the decreases were higher net sales of $13.0 million from our Heinemann products, primarily related to the Leveled Literacy Intervention product line along

with $13.0 million of higher assessment net sales driven by the release of a new version of the Woodcock Johnson program and higher sales directly to consumers. Additionally, there were net sales of $230.0 million during 2014 that were deferred, compared to net sales of $2.0 million in 2013, and will be recognized up to seven years rather than immediately due to the increase in digital and subscription components within our programs along with the length of our programs. Our billings increased $221.8 million, or 16%, from 2013 to 2014 primarily due to large Texas Math and Science adoptions and, to a lesser extent, adoptions in California and Florida.

Operating loss for the year ended December 31, 2014 decreased $1.2 million, or 1.4%, from a loss of $86.6 million for the same period in 2013, to a loss of $85.4 million, due primarily to the following:

A $32.8 million net reduction in amortization expense related to publishing rights, pre-publication and other intangible assets compared to the prior year due to our use of accelerated amortization methods,

Further, there was a $7.3 million reduction in impairment costs compared to the prior year. In 2013, there were $7.4 million of software development costs impaired, $1.1 million of pre-publication costs impaired and $0.5 million of tradenames impaired. In 2014, we recorded a $1.3 million impairment charge related to an investment in preferred stock and a $0.4 million impairment charge related to tradenames,

Partially offsetting the aforementioned, our cost of sales, excluding publishing rights and pre-publication amortization, increased $3.7 million compared to the prior year. As a percent of net sales, our cost of sales, excluding publishing rights and pre-publication amortization increased to 42.9% from 42.4%, resulting in an approximate $6.3 million decrease in profitability partially offset by a $2.6 million decrease attributed to lower volume. The increase in our costs was primarily attributed to a 1.3% increase in royalties as a percent of net sales, attributed to the increased billings, which had a negative impact on profitability of an approximate $17.7 million, along with higher depreciation expense of $9.7 million, attributed to increased platform spend over the past several years. The increases were partially offset by a reduction in our product cost of $14.5 million and $6.6 million of lower inventory obsolescence expense,

Also, there was an increase in selling and administrative costs of $31.6 million compared to the prior year, primarily due to increased variable costs of $34.9 million of commissions associated with the approximately $221.8 million increase in our billings, higher technology costs of $12.3 million, an increase of $3.0 million of outside labor to support the increased billings, and a $1.9 million increase in stock-based compensation due to additional equity award issuances, partially offset by a $19.1 million decline in fees associated with the registration of securities.

Interest expense for the year ended December 31, 2014 decreased $3.1 million, or 14.5%, to $18.2 million from $21.3 million for the same period in 2013 primarily as a result of an amendment to our previous term loan facility, which reduced the interest rate applicable to borrowings thereunder by 1.0%.

Change in fair value of derivative instruments for the year ended December 31, 2014 unfavorably changed by $1.3 million from an expense of $0.3 million in 2013 to an expense of $1.6 million in 2014. The loss on change in fair value of derivative instruments was related to unfavorable foreign exchange forward and option contracts executed on the Euro that were adversely impacted by the stronger U.S. dollar.

Income tax expense for the year ended December 31, 2014 increased $3.9 million from an expense of $2.3 million for the year ended December 31, 2013, to an expense of $6.2 million. For both periods, the income tax expense was impacted by certain discrete tax items including the accrual of potential interest and penalties on uncertain tax positions. Including the tax effects of these discrete tax items, the effective rate was 5.9% and 2.2% for the year ended December 31, 2014 and 2013, respectively.

For the year ended December 31, 2014, we recorded no tax benefit on the year-to-date loss, except for the country of Ireland where we released the valuation allowance by approximately $3.0 million. The income tax expense of $6.2 million was primarily related to movement in the deferred tax liability associated with tax amortization on indefinite lived intangibles, and accrual of interest and penalties on uncertain tax positions.

Adjusted EBITDA and Adjusted Cash EBITDA

To supplement our financial statements presented in accordance with GAAP, we have presented Adjusted EBITDA and Adjusted Cash EBITDA, defined as Adjusted EBITDA plus the change in deferred revenue. These

measures are not prepared in accordance with GAAP. This information should be considered as supplemental in nature and should not be considered in isolation or as a substitute for the related financial information prepared in accordance with GAAP. Management believes that the presentation of Adjusted EBITDA and Adjusted Cash EBITDA provides useful information to investors regarding our results of operations because it assists both investors and management in analyzing and benchmarking the performance and value of our business. Adjusted EBITDA and Adjusted Cash EBITDA provides an indicator of general economic performance that is not affected by debt restructurings, fluctuations in interest rates or effective tax rates, non-cash charges, or levels of depreciation or amortization along with costs such as severance, facility closure costs, and acquisition costs. Accordingly, our management believes that this measurement is useful for comparing general operating performance from period to period. In addition, targets and positive trends in Adjusted EBITDA and Adjusted Cash EBITDA are used as performance measures and to determine certain compensation of management and in calculations relating to covenants in our debt agreements. Other companies may define Adjusted EBITDA and Adjusted Cash EBITDA differently and, as a result, our measure of Adjusted EBITDA and Adjusted Cash EBITDA may not be directly comparable to Adjusted EBITDA and Adjusted Cash EBITDA of other companies. Although we use Adjusted EBITDA and Adjusted Cash EBITDA as a financial measure to assess the performance of our business, the use of Adjusted EBITDA and Adjusted Cash EBITDA is limited because it does not include certain material costs, such as interest and taxes, necessary to operate our business. Adjusted EBITDA and Adjusted Cash EBITDA should be considered in addition to, and not as a substitute for, net earnings in accordance with GAAP as a measure of performance. Adjusted EBITDA and Adjusted Cash EBITDA are not intended to be a measure of liquidity or free cash flow for discretionary use. You are cautioned not to place undue reliance on Adjusted EBITDA and Adjusted Cash EBITDA.

Below is a reconciliation of our net loss to Adjusted EBITDA and Adjusted Cash EBITDA for the years ended December 31, 2015, 2014 and 2013:

	Years Ended December 31,		
	2015	**2014**	**2013**
Net loss	$ (133,869)	$ (111,491)	$ (111,186)
Interest expense	32,045	18,245	21,344
Provision (benefit) for income taxes	(19,640)	6,242	2,347
Depreciation expense	72,639	72,290	61,705
Amortization expense	223,551	247,487	280,271
Non-cash charges stock compensation	12,452	11,376	9,524
Non-cash charges gain (loss) on derivative instruments	2,362	1,593	252
Asset impairment charges		1,679	9,000
Purchase accounting adjustments (1)	7,487	3,661	11,460
Fees, expenses or charges for equity offerings, debt or acquisitions	25,562	4,424	23,540
Restructuring	4,572	2,577	3,123
Severance separation costs and facility closures (2)	4,767	7,300	13,040
Debt extinguishment loss	3,051		598
Adjusted EBITDA	$ 234,979	$ 265,383	$ 325,018
Change in deferred revenue	124,455	229,956	1,842
Adjusted Cash EBITDA	$ 359,434	$ 495,339	$ 326,860

(1) Represents certain non-cash accounting adjustments, most significantly relating to deferred revenue and inventory costs.
(2) Represents costs associated with restructuring. Included in such costs are severance, facility integration (including inventory excess) and vacancy of excess facilities.

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Segment Operating Results

Results of Operations Comparing Years Ended December 31, 2015, 2014 and 2013

Education

	Years Ended December 31,			2015 vs. 2014		2014 vs. 2013	
	2015	2014	2013	Dollar change	Percent change	Dollar change	Percent change
Net sales	$ 1,251,122	$ 1,209,142	$ 1,207,908	$ 41,980	3.5%	$ 1,234	0.1%
Costs and expenses:							
Cost of sales, excluding publishing rights and pre-publication amortization	511,706	482,765	476,488	28,941	6.0%	6,277	1.3%
Publishing rights amortization	71,109	94,225	126,781	(23,116)	(24.5)%	(32,556)	(25.7)%
Pre-publication amortization	119,894	128,793	120,562	(8,899)	(6.9)%	8,231	6.8%
Cost of sales	702,709	705,783	723,831	(3,074)	(0.4)%	(18,048)	(2.5)%
Selling and administrative	534,477	495,421	452,561	39,056	7.9%	42,860	9.5%
Other intangible asset amortization	18,840	9,865	17,079	8,975	91.0%	(7,214)	(42.2)%
Impairment charge for investment in preferred stock, intangible assets, pre-publication costs and fixed assets		1,279	8,500	(1,279)	NM	(7,221)	(85.0)%
Operating income (loss)	$ (4,904)	$ (3,206)	$ 5,937	$ (1,698)	(53.0)%	$ (9,143)	(154.0)%
Net income (loss)	$ (4,904)	$ (3,206)	$ 5,937	$ (1,698)	(53.0)%	$ (9,143)	(154.0)%
Adjustments from net income (loss) to Education segment Adjusted EBITDA and Adjusted Cash EBITDA							
Depreciation expense	$ 56,960	$ 63,865	$ 53,875	$ (6,905)	(10.8)%	$ 9,990	18.5%
	209,843	232,884	264,422	(23,041)	(9.9)%	(31,538)	(11.9)%

Amortization expense							
Non-cash charges asset impairment charges		1,279	8,500	(1,279)	NM	(7,221)	(85.0)%
Purchase accounting adjustments	7,487	3,661	10,449	3,826	NM	(6,788)	(65.0)%
Education segment Adjusted EBITDA	$ 269,386	$ 298,483	$ 343,183	$ (29,097)	(9.7)%	$ (44,700)	(13.0)%
Change in deferred revenue	124,455	229,956	1,842	(105,501)	(45.9)%	228,114	NM
Education segment Adjusted Cash EBITDA	$ 393,841	$ 528,439	$ 345,025	$ (134,598)	(25.5)%	$ 183,414	53.2%
Education segment Adjusted Cash EBITDA as a % of net sales	31.5%	43.7%	28.6%				

NM = not meaningful

Our Education segment net sales for the year ended December 31, 2015 increased $42.0 million, or 3.5%, from $1,209.1 million for the same period in 2014, to $1,251.1 million. The net sales increase was driven by the $148.0 million contribution from the acquired EdTech business. The increase was substantially offset by lower net sales of the domestic education business, which decreased by $98.0 million, due to the comparable prior year Texas math and science adoptions, and to a lesser extent the Florida language arts adoption, all of which contributed to $90.0 million of higher net sales in 2014 as compared to the same period in 2015, as the adoption market was substantially lower in 2015. Additionally, international net sales decreased $9.0 million from the prior year due to the timing of purchases. Offsetting a portion of the lower domestic education sales in 2015 was a strong performance in the California math and West Virginia adoptions. There were net sales of $124.0 million during 2015 that were deferred, compared to net sales of $230.0 million in 2014, primarily due to the previously mentioned large Texas math and science adoptions and Florida language arts adoption that existed in 2014. The deferred revenue will be recognized up to seven years rather than immediately as a result of the digital and subscription components within our programs along with the length of our programs.

Our Education segment net sales for the year ended December 31, 2014 increased $1.2 million, or 0.1%, from $1,207.9 million for the same period in 2013, to $1,209.1 million. The increase was largely driven by higher net sales of $13.0 million from the Heinemann business, primarily related to the Leveled Literacy Intervention product line along with $13.0 million of higher assessment net sales driven by the release of a new version of the Woodcock Johnson program and higher sales directly to consumers. Additionally, there were net sales of $230.0 million during 2014 that were deferred, compared to net sales of $2.0 million in the prior year primarily due to large Texas math and science adoptions and, to a lesser extent, adoptions in California and Florida. The deferred revenue is being recognized over seven years rather than immediately due to the increase in digital and subscription components within our programs along with the length of our programs. Partially offsetting the increase were lower net sales of professional development and professional services, primarily due to the prior year period benefitting $8.0 million from the completion of a contract that led to the recognition of revenue previously deferred, coupled with lower learning management system sales and services as we have exited those offerings. Further, there was a $9.0 million decrease in net sales of traditional print supplemental products due to an aging product base and a $3.0 million decline in international sales due to a decline in licensing revenue.

Our Education segment cost of sales for the year ended December 31, 2015, decreased $3.1 million, or 0.4%, from $705.8 million for the same period in 2014, to $702.7 million. The decrease was attributed to a $32.0 million reduction in net amortization expense related to publishing rights and pre-publication costs primarily due to our use of accelerated amortization methods. Partially offsetting the aforementioned reductions was an increase in our cost of sales, excluding publishing rights and pre-publication amortization of $28.9 million, of which $16.7 million is attributed to additional volume. Our cost of sales excluding publishing rights and pre-publication amortization, as a percent of net sales increased to 40.9% from 39.9%, resulting in an approximate $12.2 million decrease in profitability primarily attributed to product and services mix, shorter print runs with the lack of major adoptions, and technology costs to support our digital products.

Our Education segment cost of sales for the year ended December 31, 2014, decreased $18.0 million, or 2.5%, from $723.8 million for the same period in 2013, to $705.8 million. The decrease was attributed to a $24.3 million reduction in net amortization expense related to publishing rights and pre-publication amortization due to our use of accelerated amortization methods. Partially offsetting the aforementioned decrease was an increase in cost of sales, excluding publishing rights and pre-publication amortization, of $6.3 million as our cost of sales, excluding publishing rights and pre-publication amortization, as a percent of net sales, increased to 39.9% from 39.4%, resulting in higher product cost of approximately $5.8 million with $0.6 million of the increase due to higher volume. The increase in product cost was primarily due to higher royalty costs, which as a percent of net sales, increased to 7.2% from 5.8%, resulting in an approximate $16.9 million of decreased profitability offset by lower production costs of $7.6 million

attributed to longer print runs along with $3.5 million of lower inventory obsolescence.

Our Education segment selling and administrative expense for the year ended December 31, 2015, increased $39.1 million, or 7.9%, from $495.4 million for the same period in 2014, to $534.5 million. The increase was primarily due to $63.0 million of expenses attributed to the EdTech business and $11.9 million of higher operating expenses, largely salary and marketing, associated with growth initiatives, partially offset by $28.3 million of lower commissions and $7.7 million of variable expenses such as transportation, depository fees and samples as a result of the lower billings in 2015.

Our Education segment selling and administrative expense for the year ended December 31, 2014 increased $42.9 million, or 9.5%, from $452.6 million for the same period in 2013, to $495.4 million. The increase was primarily due to increased variable costs of $35.5 million of commissions, associated with the approximately $221.8 million increase in our billings. Additionally, both labor-related and marketing and promotion costs increased modestly.

Our Education segment Adjusted EBITDA for the year ended December 31, 2015, decreased $29.1 million, or 9.7%, from $298.5 million for the same period in 2014, to $269.4 million. Our Education segment Adjusted EBITDA excludes depreciation, amortization and purchase accounting adjustments. The purchase accounting adjustments primarily relate to the acquisition of the EdTech business and the 2010 restructuring. Education segment Adjusted EBITDA as a percentage of net sales decreased from 24.7% of net sales for the year ended December 31, 2014 to 21.5% for the same period in 2015 due to the identified factors impacting net sales, cost of sales and selling and administrative expense after removing those items not included in Education segment Adjusted EBITDA. Adjusted Cash EBITDA for the year ended December 31, 2015 decreased $134.6 million, or 25.5%, from $528.5 for the same period in 2014, to $393.8 million due to the unfavorable change in deferred revenue of $105.5 million due to lower billings in the current year.

Our Education segment Adjusted EBITDA for the year ended December 31, 2014 decreased $44.7 million, or 13.0%, from income of $343.2 million for the same period in 2013, to income of $298.5 million. Our Education segment Adjusted EBITDA excludes depreciation, amortization, impairment charges and purchase accounting adjustments. The purchase accounting adjustments for both 2014 and 2013 related to adjustments to deferred revenue for the 2010 restructuring where we adjusted our balance sheet to fair value. The purchase accounting adjustments will gradually decrease each year. Our Education segment Adjusted EBITDA as a percentage of net sales were 24.7% and 28.4% for the years ended December 31, 2014 and 2013, respectively, due to the identified factors impacting net sales, cost of sales and selling and administrative expense after removing those items not included in Education segment Adjusted EBITDA. Adjusted Cash EBITDA for the year ended December 31, 2014 increased $183.4 million, or 53.2%, from $345.0 for the same period in 2013, to $528.5 million due to the favorable change in deferred revenue of $228.1 million due to higher billings in 2014.

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Trade Publishing

	Years Ended December 31,			2015 vs. 2014		2014 vs. 2013	
	2015	2014	2013	Dollar change	Percent change	Dollar change	Percent change
Net sales	$ 164,937	$ 163,174	$ 170,704	$ 1,763	1.1%	$ (7,530)	(4.4)%
Costs and expenses:							
Cost of sales, excluding publishing rights and pre-publication amortization	110,962	105,961	105,571	5,001	4.7%	390	0.4%
Publishing rights amortization	9,898	11,399	12,807	(1,501)	(13.2)%	(1,408)	(11.0)%
Pre-publication amortization	612	900	1,153	(288)	(32.0)%	(253)	(21.9)%
Cost of sales	121,472	118,260	119,531	3,212	2.7%	(1,271)	(1.1)%
Selling and administrative	47,363	45,128	42,227	2,235	5.0%	2,901	6.9%
Other intangible asset amortization	3,198	2,305	1,889	893	38.7%	416	22.0%
Impairment charge for intangible assets		400	500	(400)	NM	(100)	(20.0)%
Operating income (loss)	$ (7,096)	$ (2,919)	$ 6,557	$ (4,177)	NM	$ (9,476)	NM
Net income (loss)	$ (7,096)	$ (2,919)	$ 6,557	$ (4,177)	NM	$ (9,476)	NM
Adjustments from net income (loss) to Trade Publishing segment Adjusted EBITDA and Adjusted Cash EBITDA							
Depreciation expense	$ 1,091	$ 591	$ 531	$ 500	84.6%	$ 60	11.3%
Amortization expense	13,708	14,603	15,849	(895)	(6.1)%	(1,246)	(7.9)%
Non-cash charges asset impairment charges		400	500	(400)	NM	(100)	(20.0)%
Purchase accounting adjustments			1,011		NM	(1,011)	NM
Trade Publishing segment Adjusted EBITDA	$ 7,703	$ 12,675	$ 24,448	$ (4,972)	(39.2)%	$ (11,773)	(48.2)%
Change in deferred revenue					NM		NM
Trade Publishing segment Adjusted Cash EBITDA	$ 7,703	$ 12,675	$ 24,448	$ (4,972)	(39.2)%	$ (11,773)	(48.2)%
	4.7%	7.8%	14.3%				

Trade Publishing segment
Adjusted Cash EBITDA as a
% of net sales

NM = not meaningful

Our Trade Publishing segment net sales for the year ended December 31, 2015 increased $1.8 million, or 1.1%, from $163.2 million for the same period in 2014, to $164.9 million. The increase in net sales was driven by increased net sales of frontlist culinary titles such as *The Whole 30*, *Jacques Pépin Heart & Soul in the Kitchen* and general interest titles lead by *Thing Explainer* partially offset by prior year strong net sales of titles such as *The Giver* and the bestselling *What If*.

Our Trade Publishing segment net sales for the year ended December 31, 2014 decreased $7.5 million, or 4.4%, from $170.7 million for the same period in 2013, to $163.2 million. The decrease was largely driven by the

prior year period benefitting from strong net sales of backlist titles associated with the theatrical releases of *The Hobbit* and *Life of Pi*, which did not occur in 2014. Additionally, sales of general interests front list titles were down from the prior year as the prior year benefited from successful front list titles such as Francona. While 2014 did have strong front list titles, *The Giver* movie tie-in title and New York Times number one best seller *What If,* these titles could not offset the strength of the prior year titles.

Our Trade Publishing segment cost of sales for the year ended December 31, 2015 increased $3.2 million, or 2.7%, from $118.3 million for the same period in 2014, to $121.5 million. Our cost of sales excluding publishing rights and pre-publication amortization as a percent of sales increased to 67.3% from 64.9% adversely impacting cost of sales by $3.9 million primarily due to increased royalty costs due to product mix. Additionally, $1.1 million of the increase in cost of sales excluding publishing rights and pre-publication amortization, was due to increased sales. Partially offsetting the increase in cost of sales was lower amortization expense of $1.5 million related to publishing rights, which was lower due to our use of accelerated amortization methods.

Our Trade Publishing segment cost of sales for the year ended December 31, 2014 decreased $1.3 million, or 1.1%, from $119.5 million for the same period in 2013, to $118.3 million. The decrease is primarily related to decreased net sales and lower amortization expense of $1.4 million related to publishing rights, which was lower due to our use of accelerated amortization methods. Our cost of sales, excluding publishing rights and pre-publication amortization, as a percent of net sales, increased to 64.9% from 61.8%, resulting in an approximate $5.0 million of loss in profitability. The decrease in product profitability was the result of product mix and higher royalties. The decrease was offset by a $4.7 million lower cost of sales, excluding publishing rights and pre-publication amortization, due to less volume.

Our Trade Publishing segment selling and administrative expense for the year ended December 31, 2015 increased $2.2 million, or 5.0%, from $45.1 million for the same period in 2014, to $47.4 million. The increase was primarily related to higher salary costs and promotion expense.

Our Trade Publishing segment selling and administrative expense for the year ended December 31, 2014 increased $2.9 million, or 6.9%, from $42.2 million for the same period in 2013, to $45.1 million. The increase was primarily related to higher promotional expenses and development costs of $1.4 million.

Our Trade Publishing segment Adjusted EBITDA and Adjusted Cash EBITDA for the year ended December 31, 2015 decreased $5.0 million, from $12.7 million for the same period in 2014, to $7.7 million in 2015. Our Trade Publishing segment Adjusted EBITDA excludes depreciation and amortization costs. Our Trade Publishing segment Adjusted EBITDA as a percentage of net sales was 4.7% for the year ended December 31, 2015, which decreased from 7.8% for the same period in 2014 due to the identified factors impacting net sales, cost of sales and selling and administrative expenses after removing those items not included in segment Adjusted EBITDA.

Our Trade Publishing segment Adjusted EBITDA and Adjusted Cash EBITDA for the year ended December 31, 2014 decreased $11.8 million, or 48.2%, from $24.4 million for the same period in 2013, to $12.7 million. Our Trade Publishing segment Adjusted EBITDA excludes depreciation, amortization, impairment charges and purchase accounting adjustments. Our Trade Publishing segment Adjusted EBITDA as a percentage of net sales was 7.8% for the year ended December 31, 2014, which was down from 14.3% for the same period in 2013, due to the identified factors impacting net sales, cost of sales and selling and administrative expenses after removing those items not included in segment adjusted EBITDA.

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Corporate and Other

	Years Ended December 31,			2015 vs. 2014		2014 vs. 2013	
	2015	2014	2013	Dollar change	Percent change	Dollar change	Percent change
Net sales	$	$	$	$	NM	$	NM
Costs and expenses:							
Cost of sales, excluding publishing rights and pre-publication amortization			3,000		NM	(3,000)	NM
Publishing rights amortization					NM		NM
Pre-publication amortization					NM		NM
Cost of sales			3,000		NM	(3,000)	NM
Selling and administrative	99,284	71,986	86,099	27,298	37.9%	(14,113)	(16.4)%
Severance and other charges	4,767	7,300	10,040	(2,533)	(34.7)%	(2,740)	(27.3)%
Operating loss	$ (104,051)	$ (79,286)	$ (99,139)	$ (24,765)	(31.2)%	$ 19,853	20.0%
Interest expense	(32,045)	(18,245)	(21,344)	(13,800)	(75.6)%	3,099	14.5%
Change in fair value of derivative instruments	(2,362)	(1,593)	(252)	(769)	(48.3)%	1,341	NM
Loss on debt extinguishment	(3,051)		(598)	(3,051)	NM	598	NM
Loss before taxes	(141,509)	(99,124)	(121,333)	(42,385)	(42.8)%	22,209	18.3%
Income tax expense (benefit)	(19,640)	6,242	2,347	(25,882)	NM	3,895	NM
Net loss	$ (121,869)	$ (105,366)	$ (123,680)	$ (16,503)	(15.7)%	$ 18,314	14.8%
Adjustments from net loss to Corporate and Other Adjusted EBITDA and Adjusted Cash EBITDA							
Interest expense	$ 32,045	$ 18,245	$ 21,344	$ 13,800	75.6%	$ (3,099)	(14.5)%
Provision for income taxes	(19,640)	6,242	2,347	(25,882)	NM	3,895	NM
Depreciation expense	14,588	7,834	7,299	6,754	86.2%	535	7.3%
Non-cash charges (gain) loss on derivative instruments	2,362	1,593	252	769	48.3%	1,341	NM
Non-cash charges stock compensation	12,452	11,376	9,524	1,076	9.5%	1,852	19.4%
Fees, expenses or charges for equity offerings, debt or acquisitions	25,562	4,424	23,540	21,138	NM	(19,116)	(81.2)%

Restructuring	4,572	2,577	3,123	1,995	77.4%	(546)	(17.5)%
Severance separation costs and facility closures	4,767	7,300	13,040	(2,533)	(34.7)%	(5,740)	(44.0)%
Debt extinguishment loss	3,051		598	3,051	NM	(598)	NM
Corporate and Other Adjusted EBITDA	$ (42,110)	$ (45,775)	$ (42,613)	$ 3,665	8.0%	$ (3,162)	(7.4)%
Change in deferred revenue					NM		NM
Corporate and Other Adjusted Cash EBITDA	$ (42,110)	$ (45,775)	$ (42,613)	$ 3,665	8.0%	$ (3,162)	(7.4)%

NM= not meaningful

The Corporate and Other category represents certain general overhead costs not fully allocated to the business segments such as legal, accounting, treasury, human resources, technology and executive functions.

Our cost of sales for the Corporate and Other category for the year ended December 31, 2015 was the same as the period in 2014, as no costs of sales from a segment perspective were considered Other.

Our cost of sales for the Corporate and Other category for the year ended December 31, 2014 decreased $3.0 million. The decrease was attributed to a non-recurring $3.0 million inventory reserve associated with the closure of a warehouse in 2013, which from a segment perspective is considered Other.

Our selling and administrative expense for the Corporate and Other category for the year ended December 31, 2015 increased $27.3 million, or 37.9%, from $72.0 million for the same period in 2014, to $99.3 million. Approximately $21.9 million of this increase was attributed to the combination of higher professional and legal costs associated with an equity secondary offering along with acquisition related and integration related activity. Further, depreciation expense increased $6.8 million from the prior year due to increased technology investment in a variety of initiatives and platforms.

Our selling and administrative expense for the Corporate and Other category for year ended December 31, 2014 decreased $14.1 million, or 16.4%, from $86.1 million for the same period in 2013, to $72.0 million. The decrease was attributed to a $19.1 million decline in costs related to our initial public offering, along with acquisition related activity along with lower severance, facility closure, and restructuring cost of $6.3 million partially offset by higher legal, consulting and professional fees of $6.7 million and a $1.9 million increase in equity compensation charges due to additional equity award issuances.

Our interest expense for the Corporate and Other category for the year ended December 31, 2015 increased $13.8 million, or 75.6%, to $32.0 million from $18.2 million for the same period in 2014, primarily as a result of the increase to our outstanding term loan credit facility from $243.1 million to $800.0 million, all of which was drawn at closing of the EdTech acquisition in May 2015. Further, interest expense also increased as a result of expensing of $2.0 million deferred financing costs due to the accelerated principal payment of $63.6 million required by the Excess Cash Flow provision of our term loan facility.

Our interest expense for the Corporate and Other category for the year ended December 31, 2014 decreased $3.1 million, or 14.5%, to $18.2 million from $21.3 million for the same period in 2013 primarily as a result of Amendment No. 4 to our term loan facility, which reduced the interest rate applicable to borrowings thereunder by 1.0%.

Our change in fair value of derivative instruments for the Corporate and Other category for the year ended December 31, 2015 unfavorably changed by $0.8 million from an expense of $1.6 million in 2014 to an expense of $2.4 million in 2015. The loss on change in fair value of derivative instruments was related to unfavorable foreign exchange forward and option contracts executed on the Euro that were adversely impacted by the stronger U.S. dollar against the Euro during the period compared to the same period last year.

Our change in fair value of derivative instruments for the Corporate and Other category for the year ended December 31, 2014 unfavorably changed by $1.3 million from an expense of $0.3 million in 2013 to an expense of $1.6 million in 2014. The loss on change in fair value of derivative instruments was related to unfavorable foreign exchange forward and option contracts executed on the Euro that were adversely impacted by the stronger U.S. dollar.

Our loss on extinguishment of debt for the Corporate and Other category for the year ended December 31, 2015 consisted of a $2.2 million write off of the portion of the unamortized deferred financing fees associated with the portion of our previous term loan credit facility accounted for as an extinguishment. Further, there was a $0.9 million write off of the portion of the unamortized deferred financing fees associated with the portion of our previous revolving credit facility which was also accounted for as an extinguishment.

Our loss on extinguishment of debt for the Corporate and Other category for the year ended December 31, 2013 was due to an amendment to our previous term loan which reduced the interest rate and included a change in syndication. We recorded a loss on debt extinguishment of approximately $0.6 million relating to the write off of capitalized deferred financing fees in accordance with the accounting guidance for debt modifications and extinguishments.

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Income tax expense for the year ended December 31, 2015 decreased $25.9 million from an expense of $6.2 million for the same period in 2014, to a benefit of $19.6 million in 2015. The 2015 income tax benefit was primarily related to a $34.9 million release of an accrual for uncertain tax positions due to the lapsing of the statute, partially offset by movement in the deferred tax liability associated with tax amortization on indefinite-lived intangibles, and state and foreign taxes. The income tax expense of $6.2 million for the year ended December 31, 2014 was primarily related to movement in the deferred tax liability associated with tax amortization on indefinite-lived intangibles. For both periods, the income tax expense was impacted by certain discrete tax items including the accrual of potential interest and penalties on uncertain tax positions. Including the tax effects of these discrete tax items, the effective tax rate was 12.8% and (5.9)% for the years ended December 31, 2015 and 2014, respectively.

Our Income tax expense for the Corporate and Other category for the year ended December 31, 2014 increased $3.9 million from an expense of $2.3 million for the year ended December 31, 2013 to an expense of $6.2 million. For both periods, the income tax expense was impacted by certain discrete tax items including the accrual of potential interest and penalties on uncertain tax positions. Including the tax effects of these discrete tax items, the effective rate was 5.9% and 2.2% for the year ended December 31, 2014 and 2013, respectively. For the year ended December 31, 2014, we recorded no tax benefit on the year-to-date loss, except for the country of Ireland where we released the valuation allowance by approximately $3.0 million. The income tax expense of $6.2 million was primarily related to movement in the deferred tax liability associated with tax amortization on indefinite lived intangibles, and accrual of interest and penalties on uncertain tax positions.

Adjusted EBITDA and Adjusted Cash EBITDA for the Corporate and Other category for the year ended December 31, 2015, improved $3.7 million, or 8.0%, from a loss of $45.8 million for the same period in 2014, to a loss of $42.1 million. Our Adjusted EBITDA for the Corporate and Other category excludes depreciation, equity compensation charges, acquisition-related activity, restructuring costs, severance and facility vacant space costs. The decrease in our Adjusted EBITDA for the Corporate and Other category was due to the factors described above after removing those items not included in Adjusted EBITDA for the Corporate and Other category.

Adjusted EBITDA and Adjusted Cash EBITDA for the Corporate and Other category for the year ended December 31, 2014, decreased $3.2 million, or 7.4%, from a loss of $42.6 million for the same period in 2013, to a loss of $45.8 million. Our Adjusted EBITDA for the Corporate and Other category excludes depreciation, equity compensation charges, initial public offering costs, acquisition related activity, restructuring costs, severance and facility costs. The decrease in our Adjusted EBITDA for the Corporate and Other category was due to the factors described above after removing those items not included in Adjusted EBITDA for the Corporate and Other category.

Seasonality and Comparability

Our net sales, operating profit or loss and net cash provided by or used in operations are impacted by the inherent seasonality of the academic calendar. Consequently, the performance of our businesses may not be comparable quarter to consecutive quarter and should be considered on the basis of results for the whole year or by comparing results in a quarter with results in the same quarter for the previous year.

Approximately 88% of our net sales for the year ended December 31, 2015 were derived from our Education segment, which is a markedly seasonal business. Schools conduct the majority of their purchases in the second and third quarters of the calendar year in preparation for the beginning of the school year. Thus, over the past three completed fiscal years, approximately 68% of our consolidated net sales were realized in the second and third quarters. Sales of K-12 instructional materials and customized testing products are also cyclical, with some years offering more sales opportunities than others. The amount of funding available at the state level for educational materials also has a significant effect on year-to-year net sales. Although the loss of a single customer would not have a material adverse

effect on our business, schedules of school adoptions and market acceptance of our products can materially affect year-to-year net sales performance.

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The following table is indicative of the seasonality of our business and the related results:

Quarterly Results of Operations

(in thousands)	First Quarter 2014	Second Quarter 2014	Third Quarter 2014	Fourth Quarter 2014	First Quarter 2015	Second Quarter 2015	Third Quarter 2015	Fourth Quarter 2015
Education segment	$ 121,874	$ 364,618	$ 504,724	$ 217,926	$ 128,870	$ 342,441	$ 532,245	$ 247,566
Trade Publishing segment	32,059	37,272	46,284	47,559	33,799	37,442	43,262	50,434
Net sales	153,933	401,890	551,008	265,485	162,669	379,883	575,507	298,000
Costs and expenses:								
Cost of sales, excluding publishing rights and pre-publication amortization	92,648	166,796	205,395	123,887	96,569	168,076	220,492	137,531
Publishing rights amortization	30,751	24,776	25,048	25,049	23,143	19,148	19,358	19,358
Pre-publication amortization	28,974	32,063	33,463	35,193	26,463	27,909	32,437	33,697
Cost of sales	152,373	223,635	263,906	184,129	146,175	215,133	272,287	190,586
Selling and administrative	137,010	152,283	167,741	155,501	143,009	170,687	191,843	175,585
Other intangible asset amortization	2,945	3,007	3,029	3,189	3,218	4,261	7,255	7,304
Impairment charge for investment in preferred stock and intangible assets		1,279		400				
Severance and other charges	1,757	3,362	181	2,000	1,057	985	1,563	1,162
Operating income (loss)	(140,152)	18,324	116,151	(79,734)	(130,790)	(11,183)	102,559	(76,637)

Other income (expense)								
Interest expense	(4,297)	(4,395)	(4,662)	(4,891)	(5,954)	(6,160)	(10,196)	(9,735)
Change in fair value of derivative instruments	(103)	(205)	(1,252)	(33)	(2,220)	369	(42)	(469)
Loss on extinguishment of debt						(2,173)	(878)	
Income (loss) before taxes	(144,552)	13,724	110,237	(84,658)	(138,964)	(19,147)	91,443	(86,841)
Income tax expense (benefit)	1,783	2,176	3,207	(924)	20,976	(11,404)	(39,638)	10,426
Net income (loss)	$ (146,335)	$ 11,548	$ 107,030	$ (83,734)	$ (159,940)	$ (7,743)	$ 131,081	$ (97,267)

During the first quarter of 2014, we recorded an out-of-period correction of approximately $1.1 million reducing net sales and increasing deferred revenue that should have been deferred previously. In addition, during the first quarter of 2014, we recorded approximately $3.5 million of incremental expense, primarily commissions, related to the prior year. These out-of-period corrections had no impact on our debt covenant compliance. Management believes these out-of-period corrections are not material to the 2014 financial statements or any previously issued financial statements.

Liquidity and Capital Resources

	December 31,		
(in thousands)	**2015**	**2014**	**2013**
Cash and cash equivalents	$ 234,257	$ 456,581	$ 313,628
Short-term investments	198,146	286,764	111,721
Current portion of long-term debt	8,000	67,500	2,500
Long-term debt, net of discount	784,389	175,625	243,125

	Years ended December 31,		
	2015	**2014**	**2013**
Net cash provided by operating activities	$ 348,359	$ 491,043	$ 157,203
Net cash used in investing activities	(676,787)	(367,619)	(168,578)
Net cash provided by (used in) financing activities	106,104	19,529	(4,075)

Operating activities

Net cash provided by operating activities was $348.4 million for the year ended December 31, 2015, a $142.7 million decrease from the $491.0 million provided by operating activities for the year ended December 31, 2014. The decrease in cash provided by operating activities from 2014 to 2015 was primarily driven by unfavorable net changes in operating assets and liabilities of $150.1 million modestly offset by more profitable operations, net of depreciation and amortization, of $7.4 million. These unfavorable net changes in operating assets and liabilities were primarily due to unfavorable changes in deferred revenue of $104.6 million attributed to lower billings compared to the prior year due to a smaller adoption market, unfavorable changes in accounts receivable of $34.7 million due to timing of receipts with the fourth quarter of 2015 being larger than the fourth quarter of 2014, unfavorable changes in royalties of $7.0 million due to volume and timing of payments and unfavorable changes in other operating assets and liabilities of $61.8 million primarily related to a reversal of a $74.3 million accrual related to uncertain tax positions as the statutory period expired, partially offset by favorable changes in accounts payable of $16.6 million, favorable changes in inventories of $28.0 million, and favorable changes in pension and postretirement benefits of $11.9 million as there were no company contributions to the pension plan in the current period, and favorable changes in severance and other charges of $1.6 million.

Net cash provided by operating activities was $491.0 million for the year ended December 31, 2014, a $333.8 million increase from the $157.2 million provided by operating activities for the year ended December 31, 2013. The increase in cash provided by operating activities from 2013 to 2014 was primarily driven by favorable net changes in operating assets and liabilities of $354.4 million. These changes were primarily due to favorable changes in deferred revenue of $228.4 million attributed to increased billings and change in product mix, favorable changes in accounts receivable of $153.5 million, favorable changes in royalties of $7.4 million, partially offset by unfavorable changes in inventories and accounts payable of $17.2 million and $4.5 million, respectively, and unfavorable net changes in other operating assets and liabilities of $13.2 million. Further, the increase was partially offset by less profitable operations, net of non-cash charges, of $20.6 million.

Investing activities

Net cash used in investing activities was $676.8 million for the year ended December 31, 2015, an increase of $309.2 million from the $367.6 million used in investing activities for the year ended December 31, 2014. The increase in

cash investing expenditures is primarily attributed to an increase in the acquisition of business expenditures of $569.1 million related primarily to our acquisition of the EdTech business in the current period compared to three smaller acquisitions that occurred during 2014. The increase in expenditures was partially

offset by an increase in net proceeds from sales and maturities of short-term investments of $263.9 million attributed to management s decision to have increased liquidity to fund strategic initiatives. Further, capital investing expenditures related to pre-publication costs and property, plant and equipment increased by $4.0 million. The increase in capital investing expenditures was primarily the result of capital spend pertaining to the EdTech business.

Net cash used in investing activities was $367.6 million for the year ended December 31, 2014, an increase of $199.0 million from the $168.6 million used in investing activities for the year ended December 31, 2013. The increase in cash investing expenditures is primarily attributed to a $209.2 million increase in net purchases of short-term investments attributed to the 2014 cash generation. Further, there was a decrease in proceeds from sale of assets of $4.8 million for 2013 activity that did not occur in 2014. The overall increase in net cash used in investing activities was offset by a decrease in acquisition of business activity expenditures of $9.6 million and $3.9 million in pre-publication costs and property, plant and equipment, due to improvements in capital allocation management.

Financing activities

Net cash provided by financing activities was $106.1 million for the year ended December 31, 2015, an increase of $86.6 million from the $19.5 million of net cash provided by financing activities for the year ended December 31, 2014. The increase was primarily due to net proceeds from the New Term Loan Facility of $796.0 million partially offset by an increase in principal payments on our previously existing term loan of $240.6 million related to our acquisition of the EdTech business, and principal payments of $4.0 million related to the New Term Loan Facility. Further, we incurred $15.3 million of deferred financing fees expenditures in connection with our New Term Loan Facility and New Revolving Credit Facility. During 2015, we also incurred cash outlays of $463.0 million under our share repurchase program for our common stock, partially offset by an increase in proceeds from stock option exercises of $13.4 million.

Net cash provided by financing activities was $19.5 million for the year ended December 31, 2014, an increase of $23.6 million from the $4.1 million of net cash used in financing activities for the year ended December 31, 2013. The increase was due to proceeds from stock option exercises of $22.7 million, partially offset by tax withholding payments related to net share settlements of restricted stock units of $0.7 million. Further, in 2013, there were $1.6 million of contingent consideration payments related to prior year acquisitions that did not occur in 2014.

Debt

Under both our revolving credit facility and term loan facility, Houghton Mifflin Harcourt Publishers Inc., HMH Publishers LLC and Houghton Mifflin Harcourt Publishing Company are the borrowers (collectively, the Borrowers), and Citibank, N.A. acts as both the administrative agent and the collateral agent.

The obligations under these senior secured facilities are guaranteed by the Company and each of its direct and indirect for-profit domestic subsidiaries (other than the Borrowers) (collectively, the Guarantors) and are secured by all capital stock and other equity interests of the Borrowers and the Guarantors and substantially all of the other tangible and intangible assets of the Borrowers and the Guarantors, including, without limitation, receivables, inventory, equipment, contract rights, securities, patents, trademarks, other intellectual property, cash, bank accounts and securities accounts and owned real estate. The revolving credit facility is secured by first priority liens on receivables, inventory, deposit accounts, securities accounts, instruments, chattel paper and other assets related to the foregoing (the Revolving First Lien Collateral), and second priority liens on the collateral which secures the term loan facility on a first priority basis. The term loan facility is secured by first priority liens on the capital stock and other equity interests of the Borrower and the Guarantors, equipment, owned real estate, trademarks and other intellectual property, general intangibles that are not Revolving First Lien Collateral and other assets related to the foregoing, and second

priority liens on the Revolving First Lien Collateral.

Term Loan Facility

In connection with our closing of the EdTech acquisition, we entered into an amended and restated term loan credit facility (the New Term Loan Facility) dated as of May 29, 2015 to, among other things, increase our outstanding term loan credit facility from $250.0 million, of which $178.9 million was outstanding, to $800.0 million, all of which was drawn at closing. As of December 31, 2015, we had approximately $796.0 million ($792.4 million, net of discount) outstanding under the New Term Loan Facility.

The New Term Loan Facility has a six year term and matures on May 29, 2021. The interest rate applicable to borrowings under the facility is based, at our election, on LIBOR plus 3.0% or an alternative base rate plus applicable margins. LIBOR is subject to a floor of 1.0%, with the length of the LIBOR contracts ranging up to six months at the option of the Company. As of December 31, 2015, the interest rate of the New Term Loan Facility was 4.0%.

The New Term Loan Facility may be prepaid, in whole or in part, at any time, without premium. The New Term Loan Facility is required to be repaid in quarterly installments equal to 0.25%, or $2.0 million, of the aggregate principal amount outstanding under the New Term Loan Facility immediately prior to the first quarterly payment date.

The New Term Loan Facility does not require us to comply with financial covenants.

The New Term Loan Facility is subject to usual and customary conditions, representations, warranties and covenants, including restrictions on additional indebtedness, liens, investments, mergers, acquisitions, asset dispositions, dividends to stockholders, repurchase or redemption of our stock, transactions with affiliates and other matters. The New Term Loan Facility is subject to customary events of default. If an event of default occurs and is continuing, the administrative agent may, or at the request of certain required lenders shall, accelerate the obligations outstanding under the New Term Loan Facility.

We are subject to excess cash flow provisions under the New Term Loan Facility that are predicated upon our leverage ratio and cash flow. The excess cash flow provision under the New Term Loan Facility did not apply in 2015. In accordance with the excess cash flow provisions of our previous term loan facility, we made a $63.6 million principal payment on March 5, 2015.

On January 15, 2014, we entered into an amendment to our previous term loan facility to, among other things, reduce the interest rates applicable to the loans under the facility. As a result of the amendment, interest rates for loans under the previous term loan facility were reduced by 1% and based, at the Company s election, on LIBOR plus 3.25% per annum or the alternate base rate plus 2.25% per annum.

Revolving Credit Facility

On July 22, 2015, we entered into an amended and restated revolving credit facility (the New Revolving Credit Facility) to, among other things, reduce the pricing, extend the maturity, conform certain terms to those of our New Term Loan Facility and to provide greater availability and operational flexibility. The New Revolving Credit Facility provides borrowing availability in an amount equal to the lesser of $250.0 million and a borrowing base that is computed monthly or weekly as the case may be and comprised of the Borrowers and certain Guarantors eligible inventory and receivables.

The New Revolving Credit Facility includes a letter of credit subfacility of $50.0 million, a swingline subfacility of $20.0 million and the option to expand the facility by up to $100.0 million in the aggregate under certain specified conditions. The amount of any outstanding letters of credit reduces borrowing availability under the New Revolving

Credit Facility on a dollar-for-dollar basis. As of December 31, 2015, we had approximately $31.9 million of outstanding letters of credit and approximately $155.5 million of borrowing availability under the New Revolving Credit Facility. No loans have been drawn on the New Revolving Credit Facility as of February 4, 2016.

The New Revolving Credit Facility has a five year term and matures on July 22, 2020. The interest rate applicable to borrowings under the facility is based, at our election, on LIBOR plus 1.75% or an alternative base rate plus 0.75%; such applicable margins may increase up to 2.25% and 1.25%, respectively, based on average daily availability. The New Revolving Credit Facility may be prepaid, in whole or in part, at any time, without premium.

The New Revolving Credit Facility requires us to maintain a minimum fixed charge coverage ratio of 1.0 to 1.0 on a trailing four-quarter basis for periods in which excess availability under the facility is less than the greater of $25.0 million and 12.5% of the lesser of the total commitment and the borrowing base then in effect, or less than $20.0 million if certain conditions are met. The minimum fixed charge coverage ratio was not applicable under the facility as of December 31, 2015, due to our level of borrowing availability.

The New Revolving Credit Facility is subject to usual and customary conditions, representations, warranties and covenants, including restrictions on additional indebtedness, liens, investments, mergers, acquisitions, asset dispositions, dividends to stockholders, repurchase or redemption of our stock, transactions with affiliates and other matters. The New Revolving Credit Facility is subject to customary events of default. If an event of default occurs and is continuing, the administrative agent may, or at the request of certain required lenders shall, accelerate the obligations outstanding under the New Revolving Facility.

General

We had $234.3 million of cash and cash equivalents and $198.1 million of short-term investments at December 31, 2015. We had $456.6 million of cash and cash equivalents and $286.8 million of short-term investments at December 31, 2014.

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

Subject to market and other conditions, we plan to increase our debt by an additional $250.0 million and use some or all of the net proceeds from the financing to fund a portion of our share repurchases under the share repurchase program among other general corporate purposes. There can be no assurance that we will be able to obtain future debt financing on favorable terms, if at all.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. GAAP requires the use of estimates, assumptions and judgments by management that affect the reported amounts of assets, liabilities, net sales, expenses and related disclosure of contingent assets and liabilities in the amounts reported in the financial statements and accompanying notes. On an on-going basis, we evaluate our estimates and assumptions, including, but not limited to, book returns, allowance for bad debts, recoverability of advances to authors, valuation of inventory, financial instruments, depreciation and amortization periods, recoverability of long-term assets such as property, plant and equipment, capitalized pre-publication costs, other identified intangibles, goodwill, deferred revenue, income taxes, pensions and other postretirement benefits, contingencies, litigation and purchase accounting. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates. For a complete description of our significant accounting policies, see Note 2 of Notes to Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data. The following policies and account descriptions include those

identified as critical to our business operations and the understanding of our results of operations.

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Revenue Recognition

Revenue is recognized only once persuasive evidence of an arrangement with the customer exists, the sales price is fixed or determinable, delivery of products or services has occurred, title and risk of loss with respect to products have transferred to the customer, all significant obligations, if any, have been performed, and collection is reasonably assured.

We enter into certain contractual arrangements that have multiple elements, one or more of which may be delivered subsequent to the delivery of other elements. These multiple-deliverable arrangements may include print and digital media, professional development services, training, software licenses, access to hosted content, and various services related to the software including but not limited to hosting, maintenance and support, and implementation. For these multiple-element arrangements, we allocate revenue to each deliverable of the arrangement based on the relative selling prices of the deliverables. In such circumstances, we first determine the selling price of each deliverable based on (i) vendor-specific objective evidence of fair value (VSOE) if that exists, (ii) third-party evidence of selling price (TPE) when VSOE does not exist, or (iii) our best estimate of the selling price when neither VSOE nor TPE exists. Revenue is then allocated to the non-software deliverables as a group and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement, based on the selling price hierarchy. Non-software deliverables include print and digital textbooks and instructional materials, trade books, reference materials, assessment materials and multimedia instructional programs; licenses to book rights and content; access to hosted content; and services including test development, test delivery, test scoring, professional development, consulting and training when those services do not relate to software deliverables. Software deliverables include software licenses, software maintenance and support services, professional services and training when those services relate to software deliverables.

For the non-software deliverables, we determine the revenue for each deliverable based on its relative selling price in the arrangement and we recognize revenue upon delivery of the product or service, assuming all other revenue recognition criteria have been met. Revenue for test delivery, test scoring and training is recognized when the service has been completed. Revenue for test development, professional development, consulting and training is recognized as the service is provided. Revenue for access to hosted interactive content is recognized ratably over the term of the arrangement.

For the software deliverables as a group, we recognize revenue in accordance with the authoritative guidance for software revenue recognition. As our software licenses are typically sold with maintenance and support, professional services or training, we use the residual method to determine the amount of software license revenue to be recognized.

Under the residual method, arrangement consideration of the software deliverables as a group is allocated to the undelivered elements based upon VSOE of those elements, with the residual amount of the arrangement fee allocated to and recognized as license revenue upon delivery, assuming all other revenue recognition criteria have been met. If VSOE of one or more of the undelivered services or other elements does not exist, all revenues of the software-deliverables arrangement are deferred until delivery of all of those services or other elements has occurred, or until VSOE of each of those services or other elements can be established.

As products are shipped with right of return, a provision for estimated returns on these sales is made at the time of sale based on historical experience by product line or customer.

Shipping and handling fees charged to customers are included in net sales.

Allowance for Doubtful Accounts and Reserves for Book Returns

Accounts receivable are recorded net of allowances for doubtful accounts and reserves for book returns. In the normal course of business, we extend credit to customers that satisfy predefined criteria. We estimate the

collectability of our receivables. Allowances for doubtful accounts are established through the evaluation of accounts receivable aging, prior collection experience and specific facts and circumstances. Reserves for book returns are based on historical return rates and sales patterns. We determine the required reserves by segregating our returns into the applicable product or sales channel pools. Returns in the K-12 market have been historically low. We have experienced higher returns with respect to sales to resellers, international sales and Trade Publishing sales, which all result in a greater degree of risk and subjectivity when establishing the appropriate level of reserves for this customer base. At the time we determine that a receivable balance, or any portion thereof, is deemed to be permanently uncollectible, the balance is written off. The allowance for doubtful accounts and reserve for returns are reported as reductions of the accounts receivable balance and amounted to $8.5 million and $24.3 million, and $5.6 million and $22.2 million as of December 31, 2015 and 2014, respectively.

Inventories

Inventories are substantially stated at the lower of weighted average cost or net realizable value. The level of obsolete and excess inventory is estimated on a program or title level-basis by comparing the number of units in stock with the expected future demand. The expected future demand of a program or title is determined by the copyright year, the previous years sales history, the subsequent year s sales forecast, known forward-looking trends including our development cycle to replace the title or program and competing titles or programs. A change in sales trends could affect the estimated reserve. The inventory obsolescence reserve is reported as a reduction of the inventories balance and amounted to $55.8 million and $59.0 million as of December 31, 2015 and 2014, respectively.

Pre-publication Costs

Pre-publication costs are capitalized and are primarily amortized from the year of sale over five years using the sum-of-the-years-digits method, which is an accelerated method for calculating an asset s amortization. Under this method, the amortization expense recorded for a pre-publication cost asset is approximately 33% (year 1), 27% (year 2), 20% (year 3), 13% (year 4) and 7% (year 5). We utilize this policy for all pre-publication costs, except with respect to our Trade Publishing young readers and general interest books, for which we expense such costs as incurred, and our assessment products, for which we use the straight-line amortization method. Additionally, pre-publication costs recorded in connection with the acquisition of the EdTech business are amortized over 7 years on a projected sales pattern. The amortization methods and periods chosen best reflect the pattern of expected sales generated from individual titles or programs. We periodically evaluate the remaining lives and recoverability of capitalized pre-publication costs, which are often dependent upon program acceptance by state adoption authorities.

Amortization expense related to pre-publication costs for the years ended December 31, 2015, 2014 and 2013 were $120.5 million, $129.7 million and $121.7 million, respectively.

For the years ended December 31, 2015 and December 31, 2014, no pre-publication costs were deemed to be impaired. For the year ended December 31, 2013, pre-publication costs of $1.1 million, were deemed to be impaired. The impairment was included as a charge to the statement of operations in the impairment charge for investment in preferred stock, intangible assets, pre-publication costs and fixed assets caption.

Goodwill and Indefinite-Lived Intangible Assets

Goodwill and indefinite-lived intangible assets (certain trade names) are not amortized but are reviewed at least annually for impairment or earlier, if an indication of impairment exists. Goodwill is allocated entirely to our Education reporting unit. Determining the fair value of a reporting unit is judgmental in nature, and involves the use of significant estimates and assumptions. These estimates and assumptions may include net sales growth

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rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, the determination of appropriate market comparables as well as the fair value of individual assets and liabilities.

We have the option of first assessing qualitative factors to determine whether it is necessary to perform the current two-step impairment test or we can perform the two-step impairment test without performing the qualitative assessment. The Education reporting unit did not experience any significant adverse changes in its business or reporting structures or any other adverse changes, and since the reporting unit s fair value substantially exceeded its carrying value from when the previous Step 1 analysis was performed, we performed the qualitative Step 0 assessment. In performing the qualitative Step 0 assessment, we considered certain events and circumstances specific to the reporting unit and to the entity as a whole, such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount.

Recoverability of goodwill and indefinite lived intangibles can also be evaluated using a two-step process. In the first step, the fair value of a reporting unit is compared to its carrying value. If the fair value of a reporting unit exceeds the carrying value of the net assets assigned to a reporting unit, goodwill is considered not impaired and no further testing is required. If the carrying value of the net assets assigned to a reporting unit exceeds the fair value of a reporting unit, the second step of the impairment test is performed in order to determine the implied fair value of a reporting unit s goodwill. Determining the implied fair value of goodwill requires valuation of a reporting unit s tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to the extent of the difference. We estimate total fair value of each reporting unit using discounted cash flow analysis, and make assumptions regarding future net sales, gross margins, working capital levels, investments in new products, capital spending, tax, cash flows and the terminal value of the reporting unit. With regard to other intangibles with indefinite lives, we determine the fair value by asset, which is then compared to its carrying value to determine if the assets are impaired.

We completed our annual goodwill and indefinite-lived intangible asset impairment tests as of October 1, 2015, 2014, and 2013. In 2015, we performed the qualitative Step 0 assessment for goodwill and determined that it is more likely than not that the fair value of the reporting unit exceeds its carrying amount, and we performed the two-step process for indefinite lived intangible assets. In 2014 and 2013, we used an income approach to establish the fair value of the reporting unit as and used the most recent five year strategic plan as the initial basis of our analysis. We recorded a non-cash impairment charge of $0.4 million and $0.5 million for the years ended December 31, 2014 and 2013, respectively. The impairments principally related to two specific tradenames within the Trade Publishing segment in 2014 and 2013. The impairment charges resulted primarily from a decline in revenue from previously projected amounts. No goodwill and indefinite-lived intangible assets were deemed to be impaired for the year ended December 31, 2015. We will continue to monitor and evaluate the carrying value of goodwill. If market and economic conditions or business performance deteriorate, this could increase the likelihood of us recording an impairment charge. However, management believes it is not reasonably likely that an impairment will occur at its reporting unit over the next twelve months.

Royalty Advances

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

is fully reserved. The reserve for royalty advances is reported as a reduction of the royalty advances to authors balance and amounted to $70.0 million and $55.0 million as of December 31, 2015 and 2014, respectively.

Stock-Based Compensation

The fair value of each restricted stock and restricted stock unit was estimated at the date of the grant based upon the target value of the award and the current market price. The fair value of each stock option grant was estimated on the date of grant using the Black-Scholes option pricing model, which requires management s use of highly subjective estimates and assumptions. The use of different estimates and assumptions in the option pricing model could have a material impact on the estimated fair value of option grants and the related expense. We estimate our expected volatility based on the historical volatility of our publicly traded peer companies (including our own) and expect to continue to do so until such time as we have adequate historical data regarding the volatility of our traded stock price. The expected life assumption is based on the simplified method for estimating expected term for awards. This option has been elected as we do not have sufficient stock option exercise experience to support a reasonable estimate of the expected term. The risk-free interest rate is the yield currently available on U.S. Treasury zero-coupon issues with a remaining term approximating the expected term of the option. The expected dividend yield is based on actual dividends paid or to be paid. We recognize stock-based compensation expense over the awards requisite service period on a straight-line basis for time based stock options, restricted stock and restricted stock units and on a graded basis for restricted stock that are contingent on the achievement of performance conditions. We recognize compensation expense for only the portion of stock based awards that are expected to vest. Accordingly, we have estimated expected forfeitures of stock based awards based on our historical forfeiture rate and used these rates in developing a future forfeiture rate. If our actual forfeiture rate varies from our historical rates and estimates, additional adjustments to compensation expense may be required in future periods.

Impact of Inflation and Changing Prices

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

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

Covenant Compliance

As of December 31, 2015, we were in compliance with all of our debt covenants.

We are currently required to meet certain incurrence based financial covenants as defined under our New Term Loan Facility and New Revolving Credit Facility. We have financial covenants primarily pertaining to a maximum leverage ratio, fixed charge coverage ratio, and liquidity. A breach of any of these covenants, ratios, tests or restrictions, as applicable, for which a waiver is not obtained could result in an event of default, in which case our lenders could elect to declare all amounts outstanding to be immediately due and payable and result in a cross-default under other

arrangements containing such provisions. A default would permit lenders to accelerate the maturity for the debt under these agreements and to foreclose upon any collateral securing the debt owed to these lenders and to terminate any commitments of these lenders to lend to us. If the lenders accelerate the payment of the indebtedness, our assets may not be sufficient to repay in full the indebtedness and any other

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indebtedness that would become due as a result of any acceleration. Further, in such an event, the lenders would not be required to make further loans to us, and assuming similar facilities were not established and we are unable to obtain replacement financing, it would materially affect our liquidity and results of operations.

Contractual Obligations

The following table provides information with respect to our estimated commitments and obligations as of December 31, 2015:

Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
			(in thousands)		
Term loan facility due May 29, 2021 (1)	$ 796,000	$ 8,000	$ 16,000	$ 16,000	$ 756,000
Interest payable on term loan facility due May 29, 2021 (2)	184,975	32,133	65,393	71,818	15,631
Payments on derivative instruments	13,269	1,544	8,155	3,570	
Capital leases	1,405	1,405			
Operating leases (3)	375,846	43,516	70,117	50,371	211,842
Purchase obligations (4)	75,211	66,788	7,647	92	684
Total cash contractual obligations	$ 1,446,706	$ 153,386	$ 167,312	$ 141,851	$ 984,157

(1) The term loan facility amortizes at a rate of 1.0% per annum of the original $800.0 million amount.
(2) As of December 31, 2015, the interest rate was 4.0%.
(3) Represents minimum lease payments under non-cancelable operating leases.
(4) Purchase obligations are agreements to purchase goods or services that are enforceable and legally binding. These goods and services consist primarily of author advances, subcontractor expenses, information technology licenses, and outsourcing arrangements.

In addition to the payments described above, we have employee benefit obligations that require future payments. For example, we expect to make $1.9 million of contributions in 2016 relating to our pension and postretirement benefit plans. We expect to periodically draw and repay borrowings under the revolving credit facility. We believe that we will be able to meet our cash interest obligations on our outstanding debt when they are due and payable.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from foreign currency exchange rates and interest rates, which could affect operating results, financial position and cash flows. We manage exposure to these market risks through our regular operating and financing activities and, when appropriate, through the use of derivative financial instruments. These derivative financial instruments are utilized to hedge economic exposures as well as reduce our earnings and cash flow volatility resulting from shifts in market rates. As permitted, we may designate certain of these derivative contracts for hedge accounting treatment in accordance with authoritative guidance regarding accounting for derivative instruments and hedging activities. However, certain of these instruments may not qualify for, or we may choose not to elect, hedge accounting treatment and, accordingly, the results of our operations may be exposed to some level of volatility. Volatility in our results of operations will vary with the type and amount of derivative hedges outstanding, as well as fluctuations in the currency and interest rate market during the period. Periodically, we may enter into derivative contracts, including interest rate swap agreements and interest rate caps and collars to manage interest rate exposures, and foreign currency spot, forward, swap and option contracts to manage foreign currency exposures. The fair market values of all of these derivative contracts change with fluctuations in interest rates and/or currency rates and are designed so that any changes in their values are offset by changes in the values of the underlying exposures. Derivative financial instruments are held solely as risk management tools and not for trading or speculative purposes.

By their nature, all derivative instruments involve, to varying degrees, elements of market and credit risk not recognized in our financial statements. The market risk associated with these instruments resulting from currency exchange and interest rate movements is expected to offset the market risk of the underlying transactions, assets and liabilities being hedged. Our policy is to deal with counterparties having a single A or better credit rating at the time of the execution. We manage our exposure to counterparty risk of derivative instruments by entering into contracts with a diversified group of major financial institutions and by actively monitoring outstanding positions.

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

As of December 31, 2015, we had $796.0 million ($792.4 million, net of discount) of aggregate principal amount indebtedness outstanding under our term loan facility that bears interest at a variable rate. An increase or decrease of 1% in the interest rate will change our interest expense by approximately $8.0 million on an annual basis. We also have up to $250.0 million of borrowing availability, subject to borrowing base availability, under our revolving credit facility, and borrowings under the revolving credit facility bear interest at a variable rate. We had no borrowings outstanding under the revolving credit facility at December 31, 2015. Assuming that the revolving credit facility is fully drawn, an increase or decrease of 1% in the interest rate will change our interest expense associated with the revolving credit facility by $2.5 million on an annual basis.

Our interest rate risk relates primarily to U.S. dollar borrowings partially offset by U.S. dollar cash investments. We have historically used interest rate derivative instruments to manage our earnings and cash flow exposure to changes in interest rates. On August 17, 2015, we entered into interest rate derivative contracts with various financial institutions having an aggregate notional amount of $400.0 million to convert floating rate debt into fixed rate debt, which we designated as cash flow hedges, and for which we had $400.0 million outstanding as of December 31, 2015. These contracts are effective beginning September 30, 2016 and mature on July 22, 2020.

We conduct various digital development activities in Ireland, and as such, our cash flows and costs are subject to fluctuations from changes in foreign currency exchange rates. We manage our exposures to this market risk through

the use of short-term foreign exchange forward and option contracts, when deemed appropriate, which were not significant as of December 31, 2015 and December 31, 2014. We do not enter into derivative transactions or use other financial instruments for trading or speculative purposes.

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Item 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Houghton Mifflin Harcourt Company:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Houghton Mifflin Harcourt Company and its subsidiaries at December 31, 2015 and December 31, 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company s internal control over financial reporting based on our audits (which were integrated audits in 2015 and 2014). We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 8 to the consolidated financial statements, the Company changed the manner in which it accounts for the classification of deferred taxes in the consolidated balance sheets due to the adoption of ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become

inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Management s Report on Internal Control over Financial Reporting management has excluded the Educational Technology and Services (EdTech) business from its assessment of internal control over financial reporting as of December 31, 2015 because it was acquired by the Company in a purchase business combination during 2015. We have also excluded EdTech from our audit of internal control over financial reporting. EdTech s total assets and total revenues represent $167.2 million and $142.2 million, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2015.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts

February 25, 2016

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Houghton Mifflin Harcourt Company

Consolidated Balance Sheets

(in thousands of dollars, except share information)	December 31, 2015	December 31, 2014
Assets		
Current assets		
Cash and cash equivalents	$ 234,257	$ 456,581
Short-term investments	198,146	286,764
Accounts receivable, net of allowance for bad debts and book returns of $32.7 million and $27.8 million, respectively	256,099	255,669
Inventories	171,446	183,961
Prepaid expenses and other assets	22,877	18,665
Total current assets	882,825	1,201,640
Property, plant, and equipment, net	149,680	138,362
Pre-publication costs, net	321,931	236,995
Royalty advances to authors, net	44,736	46,777
Goodwill	783,073	532,921
Other intangible assets, net	912,955	801,969
Deferred income taxes	3,540	3,705
Other assets	38,316	28,279
Total assets	$ 3,137,056	$ 2,990,648
Liabilities and Stockholders Equity		
Current liabilities		
Current portion of long-term debt	$ 8,000	$ 67,500
Accounts payable	94,483	51,266
Royalties payable	85,766	80,089
Salaries, wages, and commissions payable	45,340	59,733
Deferred revenue	231,172	157,016
Interest payable	106	47
Severance and other charges	4,894	5,928
Accrued postretirement benefits	1,910	2,037
Other liabilities	34,937	27,015
Total current liabilities	506,608	450,631
Long-term debt, net of discount	784,389	175,625
Long-term deferred revenue	440,625	370,103
Accrued pension benefits	23,726	18,525
Accrued postretirement benefits	23,657	26,500

Deferred income taxes	139,810	91,761
Other liabilities	19,920	97,823
Total liabilities	1,938,735	1,230,968
Commitments and contingencies (Note 12)		
Stockholders equity		
Preferred stock, $0.01 par value: 20,000,000 shares authorized; no shares issued and outstanding at December 31, 2015 and 2014		
Common stock, $0.01 par value: 380,000,000 shares authorized; 145,613,978 and 142,000,019 shares issued at December 31, 2015 and 2014, respectively; 123,940,510 and 141,917,997 shares outstanding at December 31, 2015 and 2014, respectively	1,456	1,420
Treasury stock, 21,673,468 and 82,022 shares as of December 31, 2015 and 2014, respectively, at cost (related parties of $(193,493) in 2015)	(463,013)	
Capital in excess of par value	4,833,388	4,784,962
Accumulated deficit	(3,133,782)	(2,999,913)
Accumulated other comprehensive loss	(39,728)	(26,789)
Total stockholders equity	1,198,321	1,759,680
Total liabilities and stockholders equity	$ 3,137,056	$ 2,990,648

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

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Houghton Mifflin Harcourt Company

Consolidated Statements of Operations

(in thousands of dollars, except share and per share data)	Years Ended December 31, 2015	2014	2013
Net sales	$ 1,416,059	$ 1,372,316	$ 1,378,612
Costs and expenses			
Cost of sales, excluding publishing rights and pre-publication amortization	622,668	588,726	585,059
Publishing rights amortization	81,007	105,624	139,588
Pre-publication amortization	120,506	129,693	121,715
Cost of sales	824,181	824,043	846,362
Selling and administrative (related parties of $10,489 in 2015 Note 14)	681,124	612,535	580,887
Other intangible asset amortization	22,038	12,170	18,968
Impairment charge for investment in preferred stock, intangible assets, pre-publication costs and fixed assets		1,679	9,000
Severance and other charges	4,767	7,300	10,040
Operating loss	(116,051)	(85,411)	(86,645)
Other income (expense)			
Interest expense, net	(32,045)	(18,245)	(21,344)
Change in fair value of derivative instruments	(2,362)	(1,593)	(252)
Loss on extinguishment of debt	(3,051)		(598)
Loss before taxes	(153,509)	(105,249)	(108,839)
Income tax expense (benefit)	(19,640)	6,242	2,347
Net loss	$ (133,869)	$ (111,491)	$ (111,186)
Net loss per share attributable to common stockholders			
Basic	$ (0.98)	$ (0.79)	$ (0.79)
Diluted	$ (0.98)	$ (0.79)	$ (0.79)
Weighted average shares outstanding			
Basic	136,760,107	140,594,689	139,928,650
Diluted	136,760,107	140,594,689	139,928,650

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

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Houghton Mifflin Harcourt Company

Consolidated Statements of Comprehensive Loss

(in thousands of dollars)	**Years Ended December 31, 2015**	**2014**	**2013**
Net loss	$ (133,869)	$ (111,491)	$ (111,186)
Other comprehensive income (loss), net of taxes:			
Foreign currency translation adjustments, net of tax	(2,140)	(29)	404
Net change in pension and benefit plan liability, net of tax expense of $4,977 for 2013	(7,100)	(13,380)	7,846
Unrealized loss on short-term investments, net of tax	(58)	(89)	(13)
Net change in unrealized loss on derivative financial instruments, net of tax	(3,641)		
Other comprehensive income (loss), net of taxes	(12,939)	(13,498)	8,237
Comprehensive loss	$ (146,808)	$ (124,989)	$ (102,949)

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

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Houghton Mifflin Harcourt Company

Consolidated Statements of Cash Flows

(in thousands of dollars)	**Years Ended December 31, 2015**	**2014**	**2013**
Cash flows from operating activities			
Net loss	$ (133,869)	$ (111,491)	$ (111,186)
Adjustments to reconcile net loss to net cash provided by operating activities			
Gain on sale of assets			(2,720)
Depreciation and amortization expense	296,609	319,777	341,979
Amortization of debt discount and deferred financing costs	7,216	4,750	4,797
Deferred income taxes	48,214	899	(3,121)
Stock-based compensation expense	12,452	11,376	9,524
Loss on extinguishment of debt	3,051		598
Impairment charge for investment in preferred stock, intangible assets, pre-publication costs and fixed assets		1,679	9,000
Change in fair value of derivative instruments	2,362	1,593	252
Changes in operating assets and liabilities, net of acquisitions			
Accounts receivable	30,808	65,519	(88,029)
Inventories	26,228	(1,763)	15,419
Other assets	(2,562)	(4,263)	(4,480)
Accounts payable and accrued expenses	13,145	(3,432)	1,076
Royalties, net	6,238	13,286	5,851
Deferred revenue	124,489	229,105	702
Interest payable	59	(8)	(32)
Severance and other charges	(3,615)	(5,210)	(2,759)
Accrued pension and postretirement benefits	(4,869)	(16,724)	(15,057)
Other liabilities	(77,597)	(14,050)	(4,611)
Net cash provided by operating activities	348,359	491,043	157,203
Cash flows from investing activities			
Proceeds from sales and maturities of short-term investments	286,732	134,275	251,168
Purchases of short-term investments	(198,633)	(310,149)	(217,855)
Additions to pre-publication costs	(103,709)	(115,509)	(126,718)
Additions to property, plant, and equipment	(82,987)	(67,145)	(59,803)
Acquisition of business, net of cash acquired	(578,190)	(9,091)	(18,695)
Proceeds from sale of assets			4,825
Investment in preferred stock			(1,500)
Net cash used in investing activities	(676,787)	(367,619)	(168,578)

Cash flows from financing activities			
Proceeds from term loan, net of discount	796,000		
Payments of long-term debt	(247,125)	(2,500)	(2,500)
Payments of deferred financing fees	(15,255)		
Repurchases of common stock (related parties of $(193,493) in 2015)	(463,013)		
Tax withholding payments related to net share settlements of restricted stock units	(658)	(723)	
Proceeds from stock option exercises	36,155	22,752	
Payments of contingent consideration			(1,575)
Net cash provided by (used in) financing activities	106,104	19,529	(4,075)
Net (decrease) increase in cash and cash equivalents	(222,324)	142,953	(15,450)
Cash and cash equivalent at the beginning of the period	456,581	313,628	329,078
Cash and cash equivalent at the end of the period	$ 234,257	$ 456,581	$ 313,628
Supplementary disclosure of cash flow information			
Amounts due from seller for acquisition (non-cash)	$ 2,884	$	$
Issuance of common stock upon exercise of warrants (non-cash)	1,815		
Income taxes paid	2,987	2,336	1,220
Interest paid	24,412	12,328	17,595
Pre-publication costs included in accounts payable (non-cash)	14,642	6,102	24,499
Property, plant, and equipment included in accounts payable (non-cash)	6,202	2,663	6,162
Property, plant, and equipment acquired under capital leases (non-cash)	1,356	3,495	4,289

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

Houghton Mifflin Harcourt Company

Consolidated Statements of Stockholders Equity

(in thousands of dollars, except share information)	**Common Stock Shares Issued**	**Par Value**	**Treasury Stock**	**Capital in excess of Par Value**	**Accumulated Deficit**	**Accumulated Other Comprehensive Loss**	**Total**
Balance at December 31, 2012	140,000,000	$ 1,400	$	$ 4,741,065	$ (2,777,236)	$ (21,528)	$ 1,943,701
Net loss					(111,186)		(111,186)
Other comprehensive income, net of tax expense of $4,977						8,237	8,237
Issuance of common stock for vesting of restricted stock units	44,400						
Stock-based compensation expense				9,524			9,524
Balance at December 31, 2013	140,044,400	1,400		4,750,589	(2,888,422)	(13,291)	1,850,276
Net loss					(111,491)		(111,491)
Other comprehensive loss, net						(13,498)	(13,498)
Issuance of common stock for vesting of restricted stock units	95,553	1		(1)			
Issuance of common stock for exercise of stock options	1,860,066	19		23,721			23,740
Stock withheld to cover tax withholdings requirements upon vesting of restricted stock units				(723)			(723)
Stock-based compensation expense				11,376			11,376
Balance at December 31, 2014	142,000,019	1,420		4,784,962	(2,999,913)	(26,789)	1,759,680
Net loss					(133,869)		(133,869)
Other comprehensive loss, net						(12,939)	(12,939)
Issuance of common stock for exercise of warrants	70,513	1		(1)			
Issuance of common stock for vesting of restricted stock units	67,725	1		(1)			
Issuance of common stock for exercise of stock options	2,932,839	29		36,926			36,955
Issuance of restricted stock	542,882	5		(5)			
Stock withheld to cover tax withholdings requirements upon vesting of restricted stock units				(658)			(658)
Repurchases of common stock (related parties of $(193,493))			(463,013)				(463,013)
Stock-based compensation expense				12,165			12,165

Balance at December 31, 2015	145,613,978	$ 1,456	$ (463,013)	$ 4,833,388	$ (3,133,782)	$ (39,728)	$ 1,198,321

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

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Houghton Mifflin Harcourt Company

Notes to Consolidated Financial Statements

(in thousands of dollars, except share and per share information)

1. Basis of Presentation

Houghton Mifflin Harcourt Company, formerly known as HMH Holdings (Delaware), Inc. (HMH , Houghton Mifflin Harcourt , we , us , our , or the Company), is a global learning company, specializing in education solutions across a variety of media, delivering content, services and technology to both educational institutions and consumers, reaching over 50 million students in more than 150 countries worldwide. In the United States, we are the leading provider of kindergarten through 12th grade (K-12) educational content by market share. We believe our long-standing reputation and trusted brand enable us to capitalize on consumer and digital trends in the education market through our existing and developing channels. Furthermore, our trade, general interest, young readers and reference material include adult and children s fiction and non-fiction books that have won industry awards such as the Pulitzer Prize, Newbery and Caldecott medals and National Book Award.

We believe our leadership position in the K-12 market, our primary market, provides us with strong competitive advantages. We have established relationships with educators, institutions, parents, students and life-long learners that are founded on our education expertise, content and services. Our portfolio of intellectual property spans educational, general interest, children s and reference works, and has been developed by leading educators and award-winning authors including 10 Nobel Prize winners, 48 Pulitzer Prize winners and 15 National Book Award winners. Our content includes national education programs such as *Collections*, *GO! Math*, *READ 180* and Channel One News, as well as characters and titles such as Curious George, Carmen Sandiego, *The Little Prince*, *The Lord of the Rings*, *Life of Pi*, *Webster s New World Dictionary* and *Cliffs Notes*.

The December 31, 2015 and 2014 consolidated financial statements of HMH include the accounts of all of our wholly-owned subsidiaries as of and for the periods ended December 31, 2015, December 31, 2014 and December 31, 2013.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Our accompanying consolidated financial statements include the results of operations of the Company and our wholly-owned subsidiaries. All material intercompany accounts and transactions are eliminated in consolidation.

Seasonality and Comparability

Our net sales, operating profit or loss and net cash provided by or used in operations are impacted by the inherent seasonality of the academic calendar. Consequently, the performance of our businesses may not be comparable quarter to consecutive quarter and should be considered on the basis of results for the whole year or by comparing results in a quarter with results in the same quarter for the previous year.

In the K-12 market, we typically receive payments for products and services from individual school districts, and, to a lesser extent, individual schools and states. In the Trade Publishing markets, payment is received for products and

services from book distributors and retail booksellers. In the case of testing and assessment products and services, payment is received from the individually contracted parties.

Approximately 88% of our net sales for the year ended December 31, 2015 were derived from our Education segment, which is a markedly seasonal business. Schools conduct the majority of their purchases in the second and third quarters of the calendar year in preparation for the beginning of the school year. Thus, for the years ended December 31, 2015, 2014 and 2013, approximately 68% of our consolidated net sales were realized in the second and third quarters. Sales of K-12 instructional materials and customized testing products are also cyclical, with some years offering more sales opportunities than others. The

Houghton Mifflin Harcourt Company

Notes to Consolidated Financial Statements

(in thousands of dollars, except share and per share information)

amount of funding available at the state level for educational materials also has a significant effect on year-to-year net sales. Although the loss of a single customer would not have a material adverse effect on our business, schedules of school adoptions and market acceptance of our products can materially affect year-to-year net sales performance.

2. Significant Accounting Policies

Use of Estimates

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

Revenue Recognition

We derive revenue primarily from the sale of print and digital content and instructional materials, trade books, reference materials, assessment materials and multimedia instructional programs; license fees for book rights, content and software; and services that include test development, test delivery, test scoring, professional development, consulting and training as well as access to hosted interactive content. Revenue is recognized only once persuasive evidence of an arrangement with the customer exists, the sales price is fixed or determinable, delivery of products or services has occurred, title and risk of loss with respect to products have transferred to the customer, all significant obligations, if any, have been performed, and collection is reasonably assured.

We enter into certain contractual arrangements that have multiple elements, one or more of which may be delivered subsequent to the delivery of other elements. These multiple-deliverable arrangements may include print and digital media, professional development services, training, software licenses, access to hosted content, and various services related to the software including but not limited to hosting, maintenance and support, and implementation. For these multiple-element arrangements, we allocate revenue to each deliverable of the arrangement based on the relative selling prices of the deliverables. In such circumstances, we first determine the selling price of each deliverable based on (i) vendor-specific objective evidence of fair value (VSOE) if that exists, (ii) third-party evidence of selling price

(TPE) when VSOE does not exist, or (iii) our best estimate of the selling price when neither VSOE nor TPE exists. Revenue is then allocated to the non-software deliverables as a group and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement, based on the selling price hierarchy.
Non-software deliverables include print and digital textbooks and instructional materials, trade books, reference materials, assessment materials and multimedia instructional programs; licenses to book rights and content; access to hosted content; and services including test development, test delivery, test

Houghton Mifflin Harcourt Company

Notes to Consolidated Financial Statements

(in thousands of dollars, except share and per share information)

scoring, professional development, consulting and training when those services do not relate to software deliverables. Software deliverables include software licenses, software maintenance and support services, professional services and training when those services relate to software deliverables.

For the non-software deliverables, we determine the revenue for each deliverable based on its relative selling price in the arrangement and we recognize revenue upon delivery of the product or service, assuming all other revenue recognition criteria have been met. Revenue for test delivery, test scoring and training is recognized when the service has been completed. Revenue for test development, professional development, consulting and training is recognized as the service is provided. Revenue for access to hosted interactive content is recognized ratably over the term of the arrangement.

For the software deliverables as a group, we recognize revenue in accordance with the authoritative guidance for software revenue recognition. As our software licenses are typically sold with maintenance and support, professional services or training, we use the residual method to determine the amount of software license revenue to be recognized. Under the residual method, arrangement consideration of the software deliverables as a group is allocated to the undelivered elements based upon VSOE of those elements, with the residual amount of the arrangement fee allocated to and recognized as license revenue upon delivery, assuming all other revenue recognition criteria have been met. If VSOE of one or more of the undelivered services or other elements does not exist, all revenues of the software-deliverables arrangement are deferred until delivery of all of those services or other elements has occurred, or until VSOE of each of those services or other elements can be established.

As products are shipped with right of return, a provision for estimated returns on these sales is made at the time of sale based on historical experience by product line or customer.

Shipping and handling fees charged to customers are included in net sales.

Advertising Costs and Sample Expenses

Advertising costs are charged to selling and administrative expenses as incurred. Advertising costs were $9.1 million, $8.6 million and $8.0 million for the years ended December 31, 2015, 2014 and 2013, respectively. Sample expenses are charged to selling and administrative expenses when the samples are shipped.

Cash and Cash Equivalents

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

Short-term Investments

Short-term investments typically consist of marketable securities with maturities between three and twelve months at the balance sheet date. We have classified all of our short-term investments as available-for-sale at December 31, 2015 and 2014. The investments are reported at fair value, with any unrealized gains or losses excluded from earnings and reported as a separate component of stockholders equity as other comprehensive income loss.

Houghton Mifflin Harcourt Company

Notes to Consolidated Financial Statements

(in thousands of dollars, except share and per share information)

Accounts Receivable

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

Inventories

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

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost, or in the case of assets acquired in business combinations, at fair value as of the acquisition date, less accumulated depreciation. Equipment under capital lease is stated at fair value at inception of the lease, less accumulated depreciation. Maintenance and repair costs are charged to expense as incurred, and renewals and improvements that extend the useful life of the assets are capitalized. Depreciation on property, plant, and equipment is calculated using the straight-line method over the estimated useful lives of the assets or, in the case of assets acquired in business combinations, over their remaining lives. Equipment held under capital leases and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset. Estimated useful lives of property, plant, and equipment are as follows:

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

Capitalized Internal-Use and External-Use Software

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

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

Houghton Mifflin Harcourt Company

Notes to Consolidated Financial Statements

(in thousands of dollars, except share and per share information)

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

We review internal and external software development costs for impairment. For the years ended December 31, 2015 and 2014, there was no impairment of software developments costs. For the year ended December 31, 2013, software development costs of $7.4 million were impaired. All impairments were included as a charge to the statement of operations in the impairment charge for investment in preferred stock, intangible assets, pre-publication costs and fixed assets caption.

Pre-publication Costs

We capitalize the art, prepress, manuscript and other costs incurred in the creation of the master copy of a book or other media (the pre-publication costs). Pre-publication costs are primarily amortized from the year of sale over five years using the sum-of-the-years-digits method, which is an accelerated method for calculating an asset s amortization. Under this method, the amortization expense recorded for a pre-publication cost asset is approximately 33% (year 1), 27% (year 2), 20% (year 3), 13% (year 4) and 7% (year 5). This policy is used throughout the Company, except for the Trade Publishing young readers and general interest books, which generally expenses such costs as incurred, and the assessment products, which uses the straight-line amortization method. Additionally, pre-publication costs recorded in connection with the acquisition of the EdTech business are amortized over 7 years on a projected sales pattern. The amortization methods and periods chosen best reflect the pattern of expected sales generated from individual titles or programs. We periodically evaluate the remaining lives and recoverability of capitalized pre-publication costs, which are often dependent upon program acceptance by state adoption authorities.

Amortization expense related to pre-publication costs for the years ended December 31, 2015, 2014 and 2013 were $120.5 million, $129.7 million and $121.7 million, respectively.

For the years ended December 31, 2015 and 2014, there was no impairment of pre-publication costs. For the year ended December 31, 2013 pre-publication costs of $1.1 million were impaired. The impairment was included as a charge to the statement of operations in the impairment charge for investment in preferred stock, intangible assets, pre-publication costs and fixed assets caption.

Goodwill and Indefinite-lived Intangible Assets

Goodwill is the excess of the purchase price paid over the fair value of the net assets of the business acquired. Other intangible assets principally consist of branded trademarks and trade names, acquired publishing rights and customer relationships. Goodwill and indefinite-lived intangible assets (certain trade names) are not amortized but are reviewed at least annually for impairment or earlier, if an indication of impairment exists. Goodwill is allocated entirely to our Education reporting unit. Determining the fair value of a reporting unit is judgmental in nature, and involves the use of significant estimates and assumptions. These estimates and assumptions may include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions, the determination of appropriate market comparables as well as the fair value of individual assets and liabilities.

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We have the option of first assessing qualitative factors to determine whether it is necessary to perform the current two-step impairment test or we can perform the two-step impairment test without performing the qualitative assessment. The Education reporting unit did not experience any significant adverse changes in its business or reporting structures or any other adverse changes, and since the reporting unit s fair value substantially exceeded its carrying value from when the previous Step 1 analysis was performed, we performed the qualitative Step 0 assessment. In performing the qualitative Step 0 assessment, we considered certain events and circumstances specific to the reporting unit and to the entity as a whole, such as macroeconomic conditions, industry and market considerations, overall financial performance and cost factors when evaluating whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount.

Recoverability of goodwill and indefinite lived intangibles can also be evaluated using a two-step process. In the first step, the fair value of a reporting unit is compared to its carrying value. If the fair value of a reporting unit exceeds the carrying value of the net assets assigned to a reporting unit, goodwill is considered not impaired and no further testing is required. If the carrying value of the net assets assigned to a reporting unit exceeds the fair value of a reporting unit, the second step of the impairment test is performed in order to determine the implied fair value of a reporting unit s goodwill. Determining the implied fair value of goodwill requires valuation of a reporting unit s tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, goodwill is deemed impaired and is written down to the extent of the difference. We estimate total fair value of each reporting unit using discounted cash flow analysis, and make assumptions regarding future net sales, gross margins, working capital levels, investments in new products, capital spending, tax, cash flows and the terminal value of the reporting unit. With regard to other intangibles with indefinite lives, we determine the fair value by asset, which is then compared to its carrying value to determine if the assets are impaired.

We completed our annual goodwill and indefinite-lived intangible asset impairment tests as of October 1, 2015, 2014, and 2013. In 2015, we performed the qualitative Step 0 assessment for goodwill and determined that it is more likely than not that the fair value of the reporting unit exceeds its carrying amount, and we performed the two-step process for indefinite lived intangible assets. In 2014 and 2013, we used an income approach to establish the fair value of the reporting unit as and used the most recent five year strategic plan as the initial basis of our analysis. We recorded a non-cash impairment charge of $0.4 million and $0.5 million for the years ended December 31, 2014 and 2013, respectively. The impairments principally related to two specific tradenames within the Trade Publishing segment in 2014 and 2013. The impairment charges resulted primarily from a decline in revenue from previously projected amounts as a result of the economic downturn and reduced educational spending by states and school districts. No goodwill and indefinite-lived intangible assets were deemed to be impaired for the year ended December 31, 2015.

Publishing Rights

A publishing right is an acquired right that allows us to publish and republish existing and future works as well as create new works based on previously published materials. We determine the fair market value of the publishing rights arising from business combinations by discounting the after-tax cash flows projected to be derived from the publishing rights and titles to their net present value using a rate of return that accounts for the time value of money and the appropriate degree of risk. The useful life of the publishing rights is based on the lives of the various copyrights involved. We calculate amortization using the percentage of the projected operating income before taxes derived from the titles in the current year as a percentage of the

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total estimated operating income before taxes over the remaining useful life. Acquired publication rights, as well as customer-related intangibles with definitive lives, are primarily amortized on an accelerated basis over periods ranging from three to 20 years.

Impairment of Other Long-lived Assets

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

Severance

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

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

Royalty Advances

Royalty advances to authors are capitalized and represent amounts paid in advance of the sale of an author s product and are recovered as earned. As advances are recorded, a partial reserve may be recorded immediately based primarily upon historical sales experience. Advances are evaluated periodically to determine if they are expected to be recovered. Any portion of a royalty advance that is not expected to be recovered is fully reserved. Cash payments for royalty advances are included within cash flows from operating activities, under the caption Royalties, net, in our consolidated statements of cash flows.

Income Taxes

We record income taxes using the asset and liability method. Deferred income tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax basis, and operating loss and tax credit carryforwards. Our consolidated financial statements contain certain deferred tax assets which have arisen primarily as a result of interest expense limitations, as well as other temporary differences between financial and tax accounting. We establish a valuation allowance if the likelihood of realization of the deferred tax assets is reduced based on an evaluation of

objective verifiable evidence. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against those deferred tax assets. We evaluate the weight of all available evidence to determine whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized.

We also evaluate any uncertain tax positions and only recognize the tax benefit from an uncertain tax position if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial

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statements from such positions are then measured based on the largest benefit that has a greater than 50 percent likelihood of being realized upon settlement. We record a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. Any change in judgment related to the expected ultimate resolution of uncertain tax positions is recognized in earnings in the period in which such change occurs. Interest and penalties, if any, related to unrecognized tax benefits are recorded in income tax expense.

During 2015, we retrospectively early adopted updated accounting guidance related to the balance sheet classification of deferred taxes, which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities be classified as noncurrent on the balance sheet. We reclassified approximately $20.5 million of our current deferred tax assets to noncurrent deferred tax liabilities as of December 31, 2014. This resulted in an approximately $20.5 million decrease to our noncurrent deferred tax liability of $112.2 million on our December 31, 2014 consolidated balance sheet.

Stock-Based Compensation

Certain employees and directors have been granted stock options, restricted stock and restricted stock units in our common stock. Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date and recognized over the relevant service period. We estimate the fair value of each stock-based award on the measurement date using the current market price based on the target value of the award for restricted stock and restricted stock units, and the Black-Scholes valuation model for stock options. We recognize stock-based compensation expense over the awards requisite service period on a straight-line basis for time based stock options, restricted stock and restricted stock units and on a graded basis for restricted stock that are contingent on the achievement of performance conditions.

Comprehensive Loss

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

Foreign Currency Translation

The functional currency for each of our subsidiaries is the currency of the primary economic environment in which the subsidiary operates, generally defined as the currency in which the entity generates and expends cash. Foreign currency denominated assets and liabilities are translated into United States dollars at current rates as of the balance sheet date and the revenue, costs and expenses are translated at the average rates established during each reporting period. Cumulative translation gains or losses are recorded in equity as an element of accumulated other

comprehensive income.

Financial Instruments

Derivative financial instruments are employed to manage risks associated with interest rate exposures and are not used for trading or speculative purposes. We recognize all derivative instruments in our consolidated balance sheets at fair value. Changes in the fair value of derivatives are recognized periodically either in earnings or in stockholders equity as a component of accumulated other comprehensive loss, depending on

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whether the derivative financial instrument qualifies for hedge accounting and, if so, whether it qualifies as a fair value hedge or a cash flow hedge. Gains and losses on derivatives designated as hedges, to the extent they are effective, are recorded in other comprehensive income, and subsequently reclassified to earnings to offset the impact of the hedged items when they occur. Changes in the fair value of derivatives not qualifying as hedges are reported in earnings. During 2015, our interest rate swaps were designated as hedges and qualify for hedge accounting under the accounting guidance related to derivatives and hedging. Accordingly, we recorded an unrealized loss of $3.6 million in our statements of comprehensive loss to account for the changes in fair value of these derivatives during the period. The corresponding $3.6 million hedge liability is included within long-term other liabilities in our consolidated balance sheet as of December 31, 2015. We had no interest rate derivative contracts outstanding as of December 31, 2014. Our foreign exchange forward and option contracts did not qualify for hedge accounting because we did not contemporaneously document our hedging strategy upon entering into the hedging arrangements. There were no derivative instruments that qualified for hedge accounting during 2014 and 2013.

Treasury Stock

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

Net Loss per Share

Basic net loss per share attributable to common stockholders is computed by dividing net loss attributable to common stockholders by the weighted-average common shares outstanding during the period. Except where the result would be anti-dilutive, net loss per share is computed using the treasury stock method for the exercise of stock options. For periods in which the Company has reported net losses, diluted net loss per share attributable to common stockholders is the same as basic net loss per share attributable to common stockholders, since dilutive common shares are not assumed to have been issued if their effect is anti-dilutive. Diluted net loss per share attributable to common stockholders is the same as basic net loss per share attributable to common stockholders for the years ended December 31, 2015, 2014 and 2013.

Reclassifications

Certain 2014 and 2013 amounts within the operating activities section of the statement of cash flows, as well as the income tax statutory rate reconciliation in Note 8, have been reclassified to conform to the current year presentation.

Recent Accounting Pronouncements

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

In November 2015, the Financial Accounting Standards Board (FASB) issued updated accounting guidance related to the balance sheet classification of deferred taxes, which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities be classified as noncurrent on the balance sheet. The guidance is effective for reporting periods beginning after December 15, 2016, with early adoption permitted and may be adopted either prospectively or retrospectively. We early adopted this standard retrospectively, and reclassified approximately $20.5 million of our current deferred tax assets to

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noncurrent deferred tax liabilities as of December 31, 2014. This resulted in an approximately $20.5 million decrease to our noncurrent deferred tax liability of $112.2 million on our December 31, 2014 consolidated balance sheet.

In September 2015, the FASB issued new accounting guidance which replaces the current guidance that an acquirer in a business combination account for measurement period adjustments retrospectively with a requirement that an acquirer recognize adjustments to the provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The accounting guidance requires that an acquirer record, in the same period s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. This guidance will be effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The guidance is to be applied prospectively to adjustments to provisional amounts that occur after the effective date of the guidance, with earlier application permitted for financial statements that have not been issued. Our early adoption of the accounting guidance in the third quarter of 2015 did not have a material impact on our consolidated financial statements and footnote disclosures.

In August 2015, the FASB issued guidance to defer the effective date of the new accounting guidance related to revenue recognition by one year to December 15, 2017 for annual reporting periods beginning after that date and permitted early adoption of the standard, but not before fiscal years beginning after the original effective date of December 15, 2016. This new accounting standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective beginning January 1, 2018 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. We are in the process of evaluating the impact that the adoption of this new revenue recognition standard will have on our consolidated financial statements and footnote disclosures.

In April 2015, the FASB issued new accounting guidance related to simplifying the presentation of debt issuance costs. This standard amends existing guidance to require the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred charge, consistent with debt discounts. The SEC later clarified guidance in August 2015 stating that debt issuance costs related to line-of-credit arrangements may be presented as an asset and subsequently amortized ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The recognition and measurement guidance for debt issuance costs are not affected by the new accounting guidance. The new guidance will be effective for annual reporting periods beginning after December 15, 2015, but early adoption is permitted. We evaluated the impact of adopting this standard and do not expect it to have a material impact on our consolidated financial statements and footnote disclosures.

3. Acquisitions

On April 23, 2015, we entered into a stock and asset purchase agreement with Scholastic Corporation (Scholastic) to acquire certain assets (including the stock of two of Scholastic s subsidiaries) comprising its Educational Technology and Services (EdTech) business. On May 29, 2015, we completed the acquisition and paid an aggregate purchase price of $575.0 million in cash to Scholastic, subject to

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adjustments for working capital. $34.5 million of the purchase price was deposited into an escrow account to be held for 18 months as security for potential indemnification obligations of Scholastic. Portions of such escrow is released periodically during the 18-month period.

The acquisition provided us with a leading position in intervention curriculum and services and extends our product offerings in key growth areas, including educational technology, early learning, and education services, creating a more comprehensive offering for students, teachers and schools.

The transaction was accounted for under the acquisition method of accounting. Accordingly, the results of operations of the purchased assets of EdTech are included in our consolidated financial statements from the date of acquisition.

We have allocated the purchase price to the EdTech assets acquired and liabilities assumed at estimated fair values as of May 29, 2015. The excess of the purchase price over the net of amounts assigned to the fair value of the assets acquired and the liabilities assumed has been recorded as goodwill, which is allocated to our Education segment. The goodwill recognized is primarily the result of expected synergies. All of the goodwill and identifiable intangibles associated with the acquisition will be deductible for tax purposes. During the fourth quarter of 2015, we finalized the assumed liabilities in connection with certain working capital adjustments, recorded as a measurement period adjustment, reducing the purchase price by approximately $0.9 million through a reduction to goodwill. The fair values set forth below are final.

The valuation of assets and liabilities has been determined and the purchase price has been allocated as follows:

Accounts receivable, net of allowance for bad debts and book returns of $2.2 million	$ 31,237
Inventories	13,714
Prepaid expenses and other assets	803
Property, plant, and equipment	1,725
Pre-publication costs	98,610
Royalty advances to authors	1,093
Goodwill	250,152
Other intangible assets	214,030
Other assets	28
Accounts payable	(8,117)
Royalties payable	(2,573)
Deferred revenue	(20,189)
Other accruals	(5,680)

Total purchase price	$ 574,833

The $214.0 million of other intangible assets included $54.7 million of tradenames amortizable over 20 years, and $159.3 million of customer relationships amortizable over 25 years. The tradenames are being amortized on a straight-line basis and the customer relationships over the pattern in which the economic benefits of the intangible is expected to be realized. The fair value of the other intangible assets was primarily derived using the income approach. The rate used to discount the net cash flows to their present value was based upon the weighted average cost of capital of 9.6%. This discount rate was determined based on the Capital Asset Pricing Model, which looks at the risk free rate and applies a market risk premium, business risk premium and size risk premium to the risk free rate to calculate the cost of equity. The

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weighted average cost of capital considers the cost of equity and a market participant cost of debt and capital structure. The tradenames were valued using a relief from royalty method and the customer relationships were valued using a multi-period excess earning method.

Transaction costs related to the acquisition were approximately $5.2 million during the year ended December 31, 2015 and are included in the selling and administrative line item in our consolidated statements of operations.

The unaudited pro forma information presented in the following table summarizes the consolidated results of operations for the periods presented as if the acquisition of EdTech had occurred on January 1, 2014. The pro forma financial information is presented for comparative purposes only and is not necessarily indicative of the results of operations that actually would have been achieved if the acquisition had occurred at the beginning of the periods, nor is it intended to be a projection of future results. For each period presented, the pro forma results include estimates of the interest expense on debt used to finance the acquisition, the amortization of the other intangible assets recorded in connection with the acquisition, the impact of the write-down of acquired deferred revenue to fair value and the related tax effects of the adjustments.

	Unaudited	
	Year Ended December 31, 2015	**Year Ended December 31, 2014**
Net sales	$ 1,486,810	$ 1,595,803
Net loss	(144,830)	(115,177)

Since the date of acquisition, May 29, 2015, we recorded approximately $142.2 million of net sales and $25.9 million of operating income attributable to EdTech within our consolidated statements of operations.

On July 31, 2015, we acquired select ebook and technology assets of MeeGenius, which is an ebook subscription service for children up to eight years of age. The aggregate purchase price was approximately $0.5 million. The acquisition provided us with digital content for parents and young learners and supports our strategic focus on the direct to consumer market. There was no goodwill recorded and the aggregate purchase price was recorded to pre-publication costs.

On May 12, 2014, we completed the acquisition of certain assets and liabilities of Channel One News, which is a digital content provider dedicated to encouraging kids to be informed, digitally-savvy global citizens. The acquisition allows for continued development of high-quality digital content for students, teachers and parents across multiple modalities, and brings video and cross-media production capabilities to HMH.

On May 19, 2014, we completed the acquisition of 100% of the stock of Curiosityville, which is an online personalized learning environment that helps children ages 3-8 learn through playful exploration and discovery both at home and in pre-school settings. The acquisition also includes its proprietary data collection and analytics engine, the Learning Tree, which provides real-time information on individual learners and personalized recommendations for learning, both online and offline.

On June 30, 2014, we completed the acquisition of 100% of the stock of School Chapters, which is an educational solutions provider dedicated to standards-based education quality management, accreditation services and community-based resources for educators and learners across the pre-K-12 and college spectrum.

The total aggregate purchase price for the three 2014 acquisitions described above was approximately $9.5 million, which consisted of cash at closing of approximately $9.1 million, and amounts in accrued liabilities

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of approximately $0.4 million. Goodwill, other intangible assets, accounts receivable, property, plant, and equipment, other assets and other liabilities recorded as part of the acquisitions totaled approximately $1.1 million, $0.2 million, $3.1 million, $6.8 million, $0.4 million and $1.7 million, respectively.

All transactions above were accounted for under the acquisition method of accounting. We allocated the purchase price to each of the assets and liabilities acquired at estimated fair values as of the acquisition date. The excess of the purchase price over the net amounts assigned to the fair value of the assets acquired and liabilities assumed was recorded as goodwill. The financial results of each company acquired were included within our financial statements from their respective dates of acquisition. The acquisitions, other than EdTech, were not considered to be material for purposes of additional disclosure.

In 2013, we made a $1.5 million investment in preferred stock. Based on impairment indicators, we were required to remeasure the fair value of our 2013 investment with any resulting gain or loss recognized in the statement of operations. Based on the implied fair value of the investment, we recorded an impairment charge of approximately $1.3 million during the year ended December 31, 2014 relating to the fair value remeasurement.

4. Balance Sheet Information
Short-term Investments

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

	December 31, 2015			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Short-term investments:				
U.S. Government and agency securities	$ 198,204	$ 1	$ (59)	$ 198,146

	December 31, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Short-term investments:				
U.S. Government and agency securities	$ 286,853	$ 10	$ (99)	$ 286,764

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

Account Receivable

Accounts receivable at December 31, 2015 and 2014 consisted of the following:

	2015	2014
Accounts receivable	$ 288,846	$ 283,453
Allowance for bad debt	(8,459)	(5,625)
Reserve for book returns	(24,288)	(22,159)
	$ 256,099	$ 255,669

As of December 31, 2015 and 2014, no individual customer comprised more than 10% of our accounts receivable, net balance. We believe that our accounts receivable credit risk exposure is limited and we have not experienced significant write-downs in our accounts receivable balances.

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Inventories

Inventories at December 31, 2015 and 2014 consisted of the following:

	2015	2014
Finished goods	$ 166,904	$ 178,812
Raw materials	4,542	5,149
Inventory	$ 171,446	$ 183,961

Property, Plant, and Equipment

Balances of major classes of assets and accumulated depreciation and amortization at December 31, 2015 and 2014 were as follows: