Houghton Mifflin Harcourt Co
Form 10-Q
August 04, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

OR

¨ **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	**27-1566372**
(State or other jurisdiction of incorporation or organization)	**(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)

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 number of shares of common stock, par value $0.01 per share, outstanding as of July 29, 2016 was 122,284,893.

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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, the impact of acquisitions 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 our Annual Report on Form 10-K for the year ended December 31, 2015. 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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PART 1 FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (Unaudited)

Houghton Mifflin Harcourt Company

Consolidated Balance Sheets (Unaudited)

(in thousands of dollars, except share information)	**June 30, 2016**	**December 31, 2015**
Assets		
Current assets		
Cash and cash equivalents	$ 98,010	$ 234,257
Short-term investments		198,146
Accounts receivable, net of allowance for bad debts and book returns of $28.6 million and $32.7 million, respectively	347,173	256,099
Inventories	218,924	171,446
Prepaid expenses and other assets	30,193	22,877
Total current assets	694,300	882,825
Property, plant, and equipment, net	175,469	149,680
Pre-publication costs, net	324,995	321,931
Royalty advances to authors, net	47,398	44,736
Goodwill	783,073	783,073
Other intangible assets, net	868,605	912,955
Deferred income taxes	3,540	3,540
Other assets	24,667	23,210
Total assets	$ 2,922,047	$ 3,121,950
Liabilities and Stockholders Equity		
Current liabilities		
Current portion of long-term debt	$ 8,000	$ 8,000
Accounts payable	124,183	94,483
Royalties payable	85,006	85,766
Salaries, wages, and commissions payable	33,537	45,340
Deferred revenue	209,717	231,172
Interest payable	106	106
Severance and other charges	5,797	4,894
Accrued postretirement benefits	1,910	1,910
Other liabilities	38,796	34,937
Total current liabilities	507,052	506,608
Long-term debt, net of discount and issuance costs	767,011	769,283
Long-term deferred revenue	444,715	440,625
Accrued pension benefits	21,748	23,726

Accrued postretirement benefits	22,621	23,657
Deferred income taxes	169,062	139,810
Other liabilities	27,944	19,920
Total liabilities	1,960,153	1,923,629
Commitments and contingencies (Note 12)		
Stockholders equity		
Preferred stock, $0.01 par value: 20,000,000 shares authorized; no shares issued and outstanding at June 30, 2016 and December 31, 2015		
Common stock, $0.01 par value: 380,000,000 shares authorized; 146,507,175 and 145,613,978 shares issued at June 30, 2016 and December 31, 2015, respectively; 122,201,789 and 123,940,510 shares outstanding at June 30, 2016 and December 31, 2015, respectively	1,466	1,456
Treasury stock, 24,305,386 and 21,673,468 shares as of June 30, 2016 and December 31, 2015, respectively, at cost (related parties of $193,493 in 2016 and 2015)	(514,031)	(463,013)
Capital in excess of par value	4,850,537	4,833,388
Accumulated deficit	(3,327,321)	(3,133,782)
Accumulated other comprehensive loss	(48,757)	(39,728)
Total stockholders equity	961,894	1,198,321
Total liabilities and stockholders equity	$ 2,922,047	$ 3,121,950

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

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Houghton Mifflin Harcourt Company

Consolidated Statements of Operations (Unaudited)

(in thousands of dollars, except share and per share information)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Net sales	$ 392,042	$ 379,883	$ 597,858	$ 542,552
Costs and expenses				
Cost of sales, excluding publishing rights and pre-publication amortization	173,466	168,076	278,984	264,645
Publishing rights amortization	14,413	19,148	32,206	42,291
Pre-publication amortization	31,315	27,909	59,596	54,372
Cost of sales	219,194	215,133	370,786	361,308
Selling and administrative	184,479	170,687	353,154	313,696
Other intangible asset amortization	5,968	4,261	12,144	7,479
Severance and other charges	3,553	985	5,130	2,042
Operating loss	(21,152)	(11,183)	(143,356)	(141,973)
Other income (expense)				
Interest expense, net	(9,402)	(6,160)	(18,735)	(12,114)
Change in fair value of derivative instruments	(619)	369	165	(1,851)
Loss on extinguishment of debt		(2,173)		(2,173)
Loss before taxes	(31,173)	(19,147)	(161,926)	(158,111)
Income tax expense (benefit)	(2,782)	(11,404)	31,613	9,572
Net loss	$ (28,391)	$ (7,743)	$ (193,539)	$ (167,683)
Net loss per share attributable to common stockholders				
Basic	$ (0.23)	$ (0.06)	$ (1.58)	$ (1.19)
Diluted	$ (0.23)	$ (0.06)	$ (1.58)	$ (1.19)
Weighted average shares outstanding				
Basic	122,143,971	139,961,856	122,520,786	141,090,469
Diluted	122,143,971	139,961,856	122,520,786	141,090,469

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 (Unaudited)

(in thousands of dollars, except share and per share information)	**Three Months Ended June 30, 2016**	**Three Months Ended June 30, 2015**	**Six Months Ended June 30, 2016**	**Six Months Ended June 30, 2015**
Net loss	$ (28,391)	$ (7,743)	$ (193,539)	$ (167,683)
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustments, net of tax	(257)	(182)	(210)	(1,191)
Unrealized gain (loss) on short-term investments, net of tax	(3)		57	
Net change in unrealized loss on derivative financial instruments, net of tax	(2,848)		(8,876)	
Other comprehensive loss, net of taxes	(3,108)	(182)	(9,029)	(1,191)
Comprehensive loss	$ (31,499)	$ (7,925)	$ (202,568)	$ (168,874)

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 (Unaudited)

	Six Months Ended June 30,	
(in thousands of dollars)	**2016**	**2015**
Cash flows from operating activities		
Net loss	$ (193,539)	$ (167,683)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization expense	141,680	140,327
Amortization of debt discount and deferred financing costs	2,090	4,369
Deferred income taxes	29,252	6,272
Stock compensation	6,673	6,812
Loss on extinguishment of debt		2,173
Change in fair value of derivative instruments	(165)	1,851
Changes in operating assets and liabilities, net of acquisitions		
Accounts receivable	(91,073)	(137,770)
Inventories	(47,478)	(32,050)
Other assets	(9,800)	(4,349)
Accounts payable and accrued expenses	12,137	(6,606)
Royalties, net	(3,422)	9,974
Deferred revenue	(17,365)	41,397
Interest payable		154
Severance and other charges	328	(2,208)
Accrued pension and postretirement benefits	(3,014)	(2,699)
Other liabilities	4,919	5,259
Net cash used in operating activities	(168,777)	(134,777)
Cash flows from investing activities		
Proceeds from sales and maturities of short-term investments	197,724	286,732
Additions to pre-publication costs	(65,232)	(45,484)
Additions to property, plant, and equipment	(56,238)	(31,356)
Acquisition of business, net of cash acquired		(577,717)
Net cash provided by (used in) investing activities	76,254	(367,825)
Cash flows from financing activities		
Proceeds from term loan, net of discount		796,000
Payments of long-term debt	(4,000)	(243,125)
Payments of deferred financing fees		(13,670)
Repurchases of common stock (related parties of $183,537 in 2015)	(51,018)	(191,238)
Tax withholding payments related to net share settlements of restricted stock units	(1,039)	(124)
Proceeds from stock option exercises	11,220	17,588
Issuance of common stock under employee stock purchase plan	1,113	

Net cash (used in) provided by financing activities	(43,724)	365,431
Net decrease in cash and cash equivalents	(136,247)	(137,171)
Cash and cash equivalent at the beginning of the period	234,257	456,581
Cash and cash equivalent at the end of the period	$ 98,010	$ 319,410
Supplementary disclosure of cash flow information		
Pre-publication costs included in accounts payable (non-cash)	$ 11,984	$ 7,424
Property, plant, and equipment included in accounts payable (non-cash)	14,419	3,849
Property, plant, and equipment acquired under capital leases (non-cash)	199	2,453
Amounts due from seller for acquisition (non-cash)		2,034
Issuance of common stock upon exercise of warrants (non-cash)		1,815

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 (Unaudited)

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

1. Basis of Presentation

Houghton Mifflin Harcourt Company (HMH , Houghton Mifflin Harcourt , we , us , our , or the Company) is a 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 consolidated financial statements of HMH include the accounts of all of our wholly-owned subsidiaries as of June 30, 2016 and December 31, 2015 and the three and six month periods ended June 30, 2016 and June 30, 2015.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Certain information and note disclosures normally included in our annual financial statements prepared in accordance with GAAP have been condensed or omitted consistent with Article 10 of Regulation S-X. In the opinion of management, our unaudited consolidated financial statements and accompanying notes include all adjustments (consisting of normal recurring adjustments) considered necessary by management to fairly state the results of operations, financial position and cash flows for the interim periods presented. Interim results of operations are not necessarily indicative of the results for the full year or for any future period. These financial statements should be read in conjunction with the annual financial statements and the notes thereto also included therein.

During the six months ended June 30, 2016, we recorded out-of-period corrections of approximately $2.9 million increasing net sales and reducing deferred revenue that should have been recognized previously. Management believes these out-of-period corrections are not material to the current period financial statements or any previously issued financial statements.

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 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 and Estimates

Our financial results are affected by the selection and application of accounting policies and methods. There were no material changes in the three and six months ended June 30, 2016 to the application of significant accounting policies and estimates as described in our audited financial statements for the year ended December 31, 2015.

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3. 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 March 2016, the Financial Accounting Standards Board (FASB) issued guidance that changes the accounting for certain aspects of share-based payments to employees. The guidance requires the recognition of the income tax effects of awards in the income statement when the awards vest or are settled, thus eliminating additional paid-in capital pools. The guidance also allows for the employer to repurchase more of an employee s shares for tax withholding purposes without triggering liability accounting. In addition, the guidance allows for a policy election to account for forfeitures as they occur rather than on an estimated basis. The guidance is effective in 2017 with early adoption permitted. We are currently in the process of evaluating the impact of this guidance and we do not expect it to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued guidance that primarily requires lessees to recognize most leases on their balance sheets but record expenses on their income statements in a manner similar to current accounting. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. The guidance is effective in 2019 with early adoption permitted. We are currently in the process of evaluating the impact of this guidance 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. As the new standard will supersede substantially all existing revenue guidance, it could impact the revenue recognition on a significant amount of our contracts, in addition to our business processes and our information technology systems. Further, we will be required to capitalize incremental costs to acquire new contracts, whereas we currently expense those costs as incurred. We expect to have our evaluation of the impact of the new standard complete in 2017.

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 is effective for annual reporting periods beginning after December 15, 2015. We retrospectively adopted this standard during the first quarter of 2016.

4. 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 adjustments for working capital.

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.

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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	
	Three Months Ended June 30, 2015	Six Months Ended June 30, 2015
Net sales	$ 410,308	$ 608,269
Net loss	(13,361)	(190,358)

5. Inventories

Inventories consisted of the following:

	June 30, 2016	December 31, 2015
Finished goods	$ 209,434	$ 166,904
Raw materials	9,490	4,542
Inventory	$ 218,924	$ 171,446

6. Goodwill and Other Intangible Assets

Goodwill and other intangible assets consisted of the following:

	June 30, 2016			December 31, 2015		
	Cost	Accumulated Amortization	Total	Cost	Accumulated Amortization	Total
Goodwill	$ 783,073	$	$ 783,073	$ 783,073	$	$ 783,073
Trademarks and tradenames: indefinite-lived	439,605		439,605	439,605		439,605
Trademarks and tradenames	54,730	(2,963)	51,767	54,730	(1,596)	53,134
Publishing rights	1,180,000	(1,002,773)	177,227	1,180,000	(970,567)	209,433

Customer related and other	442,640	(242,634)	200,006	442,640	(231,857)	210,783
	$ 2,900,048	$ (1,248,370)	$ 1,651,678	$ 2,900,048	$ (1,204,020)	$ 1,696,028

The changes in the carrying amount of goodwill for the period ended June 30, 2016 was as follows:

Balance at December 31, 2015	$ 783,073
Acquisitions	
Balance at June 30, 2016	$ 783,073

Amortization expense for publishing rights and customer related and other intangibles were $20.4 million and $23.4 million for the three months ended June 30, 2016 and 2015, respectively, and $44.3 million and $49.8 million for the six months ended June 30, 2016 and 2015, respectively.

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7. Debt

Our debt consisted of the following:

	June 30, 2016	December 31, 2015
$800,000 term loan due May 29, 2021 interest payable quarterly (net of discount and issuance costs)	$ 775,011	$ 777,283
Less: Current portion of long-term debt	8,000	8,000
Total long-term debt, net of discount and issuance costs	$ 767,011	$ 769,283

Term Loan Facility

In connection with our closing of the EdTech acquisition referred to in Note 4, we entered into an amended and restated term loan credit facility (the Term Loan Facility) dated May 29, 2015 to 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. The Term Loan Facility matures on May 29, 2021 and the interest rate is based 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.

The Term Loan Facility may be prepaid, in whole or in part, at any time, without premium. The 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 Term Loan Facility immediately prior to the first quarterly payment date.

The Term Loan Facility was issued at a discount equal to 0.5% of the outstanding borrowing commitment. As of June 30, 2016, the interest rate of the Term Loan Facility was 4.0%.

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

We are subject to Excess Cash Flow provisions under our Term Loan Facility which are predicated upon our leverage ratio and cash flow.

On May 29, 2015, in connection with the Term Loan Facility described above, we paid off the remaining outstanding balance of our previous $250.0 million term loan facility of approximately $178.9 million. The transaction was accounted for under the guidance for debt modifications and extinguishments. We incurred a loss on extinguishment of debt of approximately $2.2 million related to the write off of the portion of the unamortized deferred financing fees associated with the portion of the term loan accounted for as extinguishment associated with the term loan facility. We incurred approximately $15.6 million of third-party fees for the transaction, of which approximately $13.6 million were capitalized as deferred financing fees and approximately $2.0 million was recorded to expense and included in the selling and administrative line item in our consolidated statements of operations for the year ended December 31, 2015.

In accordance with the Excess Cash Flow provisions of the previous term loan facility, we made a $63.6 million principal payment on March 5, 2015. In connection with this principal payment, we accelerated the amortization of deferred financing costs of $2.0 million, which was recognized as interest expense in the consolidated statements of operations for the six months ended June 30, 2015.

Interest Rate Hedging

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 had $400.0 million outstanding as of June 30, 2016. We assessed at inception, and re-assess on an ongoing basis, whether the interest rate derivative contracts are highly effective in offsetting changes in the fair value of the hedged variable rate debt.

These 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 $8.9 million in our statements of comprehensive loss to account for the changes in fair value of these derivatives during the six months ended June 30, 2016. The total hedge liability of $12.5 million is included within long-term other liabilities in our consolidated balance sheet as of June 30, 2016. The interest rate derivative contracts mature on July 22, 2020.

Revolving Credit Facility

On July 22, 2015, we entered into an amended and restated revolving credit facility (the Revolving Credit Facility). The Revolving Credit Facility provides borrowing availability in an amount equal to the lesser of either $250.0 million or a borrowing base that is computed monthly and comprised of the borrowers and the guarantors eligible inventory and receivables. The 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 Revolving Credit Facility may be prepaid, in whole or in part, at any time, without premium. The transaction was accounted for under the accounting guidance for modifications to or exchanges of revolving debt arrangements. We incurred a loss on extinguishment of debt of approximately $0.9 million in the third quarter of 2015 related to the write off of the portion of the unamortized deferred financing fees associated with the portion of the Revolving Credit Facility accounted for as an extinguishment. We incurred approximately $1.6 million of third-party fees which were capitalized as deferred financing fees.

The Revolving Credit Facility requires the Company to maintain a minimum fixed charge coverage ratio of 1.0 to 1.0 on a trailing four-quarter basis only during certain periods commencing when excess availability under the Revolving Credit Facility is less than certain limits prescribed by the terms of the Revolving Credit Facility. The 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 Revolving Credit Facility is subject to customary events of default. No amounts have been drawn on the Revolving Credit Facility as of June 30, 2016.

As of June 30, 2016, the minimum fixed charge coverage ratio covenant under our Revolving Credit Facility was not applicable, due to our level of borrowing availability.

Guarantees and Security

Under both the Revolving Credit Facility and the 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 our senior secured credit 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 Borrowers 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.

8. Severance and Other Charges

2016

During the six months ended June 30, 2016, $2.8 million of severance payments were made to employees whose employment ended in 2016 and prior years and $2.0 million of net payments for office space no longer utilized by the Company. Further, we recorded an expense in the amount of $5.7 million to reflect additional costs for severance, which we expect to be paid over the next twelve months, along with a favorable $0.6 million accrual adjustment for vacated space.

2015

During the six months ended June 30, 2015, $1.9 million of severance payments were made to employees whose employment ended in 2015 and prior years and $2.4 million of net payments for office space no longer utilized by the Company. Further, we recorded an expense in the amount of $1.6 million to reflect additional costs for severance, which we expect to be paid over the next twelve months, along with a $0.4 million accrual for vacated space.

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A summary of the significant components of the severance/restructuring and other charges is as follows:

	2016			
	Severance/ restructuring accrual at December 31, 2015	**Severance/ restructuring expense**	**Cash payments**	**Severance/ restructuring accrual at June 30, 2016**
Severance costs	$ 1,455	$ 5,750	$ (2,804)	$ 4,401
Other accruals	5,251	(620)	(1,998)	2,633
	$ 6,706	$ 5,130	$ (4,802)	$ 7,034

	2015			
	Severance/ restructuring accrual at December 31, 2014	**Severance/ restructuring expense**	**Cash payments**	**Severance/ restructuring accrual at June 30, 2015**
Severance costs	$ 1,271	$ 1,642	$ (1,854)	$ 1,059
Other accruals	9,050	400	(2,396)	7,054
	$ 10,321	$ 2,042	$ (4,250)	$ 8,113

The current portion of the severance and other charges was $5.8 million and $4.9 million as of June 30, 2016 and December 31, 2015, respectively.

9. Income Taxes

The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment, including, but not limited to, the expected operating income for the year, projections of the proportion of income earned and taxed in various jurisdictions, permanent and temporary differences and the likelihood of recovering deferred tax assets generated in the current year. The accounting estimates used to compute the provision for income taxes may change as new events occur, more experience is acquired, additional information is obtained or as the tax environment changes.

At the end of each interim period, we estimate the annual effective tax rate and apply that rate to our ordinary quarterly earnings. The amount of interim tax benefit recorded for the year-to-date ordinary loss is limited to the amount that is expected to be realized during the year or recognizable as a deferred tax asset at year end. The tax expense or benefit related to significant, unusual or extraordinary items that will be separately reported or reported net of their related tax effect, are individually computed, and are recognized in the interim period in which those items occur. In addition, the effect of changes in enacted tax laws or rates or tax status is recognized in the interim period in which the change occurs.

For the three months ended June 30, 2016 and 2015, we recorded an income tax benefit of $2.8 million and $11.4 million, respectively, and for the six months ended June 30, 2016 and 2015, we recorded an income tax expense of approximately $31.6 million and $9.6 million, respectively. 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 8.9% and 59.6% for the three months ended June 30, 2016 and 2015, respectively, and (19.5)% and (6.1)% for the six months ended June 30, 2016 and 2015, respectively.

Reserves for unrecognized tax benefits, excluding accrued interest and penalties, were $16.4 and $16.3 million at June 30, 2016 and December 31, 2015, respectively.

10. Retirement and Postretirement Benefit Plans

We have a noncontributory, qualified defined benefit pension plan (the Retirement Plan), which covers certain employees. The Retirement Plan is a cash balance plan, which accrues benefits based on pay, length of service, and interest. The funding policy is to contribute amounts subject to minimum funding standards set forth by the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. The Retirement Plan s assets consist principally of common stocks, fixed income securities, investments in registered investment companies, and cash and cash equivalents. We also have a nonqualified defined benefit plan, or Nonqualified Plan, that previously covered employees who earned over the qualified pay limit as determined

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by the Internal Revenue Service. The Nonqualified Plan accrues benefits for the participants based on the cash balance plan calculation. The Nonqualified Plan is not funded. We use a December 31 date to measure the pension and postretirement liabilities. In 2007, both the qualified and nonqualified pension plans eliminated participation in the plans for new employees hired after October 31, 2007.

We are required to recognize the funded status of defined benefit pension and other postretirement plans as an asset or liability in the balance sheet and are required to recognize actuarial gains and losses and prior service costs and credits in other comprehensive income and subsequently amortize those items in the statement of operations. Further, we are required to use a measurement date equal to the fiscal year-end.

Net periodic benefit cost (credit) for our pension and other postretirement benefits plans consisted of the following:

	Pension Plans Six Months Ended June 30,	
	2016	**2015**
Interest cost	$ 2,612	$ 3,359
Expected return on plan assets	(4,576)	(4,878)
Amortization of net loss	24	165
Net periodic benefit (credit) cost	$ (1,940)	$ (1,354)

	Other Post Retirement Plans Six Months Ended June 30,	
	2016	**2015**
Service cost	$ 82	$ 103
Interest cost	438	541
Amortization of prior service cost	(670)	(691)
Amortization of net loss	44	110
Net periodic benefit (credit) cost	$ (106)	$ 63

There were no contributions to the pension plans for the six months ended June 30, 2016 and June 30, 2015, and we do not expect to make a contribution to the pension plans during 2016.

11. Fair Value Measurements

The accounting standard for fair value measurements, among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. The accounting standard establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

Level 1	Observable input such as quoted prices in active markets for identical assets or liabilities;
Level 2	Observable inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
Level 3	Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques identified in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

(a) Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;

(b) Cost approach: Amount that would be currently required to replace the service capacity of an asset (current replacement cost); and

(c) Income approach: Valuation techniques to convert future amounts to a single present amount based on market expectations (including present value techniques).

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On a recurring basis, we measure certain financial assets and liabilities at fair value, including our money market funds, short-term investments which consist of U.S. treasury securities and U.S. agency securities, foreign exchange forward and option contracts, and interest rate derivatives contracts. The accounting standard for fair value measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. In determining fair value, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as consider counterparty and its credit risk in its assessment of fair value.

Financial Assets and Liabilities

The following tables present our financial assets and liabilities measured at fair value on a recurring basis at June 30, 2016 and December 31, 2015:

	2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Valuation Technique
Financial assets				
Money market funds	$ 45,916	$ 45,916	$	(a)
	$ 45,916	$ 45,916	$	
Financial liabilities				
Foreign exchange derivatives	165		165	(a)
Interest rate derivatives	12,517		12,517	(a)
	$ 12,682	$	$ 12,682	

	2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Valuation Technique
Financial assets				
Money market funds	$ 175,465	$ 175,465	$	(a)
U.S. treasury securities	8,994	8,994		(a)
U.S. agency securities	189,152		189,152	(a)
	$ 373,611	$ 184,459	$ 189,152	
Financial liabilities				
Foreign exchange derivatives	$ 340	$	$ 340	(a)

Interest rate derivatives		3,641				3,641	(a)
	$	3,981	$		$	3,981	

Our money market funds and U.S. treasury securities are classified within Level 1 of the fair value hierarchy because they are valued using quoted prices in active markets for identical instruments. Our U.S. agency securities are classified within Level 2 of the fair value hierarchy because they are valued using other than quoted prices in active markets. In addition to $45.9 million and $175.5 million invested in money market funds as of June 30, 2016 and December 31, 2015, respectively, we had $52.1 million and $58.8 million of cash in bank accounts as of June 30, 2016 and December 31, 2015, respectively.

Our foreign exchange derivatives consist of forward contracts and are classified within Level 2 of the fair value hierarchy because they are valued based on observable inputs and are available for substantially the full term of our derivative instruments. We use foreign exchange forward contracts to fix the functional currency value of forecasted commitments, payments and receipts. The aggregate notional amount of the outstanding foreign exchange forward contracts was $17.9 million and $17.5 million at June 30, 2016 and December 31, 2015, respectively. Our foreign exchange forward contracts contain netting provisions to mitigate credit risk in the event of counterparty default, including payment default and cross default. At June 30, 2016 and December 31, 2015, the fair value of our counterparty default exposure was less than $1.0 million and spread across several highly rated counterparties.

Our interest rate derivatives instruments are classified within Level 2 of the fair value hierarchy because they are valued based on observable inputs and are available for substantially the full term of our derivative instruments. Our interest rate risk relates

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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 by converting floating-rate debt into fixed-rate debt. We designate these derivative instruments either as fair value or cash flow hedges under the accounting guidance related to derivatives and hedging. We record changes in the value of fair value hedges in interest expense, which is generally offset by changes in the fair value of the hedged debt obligation. Interest payments made or received related to our interest rate derivative instruments are included in interest expense. We record the effective portion of any change in the fair value of derivative instruments designated as cash flow hedges as unrealized gains or losses in other comprehensive income, net of tax, until the hedged cash flow occurs, at which point the effective portion of any gain or loss is reclassified to earnings. We record the ineffective portion of our cash flow hedges in interest expense. In the event the hedged cash flow does not occur, or it becomes no longer probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to interest expense at that time. The aggregate notional amount of the outstanding interest rate derivative instruments was $400.0 million as of June 30, 2016.

We do not have significant concentrations of credit risk arising from our interest rate derivatives financial instruments, whether from an individual counterparty or a related group of counterparties. We manage the concentration of counterparty credit risk on our interest rate derivatives instruments by limiting acceptable counterparties to a diversified group of major financial institutions with investment grade credit ratings, limiting the amount of credit exposure to each counterparty, and actively monitoring their credit ratings and outstanding fair values on an ongoing basis. Furthermore, none of our derivative transactions contain provisions that are dependent on our credit ratings from any credit rating agency.

We also employ master netting arrangements that reduce our counterparty payment settlement risk on any given maturity date to the net amount of any receipts or payments due between us and the counterparty financial institution. Thus, the maximum loss due to counterparty credit risk is limited to the unrealized gains in such contracts net of any unrealized losses should any of these counterparties fail to perform as contracted. Although these protections do not eliminate concentrations of credit risk, as a result of the above considerations, we do not consider the risk of counterparty default to be significant.

Non-Financial Assets and Liabilities

There were no impairments related to our non-financial assets and there were no non-financial liabilities measured at fair value on a non-recurring basis during the six months ended June 30, 2016.

There were no non-financial assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2015.

Our non-financial assets, which include goodwill, other intangible assets, property, plant, and equipment, and pre-publication costs, are not required to be measured at fair value on a recurring basis. However, if certain trigger events occur, or if an annual impairment test is required, we evaluate the nonfinancial assets for impairment. If an impairment did occur, the asset is required to be recorded at the estimated fair value. An impairment analysis was not performed for the preparation of this report, as there were no triggering events for the six months ended June 30, 2016.

Fair Value of Debt

The following table presents the carrying amounts and estimated fair market values of our debt at June 30, 2016 and December 31, 2015. The fair value of debt is deemed to be the amount at which the instrument could be exchanged in an orderly transaction between market participants at the measurement date.

	June 30, 2016		December 31, 2015	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Debt				
Term loan	$ 775,011	$ 759,511	$ 777,283	$ 752,021

The fair market values of our debt were estimated based on quoted market prices on a private exchange for those instruments that are traded and are classified as Level 2 within the fair value hierarchy at June 30, 2016 and December 31, 2015. The fair market values require varying degrees of management judgment. The factors used to estimate these values may not be valid on any subsequent date. Accordingly, the fair market values of the debt presented may not be indicative of their future values.

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12. Commitments and Contingencies

There were no material changes in our commitments under contractual obligations, as disclosed in our audited consolidated financial statements for the year ended December 31, 2015.

We are involved in ordinary and routine litigation and matters incidental to our business. Litigation alleging infringement of copyrights and other intellectual property rights has become extensive in the educational publishing industry. 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 textbooks. During the second quarter of 2016, we settled all such pending or actively threatened litigations alleging infringement of copyrights, and will make total settlement payments of $10.0 million collectively, with $4.0 million to be paid during the third quarter of 2016 and $6.0 million to be paid during the first quarter of 2017.

We were contingently liable for $9.3 million and $9.4 million of performance-related surety bonds for our operating activities as of June 30, 2016 and December 31, 2015, respectively. An aggregate of $31.8 million and $31.9 million of letters of credit existed as of June 30, 2016 and December 31, 2015, respectively, of which $2.4 million and $2.5 million backed the aforementioned performance-related surety bonds as of June 30, 2016 and December 31, 2015, respectively.

We routinely enter into standard indemnification provisions as part of license agreements involving use of our intellectual property. These provisions typically require us to indemnify and hold harmless licensees in connection with any infringement claim by a third party relating to the intellectual property covered by the license agreement. The assessment business routinely enters into contracts with customers that contain provisions requiring us to indemnify the customer against a broad array of potential liabilities resulting from any breach of the contract or the invalidity of the test. Although the term of these provisions and the maximum potential amounts of future payments we could be required to make is not limited, we have never incurred any costs to defend or settle claims related to these types of indemnification provisions. We therefore believe the estimated fair value of these provisions is inconsequential, and have no liabilities recorded for them as of June 30, 2016 and December 31, 2015.

Concentration of Credit Risk and Significant Customers

As of June 30, 2016 and December 31, 2015, 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.

13. Net Loss Per Share

The following table sets forth the computation of basic and diluted earnings per share (EPS):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Numerator				
Net loss attributable to common stockholders	$ (28,391)	$ (7,743)	$ (193,539)	$ (167,683)

Denominator				
Weighted average shares outstanding				
Basic	122,143,971	139,961,856	122,520,786	141,090,469
Diluted	122,143,971	139,961,856	122,520,786	141,090,469
Net loss per share attributable to common stockholders				
Basic	$ (0.23)	$ (0.06)	$ (1.58)	$ (1.19)
Diluted	$ (0.23)	$ (0.06)	$ (1.58)	$ (1.19)

As we incurred a net loss in each of the periods presented above, all outstanding stock options, restricted stock, and restricted stock units for those periods have an anti-dilutive effect and therefore are excluded from the computation of diluted weighted average shares outstanding. Accordingly, basic and diluted weighted average shares outstanding are equal for such periods.

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The following table summarizes our weighted average outstanding common stock equivalents that were anti-dilutive attributable to common stockholders during the periods, and therefore excluded from the computation of diluted EPS:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Stock options	7,167,451	9,292,913	7,017,824	9,267,637
Restricted stock and restricted stock units	1,126,298	830,812	871,685	589,252
Warrants		7,344,388		7,356,338

14. Stockholders Equity
Stock Repurchase Program

Our Board of Directors has authorized the repurchase of up to $1.0 billion in aggregate value of the Company s common stock. The aggregate share repurchase program may be executed through December 31, 2018. Repurchases under the program may be made from time to time in the open market (including under a trading plan) or in 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.

The Company s share repurchase activity was as follows:

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2016
Cost of repurchases (in thousands)	$ 20,020	$ 51,018
Shares repurchased	1,111,000	2,631,918
Average cost per share	$ 18.02	$ 19.38

As of June 30, 2016, there was approximately $486.0 million available for share repurchases under this authorization.

15. Segment Reporting

As of June 30, 2016, we had two reportable segments (Education and Trade Publishing). Our Education segment provides educational products, technology platforms and services to meet the diverse needs of today s classrooms. These products and services include print and digital content in the form of textbooks, digital courseware, instructional aids, educational assessment and intervention solutions, which are aimed at improving achievement and supporting learning for students that are not keeping pace with peers, professional development and school reform services. Our Trade Publishing segment 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.

We measure and evaluate our reportable segments based on net sales and segment Adjusted EBITDA. We exclude from our segments certain corporate-related expenses, as our corporate functions do not meet the definition of a segment, as defined in the accounting guidance relating to segment reporting. In addition, certain transactions or adjustments that our Chief Operating Decision Maker considers to be non-operational, such as amounts related to goodwill and other intangible asset impairment charges, derivative instruments charges, acquisition-related activity, restructuring/integration costs, severance, separation costs and facility closures, equity compensation charges, debt extinguishment losses, legal settlement charges, amortization and depreciation expenses, as well as interest and taxes, are excluded from segment Adjusted EBITDA. Although we exclude these amounts from segment Adjusted EBITDA, they are included in reported consolidated net loss and are included in the reconciliation below.

(in thousands)	Three Months Ended June 30,		
	Education	Trade Publishing	Corporate/ Other
2016			
Net sales	$ 353,384	$ 38,658	$
Segment Adjusted EBITDA	85,267	322	(10,186)
2015			
Net sales	$ 342,441	$ 37,442	$
Segment Adjusted EBITDA	86,452	412	(7,208)

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(in thousands)	Six Months Ended June 30, Education	Trade Publishing	Corporate/ Other
2016			
Net sales	$ 527,689	$ 70,169	$
Segment Adjusted EBITDA	61,208	(3,365)	(23,635)
2015			
Net sales	$ 471,311	$ 71,241	$
Segment Adjusted EBITDA	49,105	(728)	(20,542)

Reconciliation of Segment Adjusted EBITDA to the consolidated statements of operations is as follows:

(in thousands)	Three Months Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Total Segment Adjusted EBITDA	$ 75,403	$ 79,656	$ 34,208	$ 27,835
Interest expense	(9,402)	(6,160)	(18,735)	(12,114)
Depreciation expense	(19,390)	(17,776)	(37,734)	(36,185)
Amortization expense	(51,696)	(51,318)	(103,946)	(104,142)
Non-cash charges stock-compensation	(3,670)	(3,717)	(6,673)	(6,812)
Non-cash charges gain (loss) on derivative instrument	(619)	369	165	(1,851)
Purchase accounting adjustments	(1,236)	(877)	(3,088)	(1,074)
Fees, expenses or charges for equity offerings, debt or acquisitions	(812)	(15,515)	(979)	(18,892)
Restructuring/Integration	(6,198)	(651)	(10,014)	(661)
Severance, separation costs and facility closures	(3,553)	(985)	(5,130)	(2,042)
Loss on extinguishment of debt		(2,173)		(2,173)
Legal settlement	(10,000)		(10,000)	
Net loss before taxes	(31,173)	(19,147)	(161,926)	(158,111)
Provision (benefit) for income taxes	(2,782)	(11,404)	31,613	9,572
Net loss	$ (28,391)	$ (7,743)	$ (193,539)	$ (167,683)

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

The following discussion and analysis of the financial condition and results of operations of HMH should be read in conjunction with the interim unaudited consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited financial statements and the related notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the Securities Exchange Commission (the SEC) on February 25, 2016. This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, as amended. See Special Note Regarding Forward-Looking Statements included elsewhere in this Quarterly Report on Form 10-Q.

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.

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.

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.

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.

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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 online interactive digital content, digital and online learning components along with undelivered work-texts, workbooks and services. The work-texts, workbooks and services 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 billings being deferred compared to historical levels.

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 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 over the past several years, as the industry evolved 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
- 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 publishing of bestsellers along with obtaining recognized authors;
- 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; and
- market growth or contraction.

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 and purchased social studies and high school math materials in 2015. California adopted math materials in 2013, with purchases beginning in 2014 and continuing through 2016, and adopted English language arts materials in 2015 for purchase beginning in 2016 and continuing through 2018. 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 a leading 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 50.3% worldwide over the 10-year period from 2004 to 2014. 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.

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 evolved 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 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 and platform 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.

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 approximately 25% annually through March of 2023.

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 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, sampling and advertising. We expect our selling and administrative costs in dollars to increase as we continue to invest in new growth initiatives.

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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 three and six months ended June 30, 2016 was $6.0 million and $12.1 million, respectively.

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 three and six months ended June 30, 2016 was $9.4 million and $18.7 million, respectively.

Results of Operations

Consolidated Operating Results for the Three Months Ended June 30, 2016 and 2015

(dollars in thousands)	For the Three Months Ended June 30, 2016	For the Three Months Ended June 30, 2015	Dollar Change	Percent Change
Net sales	$ 392,042	$ 379,883	$ 12,159	3.2%
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization	173,466	168,076	5,390	3.2%
Publishing rights amortization	14,413	19,148	(4,735)	(24.7)%
Pre-publication amortization	31,315	27,909	3,406	12.2%
Cost of sales	219,194	215,133	4,061	1.9%
Selling and administrative	184,479	170,687	13,792	8.1%
Other intangible assets amortization	5,968	4,261	1,707	40.1%
Severance and other charges	3,553	985	2,568	NM
Operating loss	(21,152)	(11,183)	(9,969)	(89.1)%
Other income (expense):				
Interest expense	(9,402)	(6,160)	(3,242)	(52.6)%
Change in fair value of derivative instruments	(619)	369	(988)	NM
Loss on extinguishment of debt		(2,173)	2,173	NM
Loss before taxes	(31,173)	(19,147)	(12,026)	(62.8)%
Income tax benefit	(2,782)	(11,404)	8,622	75.6%

Net loss	$ (28,391)	$ (7,743)	$ (20,648)	NM

NM = not meaningful

Net sales for the three months ended June 30, 2016 increased $12.2 million, or 3.2%, from $379.9 million for the same period in 2015 to $392.0 million. The net sales increase was driven by the $18.9 million incremental contribution from the EdTech business which was acquired in May 2015. Further, there was a $11.0 million increase in net sales of the international business due primarily to Department of Defense sales, and to a lesser extent, greater sales in the Asian Pacific and Canada regions, and $1.2 million of higher Trade Publishing net sales due to bestselling titles *The Whole30* and *Weber s New American Barbecue*. Partially offsetting this increase was a decline in domestic education net sales of $12.9 million due to a smaller new adoption market in 2016 versus 2015 and $6.0 million lower net sales of clinical and formative assessment products.

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Operating loss for the three months ended June 30, 2016 changed unfavorably by $10.0 million from an operating loss of $11.2 million for the same period in 2015 to a loss of $21.2 million, due primarily to the following:

An increase in selling and administrative costs of $13.8 million due to approximately $15.0 million of incremental fixed and discretionary expenses attributed to the EdTech business coupled with an increase in legal settlements and integration expenses largely offset by lower transactional expenses due to prior year equity and acquisition activity,

A $5.4 million increase to our cost of sales, excluding publishing rights and pre-publication amortization, which was due to higher volume. Our cost of sales, excluding publishing rights and pre-publication amortization, as a percentage of net sales, remained consistent at 44.2%,

A $2.6 million increase in severance and other charges due to continued restructuring activities, and

Partially offsetting the aforementioned was an increase in net sales of $12.2 million.

Interest expense for the three months ended June 30, 2016 increased $3.2 million, from $6.2 million for the same period in 2015 to $9.4 million, primarily as a result of the increase to our outstanding term loan credit facility from $178.9 million to $800.0 million, all of which was drawn at closing of the EdTech business acquisition in May 2015.

Change in fair value of derivative instruments for the three months ended June 30, 2016 unfavorably changed by $1.0 million from a gain of $0.4 million for the same period in 2015 to an expense of $0.6 million in 2016. The change in fair value of derivative instruments was related to foreign exchange forward and option contracts executed on the Euro that were unfavorably impacted by the stronger U.S. dollar against the Euro during the quarter.

Income tax benefit for the three months ended June 30, 2016 changed $8.6 million, from a benefit of $11.4 million for the same period in 2015, to a benefit of $2.8 million in 2016. For 2016, our annual effective tax rate, exclusive of discrete items used to calculate the tax provision, is expected to be approximately (19.5)% which is primarily attributed to the movement in the deferred tax liability associated with tax amortization on indefinite-lived intangibles, and state and foreign taxes. For 2015, the annual effective tax rate was estimated to be (6.1)% due to similar items impacting the tax rate. The increase in the rate in 2016 from 2015 is due to the higher deferred tax liability associated with tax amortization on indefinite-lived intangibles partially resulting from the acquisition of the EdTech business. 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.

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Consolidated Operating Results for the Six Months Ended June 30, 2016 and 2015

(dollars in thousands)	For the Six Months Ended June 30, 2016	For the Six Months Ended June 30, 2015	Dollar Change	Percent Change
Net sales	$ 597,858	$ 542,552	$ 55,306	10.2%
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization	278,984	264,645	14,339	5.4%
Publishing rights amortization	32,206	42,291	(10,085)	(23.8)%
Pre-publication amortization	59,596	54,372	5,224	9.6%
Cost of sales	370,786	361,308	9,478	2.6%
Selling and administrative	353,154	313,696	39,458	12.6%
Other intangible assets amortization	12,144	7,479	4,665	62.4%
Severance and other charges	5,130	2,042	3,088	NM
Operating loss	(143,356)	(141,973)	(1,383)	(1.0)%
Other income (expense):				
Interest expense	(18,735)	(12,114)	(6,621)	(54.7)%
Change in fair value of derivative instruments	165	(1,851)	2,016	NM
Loss on extinguishment of debt		(2,173)	2,173	NM
Loss before taxes	(161,926)	(158,111)	(3,815)	(2.4)%
Income tax expense	31,613	9,572	22,041	NM
Net loss	$ (193,539)	$ (167,683)	$ (25,856)	(15.4)%

NM = not meaningful

Net sales for the six months ended June 30, 2016 increased $55.3 million, or 10.2%, from $542.6 million for the same period in 2015 to $597.9 million. The net sales increase was driven by the $54.0 million incremental contribution from the EdTech business which was acquired in May 2015. Further, there was a $11.0 million increase in net sales of the international business due primarily to Department of Defense sales, and to a lesser extent, greater sales in the Asian Pacific and Canada regions. Partially offsetting this increase was $9.0 million of lower net sales of clinical and formative assessment products. Further, there was $1.1 million of lower Trade Publishing net sales due to lower eBook sales offset to an extent by frontlist titles *The Whole30, Weber s New American Barbecue*, *Meathead* and *Ted Talks*.

Operating loss for the six months ended June 30, 2016 changed unfavorably $1.4 million from an operating loss of $142.0 million for the same period in 2015 to $143.4 million, due primarily to the following:

A $14.3 million increase to our cost of sales, excluding publishing rights and pre-publication amortization, of which $26.9 million was due to higher volume partially offset by favorability in our cost of sales, excluding publishing rights and pre-publication amortization, as a percentage of net sales, which decreased to 46.7% from 48.8%, resulting in a $12.6 million improvement to the operating loss. A substantial portion of this improvement was due to the increased recognition of previously deferred digital billings which carries lower cost along with the low product cost associated with the EdTech digital products,

A $39.5 million increase in selling and administrative costs due to approximately $36.0 million of incremental fixed and discretionary expenses attributed to the EdTech business. Further there was additional expenses relating to legal settlements and integration activity which were partially offset by lower transactional expenses due to prior year equity and acquisition activity,

Additionally, there was a $3.1 million increase in severance and other charges attributed to cost reduction activities in the current year, and

Partially offsetting the operating loss increase was an increase in net sales of $55.3 million.

Interest expense for the six months ended June 30, 2016 increased $6.6 million, from $12.1 million for the same period in 2015 to $18.7 million, 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 business acquisition in May 2015.

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Change in fair value of derivative instruments for the six months ended June 30, 2016 favorably changed by $2.0 million from an expense of $1.9 million for the same period in 2015 to a gain of $0.2 million in 2016. The change in fair value of derivative instruments was related to favorable foreign exchange forward and option contracts executed on the Euro that were favorably impacted by the weaker U.S. dollar against the Euro during the comparative six months.

Income tax expense for the six months ended June 30, 2016 increased $22.0 million, from an expense of $9.6 million for the same period in 2015 to $31.6 million in 2016. For 2016, our annual effective tax rate, exclusive of discrete items used to calculate the tax provision, is expected to be approximately (19.5)% which is primarily attributed to the movement in the deferred tax liability associated with tax amortization on indefinite-lived intangibles, and state and foreign taxes. For 2015, the effective tax rate method was estimated to be (6.1)% due to similar items impacting the tax rate. The increase in the rate in 2016 from 2015 is due to the higher deferred tax liability associated with tax amortization on indefinite-lived intangibles partially resulting from the acquisition of the EdTech business. 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.

Adjusted EBITDA

To supplement our financial statements presented in accordance with GAAP, we have presented Adjusted EBITDA, which is 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 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 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, separation and facility closure costs, acquisition-related activity costs, and restructuring/integration costs. Accordingly, our management believes that this measurement is useful for comparing general operating performance from period to period. In addition, targets in Adjusted EBITDA (further adjusted to include changes in deferred revenue and exclude pre-publication costs spend) are used as performance measures to determine certain compensation of management and Adjusted EBITDA is used as the base for calculations relating to incurrence covenants in our debt agreements. Other companies may define Adjusted EBITDA differently and, as a result, our measure of Adjusted EBITDA may not be directly comparable to Adjusted EBITDA of other companies. Although we use Adjusted EBITDA as a financial measure to assess the performance of our business, the use of Adjusted EBITDA is limited because it does not include certain material costs, such as interest and taxes, necessary to operate our business. Adjusted EBITDA should be considered in addition to, and not as a substitute for, net loss/income in accordance with GAAP as a measure of performance. Adjusted EBITDA is 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.

Below is a reconciliation of our net loss to Adjusted EBITDA for the three and six months ended June 30, 2016 and 2015:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	$ (28,391)	$ (7,743)	$ (193,539)	$ (167,683)
Interest expense	9,402	6,160	18,735	12,114

Provision (benefit) for income taxes	(2,782)	(11,404)	31,613	9,572
Depreciation expense	19,390	17,776	37,734	36,185
Amortization expense	51,696	51,318	103,946	104,142
Non-cash charges stock compensation	3,670	3,717	6,673	6,812
Non-cash charges (gain) loss on derivative instrument	619	(369)	(165)	1,851
Purchase accounting adjustments	1,236	877	3,088	1,074
Fees, expenses or charges for equity offerings, debt or acquisitions	812	15,515	979	18,892
Restructuring/Integration	6,198	651	10,014	661
Severance, separation costs and facility closures	3,553	985	5,130	2,042
Loss on extinguishment of debt		2,173		2,173
Legal settlement	10,000		10,000	
Adjusted EBITDA	$ 75,403	$ 79,656	$ 34,208	$ 27,835

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Segment Operating Results

Results of Operations Comparing Three Months Ended June 30, 2016 and 2015

Education

	Three Months Ended June 30, 2016	2015	Dollar Change	Percent Change
Net sales	$ 353,384	$ 342,441	$ 10,943	3.2%
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization	147,263	142,664	4,599	3.2%
Publishing rights amortization	12,299	16,751	(4,452)	(26.6)%
Pre-publication amortization	31,220	27,762	3,458	12.5%
Cost of sales	190,782	187,177	3,605	1.9%
Selling and administrative	136,025	128,697	7,328	5.7%
Other intangible asset amortization	5,110	3,482	1,628	46.8%
Operating income	21,467	23,085	(1,618)	(7.0)%
Net income	$ 21,467	$ 23,085	$ (1,618)	(7.0)%
Adjustments from net loss to Education segment Adjusted EBITDA				
Depreciation expense	$ 13,935	$ 14,494	$ (559)	(3.9)%
Amortization expense	48,629	47,996	633	1.3%
Purchase accounting adjustments	1,236	877	359	40.9%
Education segment Adjusted EBITDA	$ 85,267	$ 86,452	$ (1,185)	(1.4)%
Education segment Adjusted EBITDA as a % of net sales	24.1%	25.2%		

NM = not meaningful

Our Education segment net sales for the three months ended June 30, 2016 increased $10.9 million, or 3.2%, from $342.4 million for the same period in 2015 to $353.4 million. The net sales increase was driven by the $18.9 million incremental contribution from the EdTech business which was acquired in May 2015. Further, there was a $11.0 million increase in net sales of the international business due primarily to Department of Defense sales, and to a lesser extent, greater sales in the Asian Pacific and Canada regions. Partially offsetting this increase was a decline in domestic education net sales of $13.0 million due to a smaller new adoption market in 2016 versus 2015 and $6.0 million lower net sales primarily related to lower clinical and formative assessment products.

Our Education segment cost of sales for the three months ended June 30, 2016 increased $3.6 million, or 1.9%, from $187.2 million for the same period in 2015 to $190.8 million. Our cost of sales, excluding publishing rights and pre-publication amortization, increased $4.6 million from $142.7 million in 2015 to $147.3 million in 2016, which was due to higher volume. As a percent of net sales, the cost of sales, excluding publishing rights and pre-publication amortization, remained consistent at 41.7%.

Our Education segment selling and administrative expense for the three months ended June 30, 2016 increased $7.3 million, or 5.7%, from $128.7 million for the same period in 2015 to $136.0 million. The increase was due to $15.0 million of fixed and discretionary expenses attributed to the EdTech business and higher sampling costs of $1.2 million partially offset by $4.6 million of lower commission expenses attributed to lower billings and $1.2 million of lower depository fees.

Our Education segment Adjusted EBITDA for the three months ended June 30, 2016 declined $1.2 million, or 1.4%, from $86.5 million for the same period in 2015 to $85.3 million in 2016. Our Education segment Adjusted EBITDA excludes depreciation, amortization and purchase accounting adjustments. The purchase accounting adjustments primarily relates to the acquisition of the EdTech business. The decline is due to the identified factors impacting net sales, cost of sales and selling and administrative expenses after removing those items not included in Education segment Adjusted EBITDA. Education Segment Adjusted EBITDA as a percentage of net sales was 24.1% and 25.2% of net sales for each of the three months ended June 30, 2016 and 2015, respectively.

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Trade Publishing

	Three Months Ended June 30, 2016	2015	Dollar Change	Percent Change
Net sales	$ 38,658	$ 37,442	$ 1,216	3.2%
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization	26,203	25,412	791	3.1%
Publishing rights amortization	2,114	2,397	(283)	(11.8)%
Pre-publication amortization	95	147	(52)	(35.4)%
Cost of sales	28,412	27,956	456	1.6%
Selling and administrative	12,281	11,848	433	3.7%
Other intangible asset amortization	858	779	79	10.1%
Operating loss	(2,893)	(3,141)	248	7.9%
Net loss	$ (2,893)	$ (3,141)	$ 248	7.9%
Adjustments from net loss to Trade Publishing segment Adjusted EBITDA				
Depreciation expense	$ 148	$ 231	$ (83)	(35.9)%
Amortization expense	3,067	3,322	(255)	(7.7)%
Trade Publishing segment Adjusted EBITDA	$ 322	$ 412	$ (90)	(21.8)%
Trade Publishing segment Adjusted EBITDA as a % of net sales	0.8%	1.1%		

NM = not meaningful

Our Trade Publishing segment net sales for the three months ended June 30, 2016 increased $1.2 million, or 3.2%, from $37.4 million for the same period in 2015 to $38.7 million. The increase in net sales was driven by strong net sales of current year and prior year frontlist culinary titles such as *The Whole 30*, *Weber s New American Barbecue*, *Meathead* and *Ted Talks*. Partially offsetting the increase was a decline in net sales of eBooks attributed to fewer movie tie-ins of bestselling eBook titles coupled with lower eBook subscription revenue.

Our Trade Publishing segment cost of sales for the three months ended June 30, 2016 increased $0.5 million, 1.6%, from $28.0 million for the same period in 2015 to $28.4 million. The increase is due to higher net sales volume offset by lower amortization expense of publishing rights due to our use of accelerated amortization methods. As a percent of net sales, our cost of sales, excluding publishing rights and pre-publication amortization, was 67.8% for the three months ended June 30, 2016 and 2015.

Our Trade Publishing segment selling and administrative expense for the three months ended June 30, 2016 increased $0.4 million, or 3.7%, from $11.8 million for the same period in 2015 to $12.3 million. The increase was primarily related to higher advertising and promotion expense and rent expense associated with a new office.

Our Trade Publishing segment Adjusted EBITDA for the three months ended June 30, 2016 decreased $0.1 million from $0.4 million for the same period in 2015 to $0.3 million. Our Trade Publishing segment Adjusted EBITDA excludes depreciation and amortization costs. Our Trade Publishing segment Adjusted EBITDA and as a percentage of net sales was 0.8% for the three months ended June 30, 2016, which was an unfavorable change from 1.1% for the same period in 2015 due to the identified factors impacting net sales, cost of sales and selling and administrative expenses after removing those items not included in Trade Publishing segment Adjusted EBITDA.

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Corporate and Other

	Three Months Ended June 30, 2016	2015	Dollar Change	Percent Change
Net sales	$	$	$	NM
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization				NM
Publishing rights amortization				NM
Pre-publication amortization				NM
Cost of sales				NM
Selling and administrative	36,173	30,142	6,031	20.0%
Severance and other charges	3,553	985	2,568	NM
Operating loss	(39,726)	(31,127)	(8,599)	(27.6)%
Interest expense	(9,402)	(6,160)	(3,242)	(52.6)%
Change in fair value of derivative instruments	(619)	369	(988)	NM
Loss on extinguishment of debt		(2,173)	2,173	NM
Loss before taxes	(49,747)	(39,091)	(10,656)	(27.3)%
Income tax benefit	(2,782)	(11,404)	8,622	75.6%
Net loss	$ (46,965)	$ (27,687)	$ (19,278)	(69.6)%
Adjustments from net loss to Corporate and Other segment Adjusted EBITDA				
Interest expense	$ 9,402	$ 6,160	$ 3,242	52.6%
Provision (benefit) for income taxes	(2,782)	(11,404)	8,622	75.6%
Depreciation expense	5,307	3,051	2,256	73.9%
Non-cash charges (gain) loss on derivative instruments	619	(369)	988	NM
Non-cash charges stock compensation	3,670	3,717	(47)	(1.3)%
Fees, expenses or charges for equity offerings, debt or acquisitions	812	15,515	(14,703)	(94.8)%
Restructuring/Integration	6,198	651	5,547	NM
Severance, separation costs and facility closures	3,553	985	2,568	NM
Loss on extinguishment of debt		2,173	(2,173)	NM
Legal settlement	10,000		10,000	NM
Corporate and Other segment Adjusted EBITDA	$ (10,186)	$ (7,208)	$ (2,978)	(41.3)%

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 selling and administrative expense for the Corporate and Other category for the three months ended June 30, 2016 increased $6.0 million, or 20.0%, from $30.1 million for the same period in 2015 to $36.2 million. The increase was primarily due $2.3 million of higher depreciation as a result of our increased investment in business systems, technology platforms and infrastructure. Additionally, we incurred expenses relating to a legal settlement and the cost of integrating the EdTech business partially offset by lower transaction expenses due to the prior year equity and acquisition activity.

Our interest expense for the three months ended June 30, 2016 increased $3.2 million from $6.2 million for the same period in 2015 to $9.4 million in 2016, primarily as a result of the increase to our outstanding term loan credit facility from $178.9 million to $800.0 million, all of which was drawn at closing of the EdTech acquisition in May 2015.

Our change in fair value of derivative instruments for the three months ended June 30, 2016 unfavorably changed by $1.0 million from a gain of $0.4 million in 2015 to an expense of $0.6 million in 2016. The change in fair value of derivative instruments was related to unfavorable foreign exchange forward and option contracts executed on the Euro that were unfavorably impacted by the stronger U.S. dollar against the Euro during the quarter as compared to the same period last year.

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Income tax benefit for the three months ended June 30, 2016 changed $8.6 million, from a benefit of $11.4 million for the same period in 2015, to a benefit of $2.8 million in 2016. For 2016, our annual effective tax rate, exclusive of discrete items used to calculate the tax provision, is expected to be approximately (19.5)% which is primarily attributed to the movement in the deferred tax liability associated with tax amortization on indefinite-lived intangibles, and state and foreign taxes. For 2015, the effective tax rate method was estimated to be (6.1)% due to similar items impacting the tax rate. The increase in the rate in 2016 from 2015 is due to the higher deferred tax liability associated with tax amortization on indefinite-lived intangibles partially resulting from the acquisition of the EdTech business. 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.

Adjusted EBITDA for the Corporate and Other category for the three months ended June 30, 2016, unfavorably changed $3.0 million, or 41.3%, from a loss of $7.2 million for the same period in 2015 to a loss of $10.2 million. Our Adjusted EBITDA for the Corporate and Other category excludes interest, taxes, depreciation, derivative instruments charges, equity compensation charges, acquisition-related activity, restructuring costs, severance and facility vacant space costs, debt extinguishment losses and legal settlement charges. The unfavorable change 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.

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Results of Operations Comparing Six Months Ended June 30, 2016 and 2015

Education

	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015	Dollar Change	Percent Change
Net sales	$ 527,689	$ 471,311	$ 56,378	12.0%
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization	229,437	215,560	13,877	6.4%
Publishing rights amortization	27,790	37,239	(9,449)	(25.4)%
Pre-publication amortization	59,420	54,093	5,327	9.8%
Cost of sales	316,647	306,892	9,755	3.2%
Selling and administrative	267,886	237,701	30,185	12.7%
Other intangible asset amortization	10,428	5,886	4,542	77.2%
Operating loss	(67,272)	(79,168)	11,896	15.0%
Net loss	$ (67,272)	$ (79,168)	$ 11,896	15.0%
Adjustments from net loss to Education segment Adjusted EBITDA				
Depreciation expense	$ 27,754	$ 29,980	$ (2,226)	(7.4)%
Amortization expense	97,638	97,219	419	0.4%
Purchase accounting adjustments	3,088	1,074	2,014	NM
Education segment Adjusted EBITDA	$ 61,208	$ 49,105	$ 12,103	24.6%
Education segment Adjusted EBITDA as a % of net sales	11.6%	10.4%		

NM = not meaningful

Our Education segment net sales for the six months ended June 30, 2016 increased $56.4 million, or 12.0%, from $471.3 million for the same period in 2015 to $527.7 million. The net sales increase was driven by the $54.0 million incremental contribution from the EdTech business we acquired in May 2015. Further, there was a $11.0 million increase in net sales of the international business due primarily to Department of Defense sales, and to a lesser extent, greater sales in the Asian Pacific and Canada regions. Partially offsetting this increase was $9.0 million of lower net sales of clinical and formative assessment products.

Our Education segment cost of sales for the six months ended June 30, 2016 increased $9.8 million, or 3.2%, from $306.9 million for the same period in 2015 to $316.6 million. Our cost of sales, excluding publishing rights and pre-publication amortization, increased $13.9 million from $215.6 million in 2015 to $229.4 million in 2016, of which $25.8 million is attributed to higher net sales volume. As a percent of net sales, the cost of sales, excluding publishing rights and pre-publication amortization, decreased to 43.5% from 45.7%, resulting in an approximate $11.9 million improvement to the operating loss. The improvement was primarily attributed to the increased recognition of previously deferred digital billings which carries lower cost along with the low product cost associated with the EdTech digital products. Further offsetting the increase in the cost of sales was a net $4.1 million reduction of amortization cost due to the accelerated method of amortization of the publishing rights.

Our Education segment selling and administrative expense for the six months ended June 30, 2016 increased $30.2 million, or 12.7%, from $237.7 million for the same period in 2015 to $267.9 million. The increase was due to $36.0 million of fixed and discretionary expenses attributed to the EdTech business offset by lower commission expenses of $3.1 million attributed to lower billings and lower depository fees.

Our Education segment Adjusted EBITDA for the six months ended June 30, 2016 improved $12.1 million, or 24.6%, from $49.1 million for the same period in 2015 to $61.2 million. Our Education segment Adjusted EBITDA excludes depreciation, amortization and purchase accounting adjustments. The purchase accounting adjustments primarily relates to the acquisition of the EdTech business. The improvement is due to the identified factors impacting net sales, cost of sales and selling and administrative expenses after removing those items not included in Education segment Adjusted EBITDA. Education Segment Adjusted EBITDA as a percentage of net sales increased to 11.6% of net sales for the six months ended June 30, 2016 from 10.4% for the same period in 2015 primarily due to the factors identified in Education segment Adjusted EBITDA.

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Trade Publishing

	Six Months Ended June 30, 2016	2015	Dollar Change	Percent Change
Net sales	$ 70,169	$ 71,241	$ (1,072)	(1.5)%
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization	49,547	49,085	462	0.9%
Publishing rights amortization	4,416	5,052	(636)	(12.6)%
Pre-publication amortization	176	279	(103)	(36.9)%
Cost of sales	54,139	54,416	(277)	(0.5)%
Selling and administrative	24,343	23,314	1,029	4.4%
Other intangible asset amortization	1,716	1,593	123	7.7%
Operating loss	(10,029)	(8,082)	(1,947)	(24.1)%
Net loss	$ (10,029)	$ (8,082)	$ (1,947)	(24.1)%
Adjustments from net loss to Trade Publishing segment Adjusted EBITDA				
Depreciation expense	$ 356	$ 431	$ (75)	(17.4)%
Amortization expense	6,308	6,923	(615)	(8.9)%
Trade Publishing segment Adjusted EBITDA	$ (3,365)	$ (728)	$ (2,637)	NM
Trade Publishing segment Adjusted EBITDA as a % of net sales	(4.8)%	(1.0)%		

NM = not meaningful

Our Trade Publishing segment net sales for the six months ended June 30, 2016 decreased $1.1 million, or 1.5%, from $71.2 million for the same period in 2015 to $70.2 million. The decrease in net sales was driven by a decrease in net sales of eBooks attributed to fewer movie tie-ins of bestselling eBook titles coupled with lower eBook subscription revenue. Partially offsetting the decline were strong net sales of frontlist titles such as *The Whole 30*, *The Immortal Irishman*, Property Brothers *Dream Home, Weber s New American Barbecue*, *Meathead* and *Ted Talks*.

Our Trade Publishing segment cost of sales for the six months ended June 30, 2016 decreased $0.3 million, 0.5%, from $54.4 million for the same period in 2015 to $54.1 million. The decrease is due to lower net sales volume along with lower amortization expense of publishing rights due to our use of accelerated amortization methods, partially offset by higher production cost due to product mix. Cost of sales, excluding publishing rights and pre-publication amortization increased as a percent of net sales, from 68.9% in 2015 to 70.6% in 2016. The increase is attributed to the mix of products, as 2016 had lower eBook sales and higher sales of culinary product line which carries a higher cost.

Our Trade Publishing segment selling and administrative expense for the six months ended June 30, 2016 increased $1.0 million, or 4.4%, from $23.3 million for the same period in 2015 to $24.3 million. The increase was primarily related to higher advertising and promotion expense and salary related costs.

Our Trade Publishing segment Adjusted EBITDA for the six months ended June 30, 2016 decreased $2.6 million from a loss of $0.7 million for the same period in 2015 to a loss of $3.4 million. Our Trade Publishing segment Adjusted EBITDA excludes depreciation and amortization costs. As a percentage of net sales, our Trade Publishing segment Adjusted EBITDA was a loss of 4.8% for the six months ended June 30, 2016, which was an unfavorable change from a loss of 1.0% for the same period in 2015 due to the identified factors impacting net sales, cost of sales and selling and administrative expenses after removing those items not included in Trade Publishing segment Adjusted EBITDA.

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Corporate and Other

	Six Months Ended June 30, 2016	2015	Dollar Change	Percent Change
Net sales	$	$	$	NM
Costs and expenses:				
Cost of sales, excluding publishing rights and pre-publication amortization				NM
Publishing rights amortization				NM
Pre-publication amortization				NM
Cost of sales				NM
Selling and administrative	60,925	52,681	8,244	15.6%
Severance and other charges	5,130	2,042	3,088	NM
Operating loss	(66,055)	(54,723)	(11,332)	(20.7)%
Interest expense	(18,735)	(12,114)	(6,621)	(54.7)%
Change in fair value of derivative instruments	165	(1,851)	2,016	NM
Loss on extinguishment of debt		(2,173)	2,173	NM
Loss before taxes	(84,625)	(70,861)	(13,764)	(19.4)%
Income tax expense	31,613	9,572	22,041	NM
Net loss	$ (116,238)	$ (80,433)	$ (35,805)	(44.5)%
Adjustments from net loss to Corporate and Other segment Adjusted EBITDA				
Interest expense	$ 18,735	$ 12,114	$ 6,621	54.7%
Provision for income taxes	31,613	9,572	22,041	NM
Depreciation expense	9,624	5,774	3,850	66.7%
Non-cash charges (gain) loss on derivative instruments	(165)	1,851	(2,016)	NM
Non-cash charges stock compensation	6,673	6,812	(139)	(2.0)%
Fees, expenses or charges for equity offerings, debt or acquisitions	979	18,892	(17,913)	(94.8)%
Restructuring/Integration	10,014	661	9,353	NM
Severance, separation costs and facility closures	5,130	2,042	3,088	NM
Loss on extinguishment of debt		2,173	(2,173)	NM
Legal settlement	10,000		10,000	NM
Corporate and Other segment Adjusted EBITDA	$ (23,635)	$ (20,542)	$ (3,093)	(15.1)%

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 selling and administrative expense for the Corporate and Other category for the six months ended June 30, 2016 increased $8.2 million, or 15.6%, from $52.7 million for the same period in 2015 to $60.9 million. The increase was primarily due to an increase of $3.8 million of higher depreciation as a result of our increased investment in business systems, technology platforms and infrastructure. Additionally, an increase in legal settlements and integration expenses was largely offset by lower transaction expenses due to the prior year equity and acquisition activity.

Our interest expense for the six months ended June 30, 2016 increased $6.6 million from $12.1 million for the same period in 2015 to $18.7 million in 2016, 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.

Our change in fair value of derivative instruments for the six months ended June 30, 2016 favorably changed by $2.0 million from an expense of $1.9 million in 2015 to a benefit of $0.2 million in 2016. The gain on change in fair value of derivative instruments was related to favorable foreign exchange forward and option contracts executed on the Euro that were favorably impacted by the weaker U.S. dollar against the Euro during the quarter as compared to the same period last year.

Income tax expense for the six months ended June 30, 2016 increased $22.0 million, from an expense of $9.6 million for the same period in 2015, to $31.6 million in 2016. For 2016, our annual effective tax rate, exclusive of discrete items used to calculate the tax provision, is expected to be approximately (19.5)% which is primarily attributed to the movement in the deferred tax liability associated with tax amortization on indefinite-lived intangibles, and state and foreign taxes. For 2015, the effective tax rate method was estimated to be (6.1)% due to similar items impacting the tax rate. The increase in the rate in 2016 from 2015 is due to the higher deferred tax liability associated with tax amortization on indefinite-lived intangibles partially resulting from the acquisition of the EdTech business. 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.

Adjusted EBITDA for the Corporate and Other category for the six months ended June 30, 2016, unfavorably changed $3.1 million, or 15.1%, from a loss of $20.5 million for the same period in 2015 to a loss of $23.6 million. Our Adjusted EBITDA for the Corporate and Other category excludes interest, taxes, depreciation, derivative instruments charges, equity compensation charges, acquisition-related activity, restructuring/integration costs, severance and facility vacant space costs, debt extinguishment losses and legal settlement charges. The unfavorable change 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, 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 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.

Liquidity and Capital Resources

(in thousands)	**June 30, 2016**	**December 31, 2015**
Cash and cash equivalents	$ 98,010	$ 234,257
Short-term investments		198,146
Current portion of long-term debt	8,000	8,000
Long-term debt, net of discount and issuance costs	767,011	769,283

	For the Six Months Ended June 30, 2016	For the Six Months Ended June 30, 2015
Net cash used in operating activities	$ (168,777)	$ (134,777)
Net cash provided by (used in) investing activities	76,254	(367,825)
Net cash (used in) provided by financing activities	(43,724)	365,431

Operating activities

Net cash used in operating activities was $168.8 million for the six months ended June 30, 2016, a $34.0 million increase from the $134.8 million used in operating activities for the six months ended June 30, 2015. The increase in cash used in operating activities from 2015 to 2016 was primarily driven by unfavorable net changes in operating assets and liabilities of $25.9 million in addition to less profitable operations, net of non-cash items, of $8.1 million. The unfavorable net changes in operating assets and liabilities were primarily due to lower net deferrals of $58.8 million attributed to greater recognition of revenue attributed to the EdTech acquisition along with the product mix when compared to the prior year period, unfavorable changes in inventory of $15.4 million, unfavorable changes in royalties of $13.4 million due to volume and timing of payments, and net unfavorable changes in other operating assets and liabilities of $3.7 million. These unfavorable changes were partially offset by favorable changes in accounts receivable of $46.7 million attributed to greater billings in 2016 due to the EdTech acquisition and favorable changes in accounts payable of $18.7 million due to timing of disbursements.

Investing activities

Net cash provided by investing activities was $76.3 million for the six months ended June 30, 2016, an increase of $444.1 million from the $367.8 million used in investing activities for the six months ended June 30, 2015. The increase in proceeds was primarily due to the acquisition of the EdTech business in May 2015, partially offset by lower net proceeds from sales and maturities of short-term investments of $89.0 million compared to 2015. Further, capital investing expenditures related to pre-publication costs and property, plant and equipment increased by $44.6 million, due to capital spend pertaining to the EdTech business, which we acquired in May 2015 and increased spend on leasehold improvements related to various office moves, technology infrastructure and timing of spend.

Financing activities

Net cash used in financing activities was $43.7 million for the six months ended June 30, 2016, an increase of $409.1 million from the $365.4 million of net cash provided by financing activities for the six months ended June 30, 2015. The increase in cash used in financing activities was primarily due to the prior period benefiting from net proceeds of $796.0 million from our Term Loan Facility partially offset by an increase in principal payments on our previously existing term loan of $243.1 million in connection with the acquisition of the EdTech business in May 2015. Further, we incurred $13.7 million in the prior period for deferred financing fees related to the closing of the Term Loan Facility. In 2016, we made $4.0 million of principal payments under our Term Loan Facility. Offsetting the aforementioned, we incurred less cash expenditures of $140.2 million under our share repurchase program for our common stock during 2016 compared to the prior period. Also, we received $6.4 million of less proceeds during 2016 related to stock option exercises.

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 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 June 30, 2016, we had approximately $792.0 million ($775.0 million, net of discount and issuance costs) outstanding under the Term Loan Facility.

The 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 June 30, 2016, the interest rate of the Term Loan Facility was 4.0%.

The Term Loan Facility may be prepaid, in whole or in part, at any time, without premium. The 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 Term Loan Facility immediately prior to the first quarterly payment date.

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

The 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 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 Term Loan Facility.

We are subject to excess cash flow provisions under the Term Loan Facility that are predicated upon our leverage ratio and cash flow. The excess cash flow provision under the 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.

Revolving Credit Facility

On July 22, 2015, we entered into an amended and restated revolving credit facility (the Revolving Credit Facility) to, among other things, reduce the pricing, extend the maturity, conform certain terms to those of our Term Loan Facility and to provide greater availability and operational flexibility. The 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 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 Revolving Credit Facility on a dollar-for-dollar basis. As of June 30, 2016, we had approximately $31.8 million of outstanding letters of credit and approximately $200.7 million of borrowing availability under the Revolving Credit Facility. No loans have been drawn on the Revolving Credit Facility as of July 29, 2016.

The 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 Revolving Credit Facility may be prepaid, in whole or in part, at any time, without premium.

The 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 June 30, 2016, due to our level of borrowing availability.

The 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 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 Revolving Credit Facility.

General

We had $98.0 million of cash and cash equivalents and no short-term investments at June 30, 2016. We had $234.3 million of cash and cash equivalents and $198.1 million of short-term investments at December 31, 2015.

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, our Board of Directors authorized us 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 seek to, or be able to obtain future debt financing on favorable terms, if at all.

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Critical Accounting Policies and Estimates

Our financial results are affected by the selection and application of critical accounting policies and methods. There were no material changes in the six months ended June 30, 2016 to the application of critical accounting policies and estimates as described in our audited financial statements for the year ended December 31, 2015, which were included in our Annual Report on Form 10-K for the year ended December 31, 2015.

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 business requires a high level of investment in pre-publication for our educational content, and in other property, plant and equipment. We expect to continue to commit funds to these areas. 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 June 30, 2016, 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 Term Loan Facility and Revolving Credit Facility. We have incurrence based 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 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.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Stock Repurchase Program

Our Board of Directors has authorized the repurchase of up to $1.0 billion in aggregate value of the Company s common stock. The aggregate share repurchase program may be executed through December 31, 2018. Repurchases under the program may be made from time to time in the open market (including under a trading plan) or in 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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The Company s share repurchase activity was as follows:

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2016
Cost of repurchases (in thousands)	$ 20,020	$ 51,018
Shares repurchased	1,111,000	2,631,918
Average cost per share	$ 18.02	$ 19.38

As of June 30, 2016, there was approximately $486.0 million available for share repurchases under this authorization.

Recently Issued Accounting Pronouncements

See Note 3 to the Notes to Consolidated Financial Statements for a discussion of recently issued accounting pronouncements.

Item 3. 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 June 30, 2016, we had $792.0 million ($775.0 million, net of discount and issuance costs) 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 June 30, 2016. 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 June 30, 2016. These contracts are effective beginning September 30, 2016 and mature on July 22, 2020.

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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 June 30, 2016 and December 31, 2015. We do not enter into derivative transactions or use other financial instruments for trading or speculative purposes.

Item 4. Controls and Procedures

Our management, with the participation of our Chief Executive Officer (CEO), and our Executive Vice President and Chief Financial Officer (CFO), evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2016 pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (Exchange Act). Disclosure controls and procedures are designed to ensure that material information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such material information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. Based on their evaluation, our CEO and CFO concluded that, as of June 30, 2016, our disclosure controls and procedures were effective.

During the quarter ended June 30, 2016, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1. 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. During the second quarter of 2016, we settled all such pending or actively threatened litigations alleging infringement of copyrights, and will make total settlement payments of $10.0 million collectively, with $4.0 million to be paid during the third quarter of 2016 and $6.0 million to be paid during the first quarter of 2017.

Item 1A. Risk Factors

There have been no material changes since the beginning of the period covered by this Quarterly Report on Form 10-Q to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015. For more information regarding the risks regarding our business and industry, please see our Annual Report on Form 10-K for the year ended December 31, 2015.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

The following table contains the Company s purchases of equity securities in the second quarter of 2016 (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
April 1, 2016 to April 30, 2016		$		$
May 1, 2016 to May 31, 2016	1,111,000	18.02	1,111,000	485,969
June 1, 2016 to June 30, 2016				
Total	1,111,000	$ 18.02	1,111,000	$ 485,969

* 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.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit No.	Description
31.1*	Certification of CEO Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of CFO Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of CEO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

* Filed herewith.

** This certification shall not be deemed filed for the purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities under that section. Furthermore, this certification shall not be deemed to be incorporated by reference into the filings of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, regardless of any general incorporation language in such filing.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	Houghton Mifflin Harcourt Company
	(Registrant)
August 4, 2016	By: /s/ Linda K. Zecher Linda K. Zecher Chief Executive Officer (Principal Executive Officer)
	Houghton Mifflin Harcourt Company
	(Registrant)
August 4, 2016	By: /s/ Joseph P. Abbott, Jr. Joseph P. Abbott, Jr. Executive Vice President and Chief Financial Officer (Principal Financial Officer)