

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:)	Chapter 11
)	
SCHOOL SPECIALTY, INC., <i>et al.</i> ,)	Case No. 13-10125
)	
Debtors.)	Re: Docket No. 12
)	

**OBJECTION OF THE STEERING COMMITTEE OF CONVERTIBLE
NOTEHOLDERS OF SCHOOL SPECIALTY, INC. TO DEBTORS' MOTION OF
DEBTORS' FOR ENTRY OF INTERIM AND FINAL ORDERS (I) AUTHORIZING
DEBTORS (A) TO OBTAIN POSTPETITION FINANCING PURSUANT TO 11 U.S.C. §§
105, 361, 362, 364(C)(1), 364(C)(2), 364(C)(3), 364(D)(1), 364(E) AND 507 AND (B) TO
UTILIZE CASH COLLATERAL PURSUANT TO 11 U.S.C. § 363, (C) TO GRANT
PRIMING LIENS AND SUPERPRIORITY CLAIMS TO THE DIP LENDERS, (D) TO
PROVIDE ADEQUATE PROTECTION TO PREPETITION SECURED PARTIES
PURSUANT TO 11 U.S.C. §§ 361, 362, 363 AND 364, AND (E) TO REPAY IN FULL
AMOUNTS OWED IN CONNECTION WITH THE PREPETITION SECURED LOANS
OR OTHERWISE CONVERTING THE PREPETITION SECURED OBLIGATION
INTO POSTPETITION SECURED OBLIGATIONS; (II) SCHEDULING FINAL
HEARING PURSUANT TO BANKRUPTCY RULES 4001(A) AND (C); AND (III)
GRANTING RELATED RELIEF**

The Steering Committee of Convertible Noteholders of School Specialty, Inc. (the "Steering Committee"), holding approximately 99% of the \$157.5 million face amount of the unsecured 3.75% Convertible Subordinated Debentures due 2026 (the "Convertible Notes") of School Specialty, Inc. ("SSI"), hereby objects to the *Motion of Debtors' for Entry of Interim and Final Orders (I) Authorizing Debtors (A) to Obtain Postpetition Financing Pursuant to 11 U.S.C. §§ 105, 361, 362, 364(c)(1), 364(c)(2), 364(c)(3), 364(d)(1), 364(e) and 507 and (B) to Utilize Cash Collateral Pursuant to 11 U.S.C. § 363, (C) to Grant Priming Liens and Superpriority Claims to the DIP Lenders, (D) to Provide Adequate Protection to Prepetition Secured Parties Pursuant to 11 U.S.C. §§ 361, 362, 363 and 364, and (E) to Repay in Full Amounts Owed in Connection with the Prepetition Secured Loans or Otherwise Converting the Prepetition Secured Obligation into Postpetition Secured Obligations; (II) Scheduling Final*



Hearing Pursuant to Bankruptcy Rules 4001(a) and (c); and (III) Granting Related Relief [Dkt. No. 12] (the “DIP Motion”).¹ In support of this objection, the Steering Committee respectfully represents as follows:

PRELIMINARY STATEMENT

1. The Steering Committee objects to the proposed debtor-in-possession (“DIP”) financing facility from Bayside Finance LLC (“Bayside”) because the Debtors cannot satisfy their burden of proving the terms of the Bayside DIP Facility are fair and reasonable and that no better financing alternatives are available. Because alternative, superior financing is available on non-priming basis from the Steering Committee, the Bayside DIP Facility fails to satisfy the requirements of section 364(d)(1)(A) and must be rejected.

2. On January 23, 2013, the Steering Committee delivered a commitment (the “Junior DIP Facility Commitment”) to provide the *same* \$50 million of new capital offered by Bayside at a substantially lower interest rate (9.5% instead of 15.5%), without the \$1.65 million in fees and potential \$1.5 million “break-up fee” required under the Bayside DIP Facility, on a *junior third lien basis*, and *fully convertible into equity* on the effective date of a plan of reorganization (the “Junior DIP Facility”).² A side-by-side comparison of the Junior DIP Facility and the proposed Bayside DIP Facility is attached hereto as **Exhibit A**.

3. The fact that the Junior DIP Facility is convertible into equity in a reorganized debtor rather than required to be repaid preserves liquidity for the reorganized estates. Moreover, the Junior DIP Facility does not circumvent the Debtors’ exercise of their fiduciary

¹ Capitalized terms used but not defined herein shall have the meanings ascribed to such terms in the DIP Motion.

² The Junior DIP Facility Commitment presented by the Steering Committee to the Debtors on January 23, 2013, as amended, is attached hereto as **Exhibit B**. The Junior DIP Facility Commitment has been extended to be in effect through the final hearing on the Debtors’ DIP Motion and may be extended further if accepted by the Debtors. The Steering Committee is prepared to file the Restructuring Term Sheet referenced in the Junior DIP Facility Commitment and submitted to the Debtors upon leave of court. Copies will be available at the hearings on the DIP Motion.

obligations to maximize the value of their estates for the benefit of *all* creditors, unlike the proposed roll-up of the Bayside prepetition Term Loan and a forced sale to Bayside in only 56 days. If the Bayside DIP Facility is approved, the Debtors would be effectively precluded from considering any alternative, superior restructuring proposals, including a plan that would provide a refinancing, negotiated settlement, or alternative treatment of Bayside’s prepetition debt under section 1129(b) of the Bankruptcy Code.

4. The Debtors, in essence, seek this Court’s rubber stamp of their capitulation to the loud demands of Bayside on account of a \$70 million term loan made barely eight months ago, which has now grown to over \$94 million on account of a whopping 36% prepayment penalty that is unquestionably invalid under New York State law. The \$25 million make-whole payment (the “Make-Whole Payment”) was triggered by the Debtors’ breach of the \$20 million Minimum Liquidity Covenant under the Prepetition Term Loan Credit Agreement on December 31, 2012. Following that breach, Bayside negotiated an illusory 30-day forbearance period in exchange for requiring the Debtors to acknowledge the validity of the Make-Whole Payment, as set forth in the January 4, 2013 forbearance agreement between Bayside and the Debtors (the “Forbearance Agreement”). Just *two business days* later, Bayside demanded that, during the forbearance period, the Debtors file a chapter 11 case, agree to a Bayside DIP financing with a roll-up feature and expedited 363 sale procedures with credit-bidding rights for Bayside’s improperly inflated \$94 million claim—*essentially the same terms now before this Court*.

5. Indeed, despite the lip service in the DIP Motion about “good-faith negotiations with Bayside,” approval of Bayside DIP Facility would only allow Bayside to continue its coercive control over the Debtors through, among other things: (a) imposing an artificial timeline for the sale of company at a depressed value to Bayside in only 56 days; (b) cutting off any

meaningful, competitive marketing process for the sale of the Debtors' business and chilling competitive bids; (c) restricting the ability of an Official Committee of Unsecured Creditors ("Creditors' Committee") or other stakeholder to file an alternative plan of reorganization that would satisfy Bayside's prepetition claim with a refinancing, negotiated settlement, or alternative treatment under section 1129(b) of the Bankruptcy Code, thereby preserving value to distribute to junior creditors; (d) rubber stamping the allowance of the Bayside's asserted \$25 million Make-Whole Payment and limiting the Creditors' Committee's ability to challenge that claim through the imposition of a \$25,000 cap for reimbursement of legal expenses in the DIP Budget. These features demonstrate not only Bayside's gross over-reaching but also that the Bayside DIP Facility is an impermissible *sub rosa* plan that circumvents the requirements for confirmation and makes the outcome of these cases a *fait accompli* for the sole benefit of Bayside and to the detriment of all other junior creditors.

6. In sum, the proposed Bayside DIP Facility, demanded by Bayside following the recent breach of the Minimum Liquidity Covenant, exacts too high a price from the Debtors and their estates for the illusory benefits it purports to offer. If the Debtors are willing to surrender the company to Bayside to the detriment of the estates, then Bayside should be forced file a foreclosure action and be denied the opportunity to shed the company's unwanted liabilities and discharge debts through these proceedings solely to benefit itself as the self-appointed new owner of the company. Approval of the Bayside DIP Facility and embedded sale process would be tantamount to condoning the breaches of fiduciary duty of the Debtors' board of directors in failing to meaningfully pursue alternative, superior restructuring and financing proposals that maximize value for all unsecured creditors. In this regard, the Debtors admit that they barely made a list of potential buyers for the Debtors' business and quickly realized that they should

just negotiate with Bayside,³ in clear violation of their *Revlon* duties. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

7. The Debtors also seek approval of an up to \$175 million senior revolving asset-based working capital DIP financing facility (the “ABL DIP Facility”). The Steering Committee does not object to the ABL DIP Facility except for the required milestones and case controls replicated from the Bayside DIP Facility.⁴ As detailed below, Bayside is deemed to consent to any ABL DIP Facility so long as it meets the “ABL DIP Financing Conditions” under the Prepetition Intercreditor Agreement with the ABL Lenders. Those conditions relate mostly to preservation of the same relative priorities of liens between the ABL Lenders and Bayside and are easily met if the ABL DIP Facility is modified to strike the Bayside-implemented 363 sale milestones and case controls, all of which are intended to suppress the rights of the Debtors’ junior creditors.

³ See ¶ 10 of the Debtors’ Motion for Entry of (A) an Order (I) Scheduling Hearing on Approval of Asset Sale, Assumption and Assignment of Executory Contracts to Bayside School Specialty, LLC (or Its Assignee) and Assumption of Certain Liabilities, and (II) Approving Bidding Procedures, Assumption & Assignment Procedures, Breakup Fee and Expense Reimbursement, and Form and Manner of Notice Thereof; and (B) an Order (I) Approving the Asset Purchase Agreement; (II) Authorizing the Sale of All or Substantially All of the Debtors’ Assets Free and Clear of All Liens, Claims, Interests or Encumbrances; (III) Authorizing the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (IV) Granting Related Relief [Dkt. No. 18] (the “Sale Motion”) (admitting the Debtors’ financial advisor developed a list of potential purchasers in late October 2012 and that it became clear “during the course of negotiations of the Forbearance Agreements” [executed on January 4, 2012] that a sale to Purchaser would maximize the value of the Debtors’ assets”). Thus, the Debtors’ purported “negotiations” with the Steering Committee in January of 2012 were a ruse to cover up the fact that the Debtors’ board of directors had already decided to implement a fire sale of the Debtors’ assets to Bayside. The Steering Committee intends to object to the Sale Motion by the objection deadline to be established by this Court and the Steering Committee reserves all rights with respect to the Sale Motion until such time.

⁴ The Steering Committee will inform the Court of the specific problematic provisions of the ABL DIP Facility on or prior to the final hearing on the DIP Motion.

I. Relevant Background.

A. The Debtors' Business Operations.

8. The Debtors are a leading supplier of K-12 education materials, from basic school supplies to standards-based curriculum solutions. The Debtors' primary customers are school districts and teachers across the country. The Debtors' actual revenues for fiscal 2012 were \$732 million and EBITDA was \$44 million.⁵ Revenue for the first six months of fiscal 2013 was \$489 million, a slight decline of 7.3% over the same period in the prior year. However, net income for the same period increased to \$32.5 million versus \$22.4 million, according to the Debtors' November 2012 Form 8-K filing (the "November 2012 8-K"). Indeed, the Debtors' senior executives stated during their November 20, 2012 earnings call that management believes they can achieve long-term goals at double-digit EBITDA margins and, despite a slight decline in gross revenues, consolidated gross margins improved to more than 39% and net income increased by 59% for the second quarter of fiscal 2013.⁶ The *First Day Declaration of Gerald Hughes, Chief Administrative Officer and Executive Vice President of School Specialty Inc.* [Dkt. No. 2] (the "Hughes Declaration") notably fails to mention the Debtors' prepetition EBITDA performance. (Hughes Declaration ¶ 33.) The Debtors' historical bad debt write-offs are less than a fraction of 1% per year.

9. According to the Debtors' November 2012 8-K, 2013 EBITDA performance is expected to be similar to 2012 EBITDA performance. Projected EBITDA for 2013 is approximately \$46.4 million. Further, the EBITDA projections for 2014 through 2016 range from \$47 million to \$59 million. These projections are also noticeably absent from the Hughes

⁵ EBITDA means "earnings before interest, taxes, depreciation, and amortization."

⁶ A copy of the November 2012 8-K together with the transcript of that earnings call is attached hereto as Exhibit C.

Declaration even though delivered to proposed DIP Lenders in January 2013. For fiscal year 2013, the implied enterprise value of the Debtors' enterprise, using reasonable valuation assumptions, is substantially greater than \$230 million. As of the Petition Date, the Debtors' total senior secured debt to the prepetition ABL Lenders and Bayside ranged from \$115 million to \$140 million, depending on the whether the Make-Whole Payment was included and exclusive of the more than \$160 million owed to junior unsecured creditors, including members of the Steering Committee. Thus, the fire sale embedded in the proposed Bayside DIP Facility serves to hand over an additional \$100 million of enterprise value to Bayside above the cash delivered by Bayside to the company.

B. The Junior DIP Facility Proposal.

10. In late November 2012, the Debtors contacted the largest holder of the Convertible Notes, Zazove Associates, LLC ("Zazove"), regarding a potential restructuring proposal in light of the expected defaults under the Prepetition Term Loan Credit Agreement and Prepetition ABL Credit Agreement. Zazove then contacted other Convertible Noteholders to form the Steering Committee. The Steering Committee retained counsel, Baker & McKenzie LLP, on November 21, 2012.

11. The Debtors submitted presentations to certain members of the Steering Committee on December 12 and 18, 2012, before the Steering Committee retained a financial advisor. While the members of the Steering Committee expressed a strong interest in providing financial support to the Debtors, they indicated that they would need to retain a financial advisor to assist in developing and documenting the restructuring proposal. Despite previous opposition, the Debtors finally agreed to retention of a financial advisor on or about December 21, 2012. After interviewing various financial advisors, the Steering Committee selected Blackstone

Advisory Partners L.P. (“Blackstone”) to represent them. Blackstone’s retention letter was not signed by the Debtors until on or about January 9, 2013.

12. On January 9, 2013, only five days after the Steering Committee learned of the terms of the Forbearance Agreement between the Debtors and Bayside and of Bayside’s contemporaneous demands for a chapter 11 filing and 363 sale, the Steering Committee presented a formal proposal for a \$40 million junior DIP financing facility to the Debtors. Although the Debtors made no formal response, they indicated they needed a proposal for \$60 million in financing. The Steering Committee’s financial advisors met with the Debtors’ financial advisors, but struggled to understand the factual basis for the demand for \$60 million. The Steering Committee was not made aware that the Debtors and their financial advisors had already decided to sell the Debtors’ business to Bayside, as now conceded in the Sale Motion.⁷

13. After some due diligence, including review of a January 18, 2013 draft budget, Blackstone concluded that \$50 million would meet the Debtors’ liquidity needs through confirmation of a plan of reorganization on or before May 30, 2013. Thereafter, on January 23, 2013, the Steering Committee presented its restructuring proposal and accompanying Junior DIP Facility Commitment attached hereto as **Exhibit B**. This amount of financing is consistent with the Debtors’ own advisors’ determination “that the Debtors would require approximately \$50,000,000 in postpetition financing during the Chapter 11 Cases.” (DIP Motion ¶ 38).

14. Despite the superior terms of the Junior DIP Facility, the Debtors failed to even formally respond to the Junior DIP Facility Commitment or the draft Junior DIP Facility Credit Agreement submitted to the Debtors’ counsel. The Steering Committee learned of the terms of

⁷ See Footnote 3, *supra*.

the Bayside DIP Facility upon the filing of the DIP Motion and never saw the proposed final DIP Budget attached as Exhibit G to the DIP Motion until filed with this Court.

II. Objection.

A. The Debtors Have Failed To Satisfy The Standards For Obtaining Postpetition Financing.

15. The Debtors may only obtain postpetition financing secured by priming liens as proposed by the DIP Motion if, among other things, the Debtors “are unable to obtain such credit otherwise.” 11 U.S.C. § 364(d)(1)(A).

16. Moreover, the Debtors must demonstrate that the proposed DIP financing “is in the best interest of creditors generally.” *In re Roblin Indus., Inc.*, 52 B.R. 241, 244 (Bankr. W.D.N.Y. 1985) (citing *In re Texlon Corp.*, 596 F.2d 1092, 109899 (2d Cir. 1979)). This Court must review the terms of the Bayside DIP Facility to determine whether those terms are fair, reasonable, and adequate given the circumstances of the debtor-borrower, the proposed lender, and all creditors. *See, e.g., In re Tenney Vill. Co., Inc.*, 104 B.R. 562, 568 (Bankr. D.N.H. 1989) (debtor-in-possession financing terms must not “pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit” of the secured creditor); *In re Aqua Assocs.*, 123 B.R. 192, 195-96 (Bankr. E.D. Pa. 1991) (citing *In re Crouse Group, Inc.*, 71 B.R. 544, 549 E.D. Pa. 1987) (holding that proposed financing should be beneficial and reasonable); *In re Ames Dep’t Stores, Inc.*, 115 B.R. 34, 37 (Bankr. S.D.N.Y. 1990) (court should focus on terms of proposed financing to ascertain whether they are reasonable).

17. As explained further below, the Debtors woefully fail to satisfy their burden to obtain approval of the Bayside DIP Facility. First and foremost, the Debtors did not make any meaningful attempt to obtain alternative DIP financing from *any* party other than Bayside, let

alone from the Convertible Noteholders—an obvious potential source given their position as holders of the Debtors’ fulcrum security. Worse yet, when the Steering Committee, presented the Debtors with a fully committed, non-priming, economically superior financing proposal, the Debtors failed to respond with a counter-offer or engage in any meaningful negotiations. The Steering Committee remains able and willing to offer financing on better economic and non-economic terms that, unlike the Bayside DIP Facility, will allow the Debtors to maximize the value of their estate for the benefit of all junior stakeholders.

18. This Court should thus not allow the Debtors to hand over all of the enterprise value of the company and cede control of these cases to Bayside to the detriment of all junior creditors when alternative, superior financing is available. *See Mid-State Raceway*, 323 B.R. at 59 (“[B]ankruptcy courts do not allow terms in financing arrangements that convert the bankruptcy process from one designed to benefit all creditors to one designed for the unwarranted benefit of the postpetition lender.”); *Tenney Vill.*, 104 B.R. at 567-70 (finding an onerous and one-sided financing arrangement violated debtor’s fiduciary duties to the estate and its creditors).

i. The Steering Committee’s Junior DIP Facility Proposal Is Superior To The Bayside DIP Facility.

19. The Steering Committee has and continues to offer postpetition financing to the Debtors under the Junior DIP Facility on superior terms to that offered by Bayside. This fact alone precludes approval of the Bayside DIP Facility under the explicit requirements of section 364(d) of the Bankruptcy Code that permit the granting of priming liens to obtain postpetition financing only if “the [debtor] is unable to such credit otherwise.” 11 U.S.C. § 364(d)(1)(A).

20. Among the more favorable features, the Junior DIP Facility:

- a. substantially reduces the fees required to be paid under the Bayside DIP Facility, which total more than \$1.65 million;

- b. reduces the interest rate by six percentage points;
- c. will convert to equity in the reorganized company upon emergence, thereby preserving the liquidity of the reorganized estates;
- d. contains far less events of default and case controls that impermissibly circumvent the Debtors' exercise of their fiduciary duties;
- e. permits the restructuring of Bayside's prepetition debt, which, unlike the Bayside DIP Facility, requires a roll-up of the entire Bayside prepetition Term Loan that cements Bayside's right to demand payment in full in cash as a condition to the Debtors' ability to exit chapter 11;
- f. would allow for junior creditors to receive a recovery on their claims under a plan of reorganization; and
- g. does not force a rushed liquidation of the company for the sole benefit of Bayside.

21. The DIP Motion fails to disclose the terms of the Junior DIP Facility. Instead, the Debtors baldly state that the Junior DIP Facility “did not provide sufficient liquidity to fund the Chapter 11 Cases.” (DIP Motion ¶ 31). To the contrary, the Steering Committee has presented a fully committed \$50 million DIP financing proposal that will be converted to equity upon emergence. The Debtors themselves admit that their own advisors “determined that Debtors would require approximately \$50 million in postpetition financing during the Chapter 11 Cases.” (DIP Motion ¶ 38.) Moreover, the Bayside DIP Facility provides the same \$50 million with higher interest and fees. The reality is that the Debtors (as they now admit) had already agreed to ask for a fire sale to Bayside before they even received the Junior DIP Financing Commitment.⁸

⁸ See Footnote 3, *supra*.

ii. *The Prepetition Intercreditor Agreement Does Not Preclude The ABL Lenders From Funding A DIP Financing With The Convertible Noteholders.*

22. As explained above, to the extent the Debtors believe that more than \$50 million in financing is needed to fund the Debtors' operations and restructuring efforts, nothing precludes the ABL Lenders from providing the same financing (absent the objectionable terms that mirror the 363 sale milestones embedded in the Bayside DIP Facility) in connection with the Junior DIP Facility as they have agreed to with the Bayside DIP Facility. In fact, on January 15, 2013, the ABL Lenders submitted a DIP proposal to the Debtors that was agnostic as to what party would provide the DIP term loan.

23. The Prepetition Intercreditor Agreement permits the ABL Lenders to provide the Debtors with postpetition financing in a bankruptcy proceeding so long as, in summary: (a) Bayside retains its liens with respect to its collateral that existed as of the Petition Date; (b) Bayside's liens with respect to such collateral remain senior and prior to the liens of ABL Agent; (c) if a lien with respect to collateral acquired after the Petition Date is granted to secure any obligations under the ABL DIP financing, then Bayside obtains a senior lien with respect to such collateral; (d) *the proposed ABL DIP financing does not compel the Debtors to seek confirmation of a specific plan of reorganization for which any material portion of the material terms are set forth in the ABL DIP financing documentation*; and (e) that the proposed ABL financing documentation does not directly or indirectly require or compel the sale of all or substantially all of the collateral other than pursuant to the exercise of remedies after default and acceleration of such ABL DIP financing pursuant to such order or documentation.⁹

⁹ For the specific requirements of a permitted ABL DIP financing, see the definition of "ABL DIP Financing Conditions" contained in Section 1.1, page 5 of the Prepetition Intercreditor Agreement.

24. The ABL DIP Facility, as proposed, meets all of the ABL DIP Financing Conditions set forth in the Prepetition Intercreditor Agreement between the ABL Lenders and Bayside. However, it would also meet those requirements if the Bayside sale milestones were stricken by this Court. Under Section 6.2(a) of the Prepetition Intercreditor Agreement, Bayside is deemed to consent to any ABL DIP Facility that meets the “ABL DIP Financing Conditions” contained in Section 1.1 of the Prepetition Intercreditor Agreement. Consequently, Bayside should be deemed to consent to the ABL DIP Facility, even if the 363 milestones currently in the ABL DIP Facility are stricken by order of this Court.

iii. The Bayside DIP Facility Charges Excessive Fees and Interest.

25. The cost of capital under the Bayside DIP Facility is not reasonable and includes an impermissible and disguised \$1.5 million “break-up” fee if the Debtors’ business is not sold to Bayside in the proposed “Bayside Sale.” Specifically, the Bayside DIP Facility bears interest at LIBOR + 14.00% per annum, with a 1.5% LIBOR floor. It also includes a \$1 million commitment fee, a \$500,000 closing fee, a \$150,000 administrative fee (together totaling \$1.65 million), and a 1.0% unused line fee applicable to the unused portion of the Bayside DIP Facility.

26. In addition, the Bayside DIP Facility includes a \$1.5 million “commitment termination fee” unless the Bayside DIP Facility is repaid in connection with a “Bayside Sale.” As defined in the Bayside DIP Credit Agreement, “Bayside Sale” means only a sale to Bayside or one of its affiliates. (DIP Motion, Ex. B at p. 8). Consequently, should a competing bidder emerge within the absurdly short time frame proposed at the behest of Bayside, the Debtors will owe an additional \$1.5 million break-up fee to Bayside. This fee confers no benefit to the Debtors’ estates, serves no purpose other than to further engorge and entrench Bayside and does not meet the requirements for allowance of a break-up fee in

connection with a section 363 sale. *See generally Calpine Corp. v. O'Brien Environmental Energy, Inc.*, 181 F.3d 527 (3d Cir. 1999) (allowance of a break-up fee is subject to the standard for allowance of an administrative priority claim under section 503(b) of the Bankruptcy Code; that is, the fee has to be necessary to preserve the value of the bankruptcy estate.)

27. The only “new money” being advanced by Bayside is the \$50 million revolving facility. The \$94 million in the “roll-up” DIP is a legal fiction and offers no benefit to the estate. It serves only to require Bayside’s prepetition claim (including the invalid Make-Whole Payment) to be paid in full as a condition to the Debtors’ ability to exit chapter 11, thereby cutting off the Debtors’ statutory right to propose a plan that proposes to refinance, make an negotiated payment, or pay Bayside in full accordance with section 1129(b).

28. There is no justification for the estates’ incurrence of excessive fees and interests given the Steering Committee’s offer to provide the same \$50 million capital infusion on far more favorable terms to the Debtors.

B. The Terms Of The Bayside DIP Facility Circumvent The Debtors’ Control of These Cases.

29. The Debtors have fiduciary duties that run to all creditors and the Debtors’ obligation to satisfy such duties must not be stifled by an overly burdensome DIP credit agreement. *See, e.g., In re Marvel Enter. Group, Inc.*, 140 F.3d 463, 471 (3d Cir. 1998) (“The debtor in possession is a fiduciary of the creditors and, as a result, has an obligation to refrain from acting in a manner which could damage the estate, or hinder a successful reorganization”); *In re Innkeepers USA Trust*, 442 B.R. 227, 235 (Bankr. S.D.N.Y. 2010) (debtors should have “a wide berth to fulfill their fiduciary duties to conduct a plan process which maximizes value for all the estates and treats the various [interests of creditors and equity holders of each Debtor] with greater neutrality”); *Mid-State Raceway, Inc.*, 323 B.R. at 58 (“Nil the bankruptcy

context, the directors owe duties not only to the corporation and its shareholders, they also owe a duty of good faith to the creditors. Thus, the Debtors' Board of Directors had an obligation to the community of interests that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation's long term wealth creating capacity"); *Tenney Vill. Co., Inc.*, 104 B.R. at 569 (rejecting DIP financing proposal when, among other things, "the execution of the Financing Agreement violates the Debtors' fiduciary obligations to the estate," noting "the general mandate of the Bankruptcy Code is clear. The Debtors' pervading obligation is to the bankruptcy estate and, derivatively, to the creditors who are its principal beneficiaries").

30. Courts examining DIP financing proposals must examine whether "the proposed terms would prejudice the powers and rights that the Code confers for the benefit of all creditors and leverage the Chapter 11 process by granting the lender excessive control over the debtor or its assets so as to unduly prejudice the rights of other parties in interest." *Mid-State Raceway, Inc.*, 323 B.R. at 59 (noting "[c]ourts recognize that in connection with post-petition financing, lenders often extract favorable terms that may or may not have the effect of causing harm to the estate and creditors . . . bankruptcy courts do not allow terms in financing arrangements that convert the bankruptcy process from one designed to benefit all creditors to one designed for the unwarranted benefit of the post-petition lender"); *see also In re R.H. Macy & Co.*, 170 B.R. 69, 74 (Bankr. S.D. N.Y. 1994) (it is also a fundamental policy of bankruptcy law that debtor has "an affirmative, overarching duty to reorganize and maximize estate assets for the benefit of all creditors," not just a select few).

31. Indeed, courts look to whether the proposed terms would prejudice the powers and rights that the Bankruptcy Code confers the benefit of all creditors, thereby leveraging the chapter 11 process by granting a lender excessive control over the debtor or its assets to the

prejudice of other parties in interest. *In re Berry Good, LLC*, 400 B.R. 741, 747 (Bankr. D. Ariz. 2008); *see also Tenney Vill. Co., Inc.*, 104 B.R. at 569 (denying approval of DIP financing extended by pre-petition lender: “[u]nder the guise of financing a reorganization, the Bank would disarm the Debtor of all weapons usable against it for the bankruptcy estate’s benefit, place the Debtor in bondage working for the Bank, seize control of the reigns of reorganization, and steal a march on other creditors in numerous ways And the Bank would have the ultimate say over the very goal of this Chapter 11 case, a confirmed plan of reorganization. *No longer could a plan be confirmed over the Bank’s objection under the cram-down provisions of § 1129(b)(2)(A).*”) (emphasis added).

32. Here, such an examination reveals that the Bayside DIP Facility contains various onerous and disfavored provisions designed solely to ensure that Bayside dominates these cases. ***First***, the maturity date under the DIP Facility is the earlier of (a) June 30, 2013 or (b) the date of a closing of a sale of all or substantially all of the Debtors’ assets. The June 30, 2013 date is *illusory* given the requirement under the Bayside DIP Facility that the Debtors close a section 363 sale of all of their assets by April 11, 2013. (DIP Motion ¶ 14). An April 11, 2013 maturity date is precipitously early for a company like the Debtors, that operate a seasonal business where sales, EBITDA, and financial performance may fluctuate drastically from month to month. In a case of this size coupled with the nature of the Debtors’ seasonal business, an April 11, 2013 maturity date without a commercially feasible provision for the Debtors to extend the term, is arbitrary and premature. Indeed, it forces the Debtors to commence a sale process while their enterprise value is artificially deflated due to seasonal fluctuations to the exclusive advantage of Bayside, who intends to purchase the company before the market can even respond.

33. **Second**, in addition to the excessive fees and interest and short maturity, the Bayside DIP Facility contemplates a number of specific financial covenants tied to an incomplete DIP Budget by which the Debtors must abide or be in default. (DIP Motion, Ex. B § 6.31.) The DIP Motion fails to include any sensitivity analysis regarding the Debtors' ability to satisfy these requirements. Without evidence that the DIP Budget and the covenants tied to the budget were fairly set and are reasonably achievable based on the Debtors' historical and projected performance, their presence is yet another mechanism that permits Bayside to exert control over these cases to take over the company at a depressed value on an expedited and unreasonable timetable.

34. **Third**, the Bayside DIP Facility requires the Debtors to meet a number of milestones that effectively serve to lock the Debtors into a liquidation plan that hands over the company to Bayside to the exclusion of any potentially superior alternatives. Under Section 5.18 of the Bayside DIP Credit Agreement, the Debtors must: (a) obtain entry of a bidding procedures order by February 8, 2013; (b) establish a March 19, 2013 deadline for bids to purchase the company; (c) hold an auction by March 25, 2013; (d) schedule a sale hearing by March 27, 2013; and (e) close on a sale of the company by April 11, 2013. (DIP Motion, Ex. B § 5.18.) Failure to meet these milestones constitutes an event of default.

35. The Debtors admit they have not engaged in any prepetition marketing on their assets to determine if there are any alternative, superior offers to the \$95 million credit bid proposed by Bayside.¹⁰ The Debtors do not intend to even start this process until after the bidding and auction procedures are approved by the Court. (Sale Motion ¶ 12.) Even assuming the Debtors' proposed premature February 8, 2013 entry of the bidding procedures order, there

¹⁰ See Footnote 3, *supra*.

would less than 40 days to complete the marketing process and allow parties to submit competing bids by the proposed March 19, 2013 bid deadline. Moreover, the Debtors' proposal of any plan of reorganization that does not pay Bayside's prepetition claim in full on the effective date of any plan of reorganization constitutes an event of default under Section 7.1(s) of the Bayside DIP Credit Agreement—further preventing the Debtors' from exercising their fiduciary duties to pursue a restructuring proposal that maximizes the value of their estates for the benefit of all creditors.

36. ***Fourth***, the Bayside DIP Facility provides for automatic allowance of a \$25,054,001.06 Make-Whole Payment asserted by Bayside. The Debtors claim that they are “unaware of any basis for challenging the Prepetition Liens, [which include the Make-Whole Payment].” (DIP Motion ¶ 79). This is yet another misrepresentation by the Debtors. The Steering Committee has objected to any proposal that allows the Debtors to pay this Make-Whole Payment to the detriment of unsecured creditors and has voiced this objection to the Debtors for more than a month. Indeed, the January 9 and 23 proposals submitted by the Steering Committee were conditioned upon procedures for this Court to determine the validity of the Make-Whole Payment as a matter of law for purposes of determining the amount of any replacement note that may be issued to Bayside by the Debtors under a plan of reorganization.

37. The Make-Whole Payment represents a whopping 36% of the amount of the \$70 million Term Loan that was made barely seven months before a technical default that resulted in Bayside's immediate acceleration of the Term Loan. Applicable state law cases demonstrate that, at 36% of the amount of the Term Loan from inception, the Make-Whole Payment is grossly disproportionate to the probable losses of the Term Loan Lenders at the time the Term Loan was made and well outside the range of what New York courts have found constitute

permissible prepayment penalties. *See, e.g., JMD Holding Corp. v. Cong. Fin. Corp.*, 4 N.Y. 3d 373, 380 (N.Y. 2005) (approving an early termination fee between 1% and 2% of a \$40 million maximum credit line); *United Merchants & Mfrs., Inc.*, 674 F.2d 134 (2d Cir. 1982) (enforcing prepayment clause on acceleration based upon a formula for unpaid interest through the original maturity date of the loan totaling approximately 8.7% of the total loan); *In re Vanderveer Estates Holdings, Inc.*, 283 B.R. 122 (Bankr. E.D.N.Y. 2002) (enforcing a prepayment penalty formula requiring payment on acceleration in an amount equal to approximately 11% of the loan amount).

38. Moreover, the formula used to determine the amount of the Make-Whole Payment contains flawed assumptions that courts have found to be unreasonable. First, the relevant period for estimating their probable loss extends to December 31, 2015, a date beyond the actual October 31, 2014 maturity date of the Term Loan. *See, e.g., JMD*, 4 N.Y.3d at 380-82. Second, the formula assumes that the Term Loan Lenders would only make a new replacement loan at a rate close to the yield for U.S. treasury bonds, instead of to a similarly credit rated company in order to mitigate damages, which again has the effect of providing a windfall to Bayside. *Skyler Ridge*, 80 B.R. at 505 (finding a prepayment clause that applied a U.S. Treasury interest rate rather than the market rate was unreasonable); *Kroh Bros. Dev. Co.*, 88 B.R. at 1000 (same). Given these features, the Make-Whole Payment would certainly be found unreasonable under New York law and therefore must be disallowed under section 502 of the Bankruptcy Code.

39. Through inclusion in the “roll-up” Bayside DIP Facility, Bayside (in concert with the Debtors) is attempting to insulate the Make-Whole Payment from challenge from parties in interest. Once allowed through approval of the DIP Motion, Bayside intends to credit bid \$95

million, which includes the Make-Whole Payment, for purchase of substantially all of the Debtors' assets.

40. Pursuant to paragraph 21 of the proposed Interim DIP Order, the various stipulations agreed to by the Debtors for the benefit of Bayside (including the automatic allowance of the unreasonable Make-Whole Payment) are binding on all parties in interest absent the commencement of an adversary proceeding or the filing of a motion contesting each specific stipulation no later than 60 days after the formation of the Creditors' Committee or 75 days after the Petition Date. Given that Bayside is attempting to force a complete sale of the company in the same time period, the proposed investigatory period does not provide a meaningful opportunity to investigate and challenge the numerous objectionable stipulations contained in the proposed DIP order. With a proposed March 25, 2013 auction date and April 11, 2013 sale closing, any challenges to the stipulations contained in the DIP order could effectively be rendered moot long before the Court would have an opportunity to hear them—irrespective if the challenges were brought during the investigatory period. Moreover, the \$25,000 investigatory budget is wholly inadequate for any meaningful investigation and ability to prepare an objection to the numerous problematic stipulations agreed to by the Debtors under the Bayside DIP Facility.

41. The Creditors' Committee must have the ability to meaningfully investigate potential claims against Bayside as well as the amount and validity of prepetition secured debt—especially in the context of a rushed sale where the prepetition lender intends to credit bid invalid claims to seize the company. The proposed DIP Interim Order prevents such meaningful investigation and prosecution of claims against Bayside to the detriment of the estates and accordingly must be denied.

C. *The Bayside DIP Facility Is Not Proposed In Good Faith.*

42. In determining whether to approve a postpetition financing proposal, the Court must also examine, among other things, whether the financing was negotiated in good faith and at arm's length by the debtor, on the one hand, and the lender, on the other hand. *See, e.g., In re Farmland Indus., Inc.*, 294 B.R. 855, 881 (Bankr. W.D. Mo. 2003). "Where it is evident from the loan agreement itself that the transaction has an intended effect that is improper under the Bankruptcy Code," credit is not being extended in good faith. *See In re EDC Holding Co.*, 676 F.2d 945, 948 (7th Cir. 1982). In addition, where a lender extends credit with an "ulterior purpose," such extension is not in good faith. *Id.* at 949.

43. The party seeking to establish good faith bears the burden of proof. *In re The Colad Group, Inc.*, 324 B.R. 208, 225 (Bankr. W.D.N.Y. 2005) (finding that debtor failed to carry affirmative burden to establish good faith of the proposed financing transaction; the presence of offensive terms and conditions in the financing agreement created uncertainty as to lender's intent and rendered inappropriate a finding of good faith); *see also In re Revco D.S., Inc.*, 901 F.2d 1349, 1366 (6th Cir. 1990) (good faith under Bankruptcy Code section 364(e) should not be presumed); *In re Tamojira, Inc.*, 212 B.R. 824, 826 (Bankr. E.D. Va. 1997) (same).

44. Here, the Debtors simply cannot carry their burden of proof with respect to the good faith proposal of the Bayside DIP Facility. The Bayside DIP Facility's economically draconian and outcome determinative provisions represent lender overreaching at its most egregious. Without doubt, the Bayside DIP Facility was negotiated with an aggressive secured lender in the long shadow of a default—hardly an environment for good faith negotiations between a willing buyer and a willing seller. The Bayside DIP Facility's proposed maturity date and corresponding case milestones are not justified by the facts of these cases. The absence of such artificial deadlines in the Junior DIP Facility proves that they are not necessary to obtain

equivalent postpetition financing. Moreover, given the seasonal nature of the Debtors' business and the unforeseen impact these cases could have on the Debtors' supply and customer relationships, the proposed financial covenants under the facility could very well enable Bayside to declare events of default, seize control of the Debtors even earlier than currently proposed, and otherwise circumvent any legitimate efforts to maximize the value of the Debtors' estates through an open and transparent restructuring process that benefits all stakeholders.

45. Here, the oppressive and over-reaching terms proposed by Bayside evidence a lack of good faith and "ulterior purpose" to acquire the Debtors while trampling the rights of all junior creditors in chapter 11. Thus, Bayside's improper and illegal "loan to own" strategy clearly constitutes an extension of credit with an "ulterior purpose" which should be rejected by this Court.

D. The Bayside DIP Facility Is Tantamount To An Impermissible Sub Rosa Plan.

46. In light of all the foregoing, it is apparent that the proposed Bayside DIP Facility constitutes an impermissible *sub rosa* plan, which is itself sufficient reason to deny the DIP Motion. *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir. 2007) (a debtor cannot enter into a transaction that "would amount to a *sub rosa* plan of reorganization" or an attempt to circumvent the chapter 11 requirements for confirmation of a plan of reorganization).

47. A transaction is considered an impermissible *sub rosa* plan if it disposes of all or substantially all of the debtor's assets, dictates recoveries to creditors, or otherwise prescribes the terms of a debtor's reorganization without following the Bankruptcy Code's procedural protections in connection with the development and approval of a plan of reorganization. *See generally In Re Gulf Coast Oil Corp.*, 404 B.R. 407 (Bankr. S.D. Tex. 2009) ("Although the bankruptcy court need not turn every 363(b) hearing into a mini-confirmation hearing, the

bankruptcy court must not authorize a 363(b) transaction if the transaction would effectively evade the ‘carefully crafted scheme’ of the chapter 11 plan confirmation process, such as by denying 1125, 1126, 1129(a)(7), and 1129(b)(2) rights.”); *In re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983) (“The debtor and the bankruptcy court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets”); *In re Swallen’s, Inc.*, 269 B.R. 634, 638 (6th Cir. BAP 2001) (“At least when a party in interest objects, a bankruptcy court cannot issue orders that bypass the requirements of Chapter 11, such as disclosure statements, voting, and a confirmed plan, and proceed to a direct reorganization on the terms the court thinks best, no matter how expedient that might be.”); *In re GSC, Inc.*, 453 B.R. 132, 179-180 (Bankr. S.D.N.Y. 2011) (“a section 363 sale may also be ‘objectionable as a sub rosa plan if the sale itself seeks to allocate or dictate the distribution of sale proceeds among different classes of creditors.’”) (quoting *In re GMC*, 407 B.R. 463, 495 (Bankr. S.D.N.Y. 2009)); *In re Belk Props., LLC*, 421 B.R. 221, 226 (Bankr. N.D. Miss. 2009) (rejecting DIP financing agreement that dictated terms of plan of reorganization).

48. Here, the Bayside DIP Facility obligates the Debtors to pursue a fast-tracked sale plan for the sole benefit of Bayside or else risk default and sudden liquidation due to the termination of funding. Given the proposed March 19, 2013 bid deadline, there should be no realistic expectation that any third party will have sufficient opportunity to perform the due diligence necessary to present a competing bid to defeat Bayside’s \$95 million credit bid, despite the fact that the company is undoubtedly worth more, even after considering of the liabilities that Bayside is leaving behind. *See Gulf Coast Oil Corp*, 404 B.R. at 413 (40 day-period from filing of the sale motion to the auction deemed to be “virtually no time available for due diligence and

compliance with the terms of the proposed asset purchase agreement.”). Moreover, the Bayside DIP Facility also provides for inclusion of the invalid Make-Whole Payment in Bayside’s allowed, secured claim for purposes of credit-bidding that, as explained below, is insulated from any real challenge. The effect of the Bayside DIP Facility *in toto* is that Bayside is assured it will be the only party able to present a bid for the Debtors’ assets and the Debtors will be forced to use the entire sale proceeds to repay the \$50 million of new money that the Steering Committee is offering on better terms and the pay off the inflated \$94 million prepetition claim of Bayside that could otherwise be satisfied with a replacement note.

49. In short, the Bayside DIP Facility forces the company to pursue a liquidation path at the outset of these cases that all but ensures no recovery to junior creditors. This is precisely the result the procedural and substantive requirements of confirmation are designed to prevent. Thus, the Bayside DIP Facility should be denied as an impermissible *sub rosa* plan.

CONCLUSION

50. The proposed Bayside DIP Facility is a transparent attempt by Bayside to seize all control and value from the Debtors at a time when the Debtors need not give up either and cannot meet their burden to prove that they are “unable to obtain such credit otherwise.” Approval of the Bayside DIP Facility would force the Debtors into a rushed sale to Bayside to the exclusion of alternative, superior restructuring proposals. On the other hand, the Junior DIP Facility would free the Debtors to seek to maximize value for all stakeholders. The applicable legal standards, equitable considerations, and common sense all dictate denial of the Bayside DIP Facility.

WHEREFORE, the Steering Committee respectfully requests entry of an order (a) denying approval of the Bayside DIP Facility and requiring modification of the proposed ABL DIP Facility as described herein; and (b) granting such other and further relief as is just and proper.

Dated: January 29, 2013
Wilmington, DE

BIFFERATO LLC

/s/ Thomas F. Driscoll III
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*Counsel to the Ad Hoc Committee of
Convertible Noteholders*

Exhibit C

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (date of earliest event reported): **November 20, 2012**

SCHOOL SPECIALTY, INC.

(Exact name of registrant as specified in its charter)

Wisconsin
(State or other jurisdiction
of incorporation)

000-24385
(Commission
File Number)

39-0971239
(IRS Employer
Identification No.)

W6316 Design Drive
Greenville, Wisconsin 54942
(Address of principal executive offices,
including zip code)

Registrant's telephone number, including area code: (920) 734-5712

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- ☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- ☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- ☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- ☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02. Results of Operations and Financial Condition.

On November 20, 2012, School Specialty, Inc. (the “Company”) issued a press release announcing its fiscal 2013 second quarter results of operations. On the same date, the Company held a conference call, which was pre-announced and open to the public, to discuss these results.

A copy of the press release and a transcript of the call are attached hereto as Exhibits 99.1 and 99.2, respectively, and are incorporated herein by reference.

Item 9.01. Financial Statements and Exhibits.

(d) Exhibits

<u>Exhibit No.</u>	<u>Description</u>
99.1	Press Release of School Specialty, Inc. dated November 20, 2012
99.2	Transcript of the November 20, 2012 Earnings Conference Call

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 hereunto duly authorized.

SCHOOL SPECIALTY, INC.

Dated: November 20, 2012

By: /s/ David N. Vander Ploeg
David N. Vander Ploeg
Chief Financial Officer

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
99.1	Press Release of School Specialty, Inc. dated November 20, 2012
99.2	Transcript of the November 20, 2012 Earnings Conference Call

Exhibit 99.1

The power of teaching. The wonders of learning.™

W6316 Design Drive, Greenville, WI 54942
P.O. Box 1579, Appleton, WI 54912-1579

FOR IMMEDIATE RELEASEContacts:

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 Executive VP and CFO
 920-882-5854

Elizabeth M. Higashi, CFA
 Investor Relations
 920-243-5392

School Specialty Announces Fiscal 2013 Second Quarter Results

- Reports Revenue of \$236.9 Million and Net Income of \$14.1 Million
- Operating Income Increases 17 Percent to \$25.3 Million
- Gross Margin Improves in Quarter and Six Months Results

GREENVILLE, Wis., November 20, 2012 - School Specialty (NASDAQ:SCHS), a leading K-12 education company with the broadest array of products in the market, today reported second quarter and six months results for the period ending October 27, 2012. Revenue for the second quarter of fiscal 2013 was \$236.9 million, compared with \$251.4 million in the prior year, a decline of 5.8 percent. Net income for the second quarter of fiscal 2013 was \$14.1 million or \$0.75 per diluted earnings per share compared with \$8.9 million or \$0.47 per diluted share last year.

Revenue for the six months of fiscal 2013 was \$489.0 million compared with \$527.5 million last year, a decline of 7.3 percent. Net income for the six months increased to \$32.5 million or \$1.72 per diluted share, versus \$22.4 million or \$1.18 per diluted share in the comparable period last year.

“Despite the challenging marketplace, we continued to make progress on our turnaround strategy and mid and long term initiatives while staying focused on managing costs,” said Michael P. Lavelle, President and Chief Executive Officer. “Revenue declines in the second quarter were reduced from earlier this year with continued improvement in our operating performance. Our immediate priorities remain improving EBITDA and working capital while we focus our marketing and sales strategies to support our revenue goals,” he added.

Second Quarter Financial Results

- Revenue for fiscal 2013 second quarter was \$236.9 million, compared with \$251.4 million in fiscal 2012, a decline of 5.8 percent. The decline in sales reflects the continued impact of industry-wide soft educational spending on curriculum products.
- Educational Resources revenue was \$171.1 million in the quarter compared with \$173.2 million in the prior year and Accelerated Learning revenue declined 15.9 percent to \$65.6 million from \$78.0 million last year.

- More -

- Gross profit was \$92.7 million compared with \$95.1 million last year, a decline of 2.5 percent. Consolidated gross margin improved to 39.1 percent, an increase of 130 basis points, primarily due to margin improvement in both Educational Resources and Accelerated Learning.
- Selling, general and administrative (SG&A) expenses were \$67.4 million compared with \$73.4 million in the prior year's second quarter, a decline of 8.2 percent, reflecting strong cost controls. Lower overall sales levels also reduced the variable cost component which reduced expenses.
- During the second quarter, the company also recorded a \$1.4 million impairment charge related to the receipt of \$3 million in settlement of a note issued to the company with the divestiture of a business in 2008.
- Interest expense for the second quarter was \$9.3 million compared with \$6.9 million in the previous year. This increase is largely driven by higher interest rates on our term loan and a prepayment charge on a term loan principal payment.
- The provision for income taxes in the second quarter of fiscal 2013 was \$0.3 million compared with \$6.0 million in the previous year. The decline in taxes was related to projected annual tax losses for fiscal 2013.
- Earnings before interest, taxes, depreciation, amortization and impairment charges (EBITDA) improved 9.3 percent to \$34.2 million compared with \$31.3 million in the previous year.
- Net income was \$14.1 million compared with \$8.9 million last year. Diluted earnings per share increased 59.7 percent in this year's second quarter to \$0.75 from \$0.47 in the comparable period last year.
- The second quarter of fiscal 2013 included the previously mentioned impairment charge of \$1.4 million or \$0.07 per diluted share. The prior year included restructuring charges of \$0.9 million or \$0.05 per diluted share. Excluding these charges, adjusted net income for this year's second quarter was \$15.5 million or \$0.82 per diluted share compared with \$9.7 million or \$0.51 per diluted share in the prior year's second quarter

Six Months Results

- Revenue for the first six months of fiscal 2013 was \$489.0 million, compared with \$527.5 million in the same period of the prior year, a decline of 7.3 percent.
- Educational Resources revenue in the first six months of fiscal 2013 declined 4.0 percent to \$344.8 million compared with \$359.3 million in fiscal 2012. Accelerated Learning revenue declined 14.3 percent to \$143.9 million in the first six months of fiscal 2013 compared with \$167.8 million in the prior year.

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- Gross profit for the first six months of the fiscal year was \$196.3 million compared with \$206.3 million last year. The consolidated gross margin increased 100 basis points to 40.1 percent from 39.1 percent in the comparable six month period of fiscal 2012.
- SG&A expenses declined 7.0 percent to \$142.5 million compared with the prior year's \$153.2 million. The decline is due to a combination of decreased variable costs associated with the revenue decline and lower compensation costs.
- Interest expense in the six months of the current fiscal year was \$19.3 million compared with last year's \$14.8 million. Fiscal 2013 interest expense was higher due to costs related to the debt refinancing, higher interest rates on our term loan and a prepayment charge on term loan principal.
- During the first half of fiscal 2012, \$57.5 million of outstanding 3.75% convertible subordinated debentures were exchanged and refinanced with new debentures. Expenses of \$1.1 million associated with this convertible debt exchange were recognized in last year's first six months.
- EBITDA for the six months was \$71.8 million compared with \$71.7 million in the previous year's six month period.
- Net income was \$32.5 million or \$1.72 per diluted share in the first half of fiscal 2013, compared with net income of \$22.4 million or \$1.18 per diluted share last year.
- For the first six months of fiscal 2013, one-time costs included the previously mentioned \$1.4 million or \$0.07 per diluted share impairment charge, \$2.5 million or \$0.13 per diluted share related to debt refinancing expenses, and \$1.1 million or \$0.06 per diluted share in restructuring charges. For the six month comparable period last year, results included a \$0.7 million or \$0.04 per diluted share expense associated with the exchange of convertible debt and \$0.9 million or \$0.05 per diluted share from restructuring charges. On an adjusted basis for the six months, fiscal 2013 adjusted net income would have been \$37.5 million or \$1.98 per diluted share compared with \$23.9 million or \$1.26 per diluted share in fiscal 2012.
- Free cash flow in the first half of fiscal 2013 increased \$28.1 million to \$13.9 million compared to negative free cash flow of \$14.2 million in fiscal 2012's first half.

Financial Outlook

"We believe that given the challenging market this school season, fiscal year 2013 revenues are likely to decline in the mid-single digit range compared with fiscal 2012. Although revenue is softer than our previously anticipated performance levels for fiscal 2013, given our margin and cost reduction actions, we continue to believe that fiscal 2013 will look similar to fiscal 2012 actual results in terms of EBITDA," said Lavelle.

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Conference Call

The second quarter earnings conference call is scheduled for today at 11 a.m. ET/10 a.m. CT. The live audio webcast will include accompanying slides and is available on the Investors section of School Specialty's web site at www.schoolspecialty.com under Presentations. The presentation will be archived on the company's website and available later in the day.

About School Specialty, Inc.

School Specialty is a leading education company that provides innovative and proprietary products, programs and services to help educators engage and inspire students of all ages and abilities to learn.

The company designs, develops, and provides preK-12 educators with the latest and very best curriculum, supplemental learning resources, and school supplies. Working in collaboration with educators, School Specialty reaches beyond the scope of textbooks to help teachers, guidance counselors and school administrators ensure that every student reaches his or her full potential.

Accelerated Learning's major products include: Wordly Wise 3000[®], Premier[™] Agenda, Delta Education[™], FOSS[®], CPO Science[™], Frey Scientific[®], Educator's Publishing Service, Academy of Reading[®], Think Math![™], MCI[®], S.P.I.R.E.[®] and SPARK[™]. Educational Resources proprietary brands include: Education Essentials[®], Sportime[®], Childcraft[®], Sax[®] Arts & Crafts, Califone[®], abc[®], Abilitations[®], School Smart[®], Classroom Select[™] and Projects by Design[®].

For more information about School Specialty, visit www.schoolspecialty.com.

Cautionary Statement Concerning Forward-Looking Information

Any statements made in this press release about future results of operations, expectations, plans, or prospects, including but not limited to statements included under the heading "Financial Outlook," constitute forward-looking statements. Forward-looking statements also include those preceded or followed by the words "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "should," "plans," "targets" and/or similar expressions. These forward-looking statements are based on School Specialty's current estimates and assumptions and, as such, involve uncertainty and risk.

Forward-looking statements are not guarantees of future performance, and actual results may differ materially from those contemplated by the forward-looking statements because of a number of factors, including the factors described in Item 1A of School Specialty's Annual Report on Form 10-K for the fiscal year ended April 28, 2012, which factors are incorporated herein by reference. Except to the extent required under the federal securities laws, School Specialty does not intend to update or revise the forward-looking statements.

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SCHOOL SPECIALTY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended		Six Months Ended	
	October 27, 2012	October 29, 2011	October 27, 2012	October 29, 2011
Revenues	\$ 236,866	\$ 251,375	\$ 489,005	\$ 527,459
Cost of revenues	144,166	156,315	292,708	321,123
Gross profit	92,700	95,060	196,297	206,336
Selling, general and administrative expenses	67,364	73,405	142,480	153,181
Operating income	25,336	21,655	53,817	53,155
Other expense:				
Impairment of long-term asset	1,414	-	1,414	-
Interest expense	9,315	6,867	19,281	14,779
Expense associated with convertible debt exchange	-	-	-	1,090
Income before provision for income taxes	14,607	14,788	33,122	37,286
Provision for income taxes	343	6,044	602	14,972
Income before investment in unconsolidated affiliate	\$ 14,264	\$ 8,744	\$ 32,520	\$ 22,314
Equity in income/(losses) of investment in unconsolidated affiliate	(137)	135	(18)	115
Net income	<u>\$ 14,127</u>	<u>\$ 8,879</u>	<u>\$ 32,502</u>	<u>\$ 22,429</u>
Weighted average shares outstanding:				
Basic	18,930	18,880	18,915	18,877
Diluted	18,946	19,020	18,926	18,972
Net Income Per Share:				
Basic	\$ 0.75	\$ 0.47	\$ 1.72	\$ 1.19
Diluted.	\$ 0.75	\$ 0.47	\$ 1.72	\$ 1.18
Earnings before interest, taxes, depreciation, amortization and impairment charges (EBITDA) reconciliation:				
Net income	\$ 14,127	\$ 8,879	\$ 32,502	\$ 22,429
Equity in (income)/losses of unconsolidated affiliate	137	(135)	18	(115)
Provision for income taxes	343	6,044	602	14,972
Expense associated with convertible debt exchange	-	-	-	1,090
Impairment charge	1,414	-	1,414	-
Depreciation and amortization expense	6,969	7,319	13,985	14,536
Amortization of development costs	1,926	2,356	3,994	3,959
Interest expense	9,315	6,867	19,281	14,779
EBITDA	<u>\$ 34,231</u>	<u>\$ 31,330</u>	<u>\$ 71,796</u>	<u>\$ 71,650</u>

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SCHOOL SPECIALTY, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share and Per Share Amounts)
Unaudited

	October 27, 2012	April 28, 2012	October 29, 2011
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 5,577	\$ 484	\$ 4,141
Restricted cash	2,708	-	-
Accounts receivable, net	119,275	62,826	127,722
Inventories	84,769	100,504	77,253
Deferred catalog costs	3,377	11,737	7,079
Prepaid expenses and other current assets	13,371	11,111	14,218
Refundable income taxes	3,520	3,570	-
Deferred taxes	4,797	4,797	1,700
Total current assets.	237,394	195,029	232,113
Property, plant and equipment, net	50,836	57,491	59,962
Goodwill	41,093	41,263	127,990
Intangible assets, net	119,120	124,242	150,521
Development costs and other	35,807	35,206	35,054
Deferred taxes long-term	390	390	7,218
Investment in unconsolidated affiliate	9,882	9,900	20,515
Total assets	<u>\$ 494,522</u>	<u>\$ 463,521</u>	<u>\$ 633,373</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Current maturities - long-term debt	\$ 10,833	\$ 955	\$ 43,272
Accounts payable	63,770	74,244	40,816
Accrued compensation	10,974	8,094	12,284
Deferred revenue	3,481	3,095	4,389
Accrued income taxes	-	-	13,122
Other accrued liabilities	20,423	18,932	29,223
Total current liabilities	109,481	105,320	143,106
Long-term debt - less current maturities	284,519	289,668	266,350
Deferred taxes	-	-	-
Other liabilities	587	587	688
Total liabilities	<u>394,587</u>	<u>395,575</u>	<u>410,144</u>
Commitments and contingencies			
Shareholders' equity:			
Preferred stock, \$0.001 par value per share, 1,000,000 shares authorized;			
none outstanding	-	-	-
Common stock, \$0.001 par value per share, 150,000,000 authorized and			
24,599,159; 24,290,345 and 24,300,545 shares issued, respectively	24	24	24
Capital paid-in excess of par value	445,059	444,428	443,293
Treasury stock, at cost 5,420,210; 5,420,210 and 5,420,210 shares, respectively	(186,637)	(186,637)	(186,637)
Accumulated other comprehensive income	22,486	23,631	23,603
Accumulated deficit	(180,997)	(213,500)	(57,054)
Total shareholders' equity	99,935	67,946	223,229
Total liabilities and shareholders' equity	<u>\$ 494,522</u>	<u>\$ 463,521</u>	<u>\$ 633,373</u>

- More -

SCHOOL SPECIALTY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)
Unaudited

	Six Months Ended	
	October 27, 2012	October 29, 2011
Cash flows from operating activities:		
Net income	\$ 32,502	\$ 22,429
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and intangible asset amortization expense	13,985	14,536
Amortization of development costs	3,994	3,959
Amortization of debt fees and other	3,779	1,751
Share-based compensation expense	723	1,181
Impairment of long-term asset	1,414	-
Equity in losses/(income) of investment in unconsolidated affiliate	18	(115)
Deferred taxes	-	(4,246)
Expense associated with convertible debt exchange	-	1,090
Non-cash convertible debt interest expense	4,497	5,005
Changes in current assets and liabilities:		
Accounts receivable	(56,356)	(61,162)
Inventories	15,737	34,000
Deferred catalog costs	8,008	9,560
Prepaid expenses and other current assets	(2,212)	295
Accounts payable	(11,001)	(45,089)
Accrued liabilities	4,446	10,101
Net cash provided by/(used in) operating activities	<u>19,534</u>	<u>(6,705)</u>
Cash flows from investing activities:		
Additions to property, plant and equipment	(2,460)	(3,667)
Investment in product development costs	(3,182)	(3,816)
Change in restricted cash	(2,708)	-
Proceeds from note receivable	3,000	-
Net cash used in investing activities	<u>(5,350)</u>	<u>(7,483)</u>
Cash flows from financing activities:		
Proceeds from bank borrowings	819,753	300,600
Repayment of debt and capital leases	(819,591)	(290,429)
Payment of debt and other	(9,253)	(1,663)
Net cash (used in)/provided by financing activities	<u>(9,091)</u>	<u>8,508</u>
Net decrease in cash and cash equivalents	5,093	(5,680)
Cash and cash equivalents, beginning of period	484	9,821
Cash and cash equivalents, end of period	<u>\$ 5,577</u>	<u>\$ 4,141</u>
Free cash flow reconciliation:		
Net cash (used in)/provided by operating activities	\$ 19,534	\$ (6,705)
Additions to property and equipment	(2,460)	(3,667)
Investment in product development costs	(3,182)	(3,816)
Free cash flow	<u>\$ 13,892</u>	<u>\$ (14,188)</u>

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School Specialty, Inc.
Segment Analysis - Revenues and Gross Profit/Margin Analysis
(In thousands)
Unaudited

Segment Revenues and Gross Profit/Margin Analysis-QTD

	<u>2Q13-QTD</u>	<u>2Q12-QTD</u>	<u>Change \$</u>	<u>Change %</u>	<u>% of Revenues</u>	
					<u>2Q13-QTD</u>	<u>2Q12-QTD</u>
Revenues						
Educational Resources	\$ 171,089	\$ 173,222	\$ (2,133)	-1.2%	72.2%	68.9%
Accelerated Learning	65,610	77,986	(12,376)	-15.9%	27.7%	31.0%
Corporate and Interco Elims	167	167	-		0.1%	0.1%
Total Revenues	<u>\$ 236,866</u>	<u>\$ 251,375</u>	<u>\$ (14,509)</u>	<u>-5.8%</u>	<u>100.0%</u>	<u>100.0%</u>

	<u>2Q13-QTD</u>	<u>2Q12-QTD</u>	<u>Change \$</u>	<u>Change %</u>	<u>% of Gross Profit</u>	
					<u>2Q13-QTD</u>	<u>2Q12-QTD</u>
Gross Profit						
Educational Resources	\$ 57,082	\$ 53,481	\$ 3,601	6.7%	61.6%	56.3%
Accelerated Learning	35,456	40,825	(5,369)	-13.2%	38.2%	42.9%
Corporate and Interco Elims	162	754	(592)		0.2%	0.8%
Total Gross Profit	<u>\$ 92,700</u>	<u>\$ 95,060</u>	<u>\$ (2,360)</u>	<u>-2.5%</u>	<u>100.0%</u>	<u>100.0%</u>

Segment Gross Margin Summary-QTD

	<u>2Q13-QTD</u>	<u>2Q12-QTD</u>
Gross Margin		
Educational Resources	33.4%	30.9%
Accelerated Learning	54.0%	52.3%
Total Gross Margin	<u>39.1%</u>	<u>37.8%</u>

Segment Revenues and Gross Profit/Margin Analysis-YTD

	<u>2Q13-YTD</u>	<u>2Q12-YTD</u>	<u>Change \$</u>	<u>Change %</u>	<u>% of Revenue</u>	
					<u>2Q13-YTD</u>	<u>2Q12-YTD</u>
Revenues						
Educational Resources	\$ 344,776	\$ 359,286	\$ (14,510)	-4.0%	70.5%	68.1%
Accelerated Learning	143,895	167,839	(23,944)	-14.3%	29.4%	31.8%
Corporate and Interco Elims	334	334	-		0.1%	0.1%
Total Revenues	<u>\$ 489,005</u>	<u>\$ 527,459</u>	<u>\$ (38,454)</u>	<u>-7.3%</u>	<u>100.0%</u>	<u>100.0%</u>

	<u>2Q13-YTD</u>	<u>2Q12-YTD</u>	<u>Change \$</u>	<u>Change %</u>	<u>% of Gross Profit</u>	
					<u>2Q13-YTD</u>	<u>2Q12-YTD</u>
Gross Profit						
Educational Resources	\$ 117,641	\$ 113,918	\$ 3,723	3.3%	59.9%	55.2%
Accelerated Learning	78,330	90,982	(12,652)	-13.9%	39.9%	44.1%
Corporate and Interco Elims	326	1,436	(1,110)		0.2%	0.7%
Total Gross Profit	<u>\$ 196,297</u>	<u>\$ 206,336</u>	<u>\$ (10,039)</u>	<u>-4.9%</u>	<u>100.0%</u>	<u>100.0%</u>

Segment Gross Margin Summary-YTD

	<u>2Q13-YTD</u>	<u>2Q12-YTD</u>
Gross Margin		
Educational Resources	34.1%	31.7%
Accelerated Learning	54.4%	54.2%
Total Gross Margin	<u>40.1%</u>	<u>39.1%</u>

- More -

School Specialty, Inc.
Reconciliation of GAAP Net Income and Net Income per Share to Adjusted Net Income and Net
Income per Diluted Share
(In Thousands, Except Per Share Amounts)
Unaudited

	Three Months Ended		Six Months Ended	
	<u>October 27, 2012</u>	<u>October 29, 2011</u>	<u>October 27, 2012</u>	<u>October 29, 2011</u>
GAAP Net Income	\$ 14,127	\$ 8,879	\$ 32,502	\$ 22,429
Special Items, net of tax:				
Expense associated with convertible debt exchange	-	-	-	671
Expense associated with debt refinancing (included in interest expense)	-	-	2,490	-
Restructuring (included in SG&A)	-	864	1,103	864
Impairment of long-term asset	1,414	-	1,414	-
Adjusted Net Income	<u>\$ 15,541</u>	<u>\$ 9,743</u>	<u>\$ 37,509</u>	<u>\$ 23,964</u>

	Three Months Ended		Six Months Ended	
	<u>October 27, 2012</u>	<u>October 29, 2011</u>	<u>October 27, 2012</u>	<u>October 29, 2011</u>
GAAP Net Income per Diluted Share	\$ 0.75	\$ 0.47	\$ 1.72	\$ 1.18
Special Items, net of tax:				
Expense associated with convertible debt exchange	-	-	-	0.04
Expense associated with debt refinancing (included in interest expense)	-	-	0.13	-
Restructuring (included in SG&A)	-	0.05	0.06	0.05
Impairment of long-term asset	0.07	-	0.07	-
Adjusted Net Income per diluted share	<u>\$ 0.82</u>	<u>\$ 0.51</u>	<u>\$ 1.98</u>	<u>\$ 1.26</u>

Note: Totals may not foot due to rounding differences.

School Specialty's financial results for the three and six months ended October 27, 2012 and October 29, 2011 included certain items that management believes are not representative of its operating performance. This additional information and reconciliation is not meant to be considered in isolation or as a substitute for the company's results of operations as prepared and presented in accordance with GAAP.

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EX-99.2 3 exh992.htm TRANSCRIPT OF EARNINGS CONFERENCE CALL

School Specialty, Inc. Company ▲	SCHS Ticker ▲	Q2 2013 Earnings Call Event Type ▲	Nov. 20, 2012 Date ▲
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the School Specialty Second Quarter Fiscal 2013 Earnings Conference Call. As a reminder, this conference is being recorded.

It is now my pleasure to introduce Elizabeth Higashi responsible for School's Specialty's Investor Relations. Ms. Higashi, you may begin.

Elizabeth M. Higashi, Head-Media & Investor Relations

Thank you. Good morning, everyone, and welcome to School Specialty's fiscal 2013 second quarter conference call. Our presenters this morning are President and CEO, Mike Lavelle; and Chief Financial Officer, Dave Vander Ploeg.

I'd like to point out that the presentation this morning will include the use of slides. The slides will be automatically advanced during the presentation and are available on the Investor Relations portion of our website at www.schoolspecialty.com. If you are listening via conference call and have the webcast on mute, there may be a slight delay as the slides change.

Before I turn the call over to Mike, I would like to review our Safe Harbor provision. This presentation may contain statements concerning future results of operations, expectations, plans, or prospects. Such statements are forward-looking statements. Forward-looking statements also include those preceded by or followed by words like anticipate, believe, could, expect, intend, may, should, plan, targets or similar expressions.

These forward-looking statements are based on School Specialty estimates and assumptions as of the date of this presentation, and as such involve uncertainty and risk. These statements are not guarantees of future performance and actual results may differ materially from those contemplated by the forward-looking statements due to a number of factors, including those described in Item 1-A of School Specialty fiscal 2012 Annual Report on Form 10-K.

These factors are incorporated by reference. Except to the extent required under federal securities laws, School Specialty does not intend to update or revise the forward-looking statements.

And now, I'd like to introduce our President and CEO, Mike Lavelle. Mike?

Michael P. Lavelle, President, Chief Executive Officer & Director

Thank you, Elizabeth. As you could from our release this morning, our second quarter's results are beginning to reflect some improvement compared with previous quarter results, primarily reflecting the effect of improved gross margins and impacts on prior-quarter cost actions. And while we typically point out the importance of you in this school season and the entirety of the first six months, I think it's even more important that we point out our improving quarterly operating trends, despite the challenging environment. We are working hard on our turnaround strategies even as we focus on EBITDA and working capital in the short term.

This morning, I'd like to start by updating you on the overall market and current school environment and then discuss the status of our major turnaround strategies, including our initiatives, the schools in the areas affected by Hurricane Sandy. Then Dave will cover the latest operating results for the quarter and year-to-date results.

Moving on to the industry. School spending trends in 2012 have continued to be challenging this school season. The Association of American Publishers reported year-to-date declines through

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September of 19%, with sales and adoption states down 25%, and open territory states down 12%. Many of our education peers, primarily those by text book and curriculum markets, continued to report double-digit declines in revenue in their latest quarterly results.

The School Market Research Institute also disclosed a couple of weeks ago that 60% of its survey respondents reported sales declines through September. As you can see from our second quarter results, our revenues declined and our gross margins and operating income percentages improved, particularly in the largest part of our business, Educational Resources, which represents just over 70% of our revenues.

As discussed in previous calls, market headwinds have been more severe than we have anticipated planning for the school year. Our curriculum business, notably our Science division, has the most affected due to delays in the finalization of next-generation science standards with the ways possibly moving into Q1 2013 with the finalization of the standards. School districts contained or withhold spending as the impact from the pending changes to common course standards and general economic conditions remain uncertain.

Again as shown on prior calls, local funding provides approximately 44% of school budgets with state funding providing about 47% and federal funding providing the remaining. While there continues to be mixed forecast of state budgets, some positive news is beginning to pop up around the country. And while per student expenditure is down in some states, overall education budgets are showing signs of growth and property and state tax revenues are beginning to recover in selected markets from post 2008 recession levels.

On the state funding side, Proposition 30 in California was approved by voters. That means about \$6 billion annually should be available for educational spending in K-12 and state colleges and universities to spend over the next three years. Oregon also repealed a kicker for corporate tax surpluses, which will mean about \$120 million over two years for education and Colorado's governor proposed the budget to increase K-12 spending by \$416 million in the next school year.

At the city and district level, following Hurricane Sandy's devastation, the city of New York also said that they would provide \$200 million for school infrastructure repairs. Although these are isolated in specific states and/or events, their action is moving in the right direction for our market. Looking ahead at the state adoption market and school construction, the adoption market is expected to improve with planned science adoptions. Texas, which hasn't updated the science curriculum since 1999, has already announced their intention to adopt new curriculum for the 2014 school year.

As you can see, Texas represents over 5 million students in K-12 grades and will be an important contributor to industry sales.

Year-over-year forecast by third-party industry sources show gains in K-12 construction spending for the first time in five years of the school year, and we are hopeful these trends will fuel improving purchases, our classroom supplies and furniture purchases longer term.

Moving onto an update on our turnaround framework, as I had mentioned previously, the selling season has continued to be a challenge. We are making progress in our turnaround initiatives although we are at different stages of implementation. We continue to integrate our marketing initiatives through a restructuring of product marketing support and branding, and while we are still trying to catch up in terms of product management, we are moving in the right direction.

Pat Collins, our new Senior Vice President of Sales, joined us in early September and has been extremely busy analyzing and planning the implementation of a sales organizational structure and process for the company. We are focused on implementing the changes that will help us improve market share and expand sales where we can achieve our long term goals at double-digit EBITDA margins.

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Another major initiative on the list is business optimization, and we continue to work on programs more cost effectively source the way we buy materials and services. Our analysis of business operations suggests that opportunities exist to buy more effectively and efficiently with benefits to begin to start accruing by next year. And we continue to make progress in expanding our product lines through partnerships with this fall's launch of in command and partnership with New York University. In addition, we recently find a partnership agreement with Curriculum Concepts International to distribute an early intervention and prevention solution towards student planning and development group.

Lastly, the company is pleased to announce that we've engaged Perella Weinberg Partners to help us analyze these matters and provide support in achieving the company's goals.

With that, I'll move on to the financial section and pass it onto Dave Vander Ploeg.

David N. Vander Ploeg, Chief Financial Officer & Executive Vice President

Thank you, Mike, and good morning, everyone. As Mike mentioned, we continue to be impacted by a challenging market and for the second quarter just ended total revenues declined 5.8% to \$237 million. As you can see from slide 12, Educational Resources revenue was \$171 million or about flat with the prior year. Our basic school supplies sales volumes improved while purchases at schools viewed as more discretionary in nature continued to be postponed. During the quarter, online sales were up – were about 36% of educational resources, non-project sales. Accelerated Learning, our curriculum, and student planning business was off nearly 16% compared to the prior year with revenues of \$65.6 million. Uncertainty over funding priorities and the finalization of assessments for next generation science standard has many states in a holding pattern before they make any curriculum decisions.

Turning to slide 13, consolidated gross profit was \$92.7 million compared with \$95.1 million last year or a decline of 2.5%. Consolidated gross margins improved to 39.1%, an increase of 130 basis points, primarily due to strong margin improvement by both Educational Resources and Accelerated Learning. Educational Resources improved second quarter gross margin by 250 basis points to 33.4% following a 240-basis point improvement in the first quarter. Positive pricing and disciplined cost management continued to drive these favorable results. Despite revenue declines, accelerated learning gross margins improved to 54% in the quarter from 52.3% or an improvement of 170 basis points over the prior year. Reading, Health, and the Agenda businesses, all improved year-over-year, driven primarily by favorable product mix in the quarter. And on a consecutive basis, as you see on slide 14, we have been making progress overall for the last three quarters, and on a trailing 12-month basis have increased gross margin by 70 basis points.

On the next slide you can see that selling, general, and administrative expenses decreased 8.2% to \$67.4 million compared with \$73.4 million last year. The improvement was primarily related to lower employee cost, reflecting a 10% decline in our average head count and restructuring cost savings compared with last year's fiscal quarter. In addition, the company benefited from variable cost savings related to this lower volume.

During the current quarter, we received a \$3 million settlement of the note issued to the company in the divestiture of a business back in 2008. The payment related to a long-term asset, which resulted in an impairment charge of \$1.4 million. This activity brings closure to certain divestiture activities dating back four years.

Interest expense for the quarter was \$9.3 million compared with \$6.9 million in the previous year. This increase is largely driven by higher interest rates on our term loan and a pre-payment charge on the term-loan principal payment. The provision for income taxes in fiscal 2013 was \$343,000

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compared with \$6 million last year. The decline in taxes was related to projected tax losses for the current year in combination with tax valuation allowances recorded in the fourth quarter of last year. The decrease in tax expense of about \$5.5 million dollars amounted to approximately \$0.30 per diluted share.

Net income increased 59% to \$14 million compared with \$8.9 million last year. Diluted earnings per share in this year's second quarter increased 60% to \$0.75 versus \$0.47 in the prior year. EBITDA, defined as earnings before interest, taxes, depreciation, amortization and impairment charges, increased 9.3% to \$34.2 million.

Now for a quick review of the year-to-date results, let's turn to slide 16. Revenues for the six months declined 7.3% to \$489 million, a decline of \$38.5 million dollars from the prior year. Nearly two-thirds of the decline was related to the slowdown in curriculum sales within the Accelerated Learning Group, primarily due to postponements of purchasing by districts awaiting further clarification of assessments for certain core subjects. This revenue decline was comparable to other curriculum providers. Educational Resources, which represents 70% of our revenue, declined 4% for the six months. Our online business continues to grow with total revenues up 8% year-to-date and now accounts for about 36% of our non-project sales.

On the next slide, you can see that gross profit for the six months declined about 5% as the decline of \$12.7 million in Accelerated Learning offset the \$3.7 million improvement in gross profit by Educational Resources, which benefited from the previously discussed pricing and costing actions implemented earlier in the year.

Slide 18 summarizes our six-month results at a glance. SG&A expenses declined 7%, consistent with the volume declines in the overall business. This decrease was primarily driven by a reduction in employee cost, as previously mentioned, as well as reductions in variable expenses and reduced catalog circulation costs. For the six months, interest expense increased about 22%, however, this year's results include a combination of debt issuance cost, as well as the pre-payment charge previously mentioned. For annualized modeling purposes, cash interest expense is running at about \$19 million a year.

We continued to benefit from federal tax credits, as the valuation allowances we took in the fourth quarter of last year reduced our taxes substantially for the full year, and we expect to pay no federal tax and little state tax for the full year.

Net income improved nearly 45% to \$32.5 million for the six-month period, with diluted earnings per share of \$1.72 versus the \$1.18 in the prior year. EBITDA, which excluded the impairment – the impact of impairment charges was \$71.8 million for the six months compared with \$71.7 million in the previous year.

Slide 19 shows that on a non-GAAP basis, net income per diluted share would have been \$0.82 for the quarter compared with \$0.51 last year, and \$1.96 for the six months of this year versus \$1.26 per diluted share last year.

Moving to the cash flow statement on slide 20, for the six months, net cash provided by operating activities totaled \$19.5 million, an increase of more than \$27 million from the previous year. We invested nearly \$6 million in capital spending and product development costs. We received a \$3 million for the long-term asset I previously mentioned which offset the change in restricted cash, which is there for letter of credit purposes.

In total, we generated \$13.9 million in free cash flow, an improvement of more than \$27 million compared with the prior year. This improvement was largely driven by timing of certain working capital items and careful planning around capital spending and product investment decisions.

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Total funded debt ended the quarter at \$302 million, a decrease of \$70 million from Q1 levels. We met our financial covenants for the latest period, and our priority continues to be to pay down debt. We anticipate total funded debt to come down slightly to our typical trough at the end of our third quarter.

As we said in our press release, given the ongoing market headwinds, we estimate that fiscal 2013 revenue is likely to decline in the mid-single-digit range compared to \$732 million the company reported in fiscal 2012. All though revenues behind our planned levels, we are making progress on our immediate priorities and turnaround initiatives to improve EBITDA and thus are holding to our fiscal 2013 EBITDA guidance, and expect to continue to make good progress on improving gross margin.

Finally, since we will undoubtedly get questions around the debt covenants. Let me reiterate what we have previously said in our 10-Q disclosures. The company closely evaluates its ability to remain in compliance with the financial covenants under our asset-based credit and term loan credit agreements. The recent challenges affecting the company's performance have placed and are expected to continue to place in the near-term pressures on the company's ability to maintain acceptable levels of liquidity and to remain in compliance with its covenant. As previously noted, our priorities include improving EBITDA and closely managing and improving working capital. The company continues to pursue a number of alternatives, including those that were previously announced as immediate priorities and long-term initiative to address these goals. Given that these alternatives are still under evaluation, we do not intend to comment further during this call.

And now, operator, we're ready for questions.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We ask that you limit your questions to one follow-up, so that we can accommodate everyone on the line. Our first question comes from Dick Ryan of Dougherty. Your line is open.

<Q – Dick Ryan>: Congratulations on a good job of executing in a pretty tough environment. Dave, on the cost control side, that you did a much better job than we were modeling, can you kindly give us some sense of what we should maybe consider for the next couple of quarters?

<A – David Vander Ploeg>: Yeah, great question, Dick, and I appreciate your comments. I think it comes in two fronts. One is, we continue to do better than even our internal plans were for improving the gross margin in the Educational Resources business, and while we will now begin to lap ourselves with new catalogs that are coming out in January, we would anticipate that we will continue to see our gross margin expansion in educational resources.

On the accelerated learning side, it really comes down to the mix of business and so it could go up or it could go down a little bit in any given quarter based on just the mix of the products. On the SG&A side, we're doing a great job of managing our labor costs and driving productivity throughout the organization most notably in our DCs and we would continue to expect to see the types of improvement from an SG&A leverage standpoint that we've been in the first half of the year.

<Q – Dick Ryan>: Okay. My follow-up on the term loan side, Dave, what – can you talk about what – how much you paid down and of the \$9.3 million how much was prepayments and if there was a component there of prepayment fee versus interest?

<A – David Vander Ploeg>: Yes. Great question. So on the \$3 million settlement, that's something we've been working on obviously for four years since we divested off our visual media business. And because that long-term asset was part of the collateral within our term loan agreement, we were obligated to pay down the term loan by the amount that we collected which was the \$3 million. It did come with a pre-payment make whole provision and that totaled about \$1.4 million. And so that's kind of the fact around bringing down the term loan from \$70 million to now it is, at \$67 million.

And then really included in the \$9.3 million for the quarter would be the fees to pre-pay that.

Operator: Thank you. Our next question comes from David Epstein from CRT Capital. Your line is open.

<Q – David Epstein>: Hi, folks. So, I am sure I could back into it know that you have given the term loan balance, but can you just give the ABL balance and how much of that might consider short term and what are the criteria for a piece of that to be classified as short-term?

<A>: Yeah, the term loan at the end of October was \$55 million.

<Q – David Epstein>: Do you mean ABL?

<A>: I'm sorry, the ABL. I apologize.

<Q – David Epstein>: Sure.

<A>: And then \$57 million was term loan, and \$10 million of that is classified as current.

<Q – David Epstein>: What is the criteria for that, if it's backed by some inventory or receivables that's going to be worked down or...?

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<A>: Yes, exactly.

<Q – David Epstein>: Okay. And any guidance on what CapEx might be for the full year?

<A>: Yeah. We still believe that CapEx will be between \$15 million and \$16 million. You can see we're running a little wide of that in the first half of the year, but based on the projects that are in the queue, that's what I would use for modeling purposes.

<Q – David Epstein>: Okay. And one more and then I'll get back into the queue. Were there any one-time gains in the quarter?

<A>: No. There were not.

<Q – David Epstein>: Thanks very much.

Operator: Thank you. [Operator Instructions] We have a follow up question from Dick Ryan of Dougherty. Your line is open. Pardon me, Mr. Ryan; your line is open.

<Q – Dick Ryan>: Hello?

Operator: Yes, your line is open.

<Q – Dick Ryan>: Hello?

<A – David Vander Ploeg>: We can hear you.

<Q – Dick Ryan>: Okay. Maybe a two-part question. You mentioned Sandy briefly and the funding from New York, have you seen or heard anything on the New Jersey side? And maybe you're lumping in with that? What do you see, I mean, how has your furniture business been tracking and what percent was that in the quarter?

<A – Michael Lavelle>: Great question, Dick. This is Mike, I will answer this in two pieces. So the first question on Hurricane Sandy, I mean obviously, our thoughts and prayers are with everyone on the East Coast that have suffered from the damages from the storm. Schools Specialty has approached the challenges in New York and to New Jersey through multiple approaches, one we're working with some donation charitable contributions to the Red Cross, we're also working through our state contracts, also our district level support to see how we can assist the efforts in getting the schools back up and running.

In the short-term, obviously, the impact of the storm will cause some delays in traditional normal buying given that schools are closed in a lot of places, and then ultimately we expect a pickup in revenue and some incremental revenue as schools replace a lot of their damage materials and damaged furniture and we expect that to be the case in new York as well as in New Jersey and ultimately, the rate of those replacements we expect will take place over a time, not all that in immediate basis.

When we look at our furniture business, I think Dave has mentioned this in the past, our furniture pipelines, backlogs, have been good this year, we seen they moving in the right direction but is always is the case, it's a business that has long lead times, loan cycle times that they are subject to change when you talk about pipeline. But we have seen good movement and they are parts of our business that we continue to focus our efforts in growing.

Operator: Our next question comes from Gregory Macosko of Lord Abbett. Your line is open.

School Specialty, Inc. Company ▲	SCHS Ticker ▲	Q2 2013 Earnings Call Event Type ▲	Nov. 20, 2012 Date ▲
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<Q – Gregory Macosko>: Yes. Thank you. I may ask few questions and maybe little bit standard or fundamental, but could you speak just a little bit about where we stand with regard to the school budgets, is there anything with regard to municipal bond funding or other issues that may be affecting – the weakness that you saw little bit more than you had expected?

<A – Michael Lavelle>: That's good question. I would answer that question this way, I mean obviously when we look at funding, we look at the education market; multiple sources of funding impact the overall funding picture. So federal funding, state funding and local funding and ultimately activities at all of those levels impact how schools operate them by.

From our evaluation of all of the metrics that are out there and all of the market data as well as what we experience in the market, we envision that the market will remain over the short-term challenge, maybe not as challenged as what we've seen them this past year, but we remain challenged.

On the flipside, we are encouraged by some of the recent movement that we've seen over the past couple of months and with the recent election around parts of the country seeing recovery in local property tax receipts, the continued movement of improvement at state levels with state tax receipts, at an obviously selected states that we talked about that have approved new funding sources for education we believe are all actions moving in the right direction, albeit they are isolated in different places and at different levels.

Operator: Thank you. Our next question come with Peter Ellingboe of Q Investments. Your line is open.

<Q – Peter Ellingboe>: Hi Dave. Hi Mike. Congratulations on the good quarter. I just have a question on accelerated side. I know that there is a covenant that relates to just the term loan balance versus accelerated learning EBITDA. Is there – how should we be thinking about what accelerated learning EBITDA looks like after sort of being down so much on the top line?

<A – David Vander Ploeg>: Yeah, we do have that – we do have that covenant and obviously by paying down \$3 million of the term loan that improved our position on that. And we will just continue to manage that side of the business like we really have been in the entire portfolio to work at staying in compliance on it.

Operator: Thank you. Our next question comes from Owen Douglas of Gleacher & Company. Your line is open.

<Q – Owen Douglas>: Hi. Just a quick question. This is talking about your balance sheet for a second. I noticed at the end of the quarter, if I would just look at the year-over-year, there were bit more in inventories than I imagined that you would have, does this indicate that you think that some of the revenue is going to be a little higher in Q3? I know you said you think year-over-year is going to be lower. So I'm just trying to make sense of this why you have more inventory ending this period than you did last year.

<A – David Vander Ploeg>: Yeah, great question. There are really two factors that tie into it. One is as we talked about, we had softer sales in the first half of the year than we had anticipated and much of that inventory comes into our warehouses in the February, March, April timeframe. And so we didn't get quite the inventory turns that we were hoping for because of the softness that we experienced. That's probably part of the answer. The other part then is, we do have a pretty strong backlog in furniture, and we have partially assembled parts that tie to our furniture sales that are on our balance sheet and those will be converted in the finished goods and sold in the back half of the year. So those are the two primary drivers of why inventory is up slightly.

School Specialty, Inc. Company ▲	SCHS Ticker ▲	Q2 2013 Earnings Call Event Type ▲	Nov. 20, 2012 Date ▲
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<Q – Owen Douglas>: Okay. So I should I expect to see that getting monetized pretty quickly then?

<A – David Vander Ploeg>: That's correct, in the second half of the year.

<Q – Owen Douglas>: Okay. And also just looking at the payables though, the payables that's quite a bit year-over-year, so was I just wondering to what extent are your guys taking working capital as a means to try to help by your liquidity position, and just wondering whether or not you're noticing any pushback on the part of some of your suppliers?

<A – David Vander Ploeg>: Yeah, great question. We have said for the last several years that working capital is always the key focus of ours. It continued to be in the current quarter. We are regularly in communication with our vendors. They have been very supportive and we'll just continue to make that a priority.

Operator: Thank you. I'm showing no further questions in the queue at this time. I'll hand the call back to Ms. Elizabeth Higashi for closing remarks.

Elizabeth M. Higashi, Head-Media & Investor Relations

Thank you so much. We appreciate your participation in the call today, and of course, we'll follow up with any other questions that you might have later today. And a have a great Thanksgiving. Bye, bye.

Operator: Thank you, ladies and gentlemen. This concludes the conference for today. You may now disconnect. And have a wonderful day.

Disclaimer

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Exhibit B

**FIRST AMENDMENT TO JUNIOR DEBTOR-IN-POSSESSION FINANCING
COMMITMENT**

This FIRST AMENDMENT TO JUNIOR DEBTOR-IN-POSSESSION FINANCING COMMITMENT (the "Amendment"), dated as of January 24, 2013, amends certain terms and conditions set forth in that certain Junior Debtor-in Possession Financing Commitment (the "Commitment") entered into January 23, 2013 by and among the undersigned Lenders. Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to such terms in the Commitment.

1. Amendment of "Annex A" to Commitment

Annex A to the Commitment shall be hereby amended, restated and otherwise replaced in its entirety with Annex A attached hereto.

2. Amendment to "Expiration"

The "Expiration" set forth in the Commitment shall be hereby amended and restated in its entirety as follows:

Expiration: This Term Sheet automatically expires upon the later of (a) two (2) business days after the final hearing regarding the debtor-in-possession financing for the Company junior to the ABL DIP Facility in the Cases; and (b) February 21, 2013. If accepted by the Company, this Term Sheet shall continue in effect, subject to the provisions hereof, until one day after the Closing Date.

3. No Other Changes

Except as specifically amended or referenced herein, the Commitment shall remain in full force and effect in accordance with its original terms, and is hereby ratified and confirmed. Upon the effectiveness of this Amendment, each reference in the Commitment to "this Term Sheet", "hereunder", "herein", "hereof" or words of like import referring to the Commitment shall mean and be a reference to the Commitment as amended by this Amendment.

4. Counterparts.

This Amendment may be executed in any number of counterparts, each of which shall, collectively and separately, constitute one and the same agreement.

5. Successors and Assigns.

This Amendment and the Commitment shall be binding upon and inure to the benefit of and shall be enforceable by the parties and their respective affiliates as permitted by and in accordance with the terms of the Commitment.


6. No Novation.

This Amendment is not intended to be, nor shall it be construed to create, a novation or accord and satisfaction, and except as otherwise expressly stated herein, the Commitment (which, along with all

exhibits attached thereto, is incorporated herein by reference) shall remain in full force and effect, and the terms and conditions thereof shall apply to this Amendment.

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Amendment.

Zazove Associates LLC

By: 
Its: Chief Operating Officer

Davis Selected Advisors

By: _____
Its: _____

Angelo Gordon

By: _____
Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager
By: Scepter Holdings, Inc., Its General Partner
By: _____
Noel Nesser, CFO

Lazard Asset Management

By: _____
Its: _____

Steel Excel Inc.

By: _____
Its: _____

Wolverine Flagship Fund Trading Limited

By: _____
Its: _____

One East Master L.P.

By: _____

Its: _____

One East Partners Opportunities Fund

By: _____

Its: _____

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Amendment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: Keith S. Bell

Its: Portfolio Manager

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____
Noel Nesser, CFO

Lazard Asset Management

By: _____

Its: _____

Steel Excel Inc.

By: _____

Its: _____

Wolverine Flagship Fund Trading Limited

By: _____

Its: _____

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Amendment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon LLC

By: Angelo Gordon

Its: Managing Director

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____
Noel Nesser, CFO

Lazard Asset Management

By: _____

Its: _____

Steel Excel Inc.

By: _____

Its: _____

Wolverine Flagship Fund Trading Limited

By: _____

Its: _____

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Amendment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

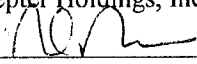
By: _____

Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By:  _____

Noel Nesser, CFO

Lazard Asset Management

By: _____

Its: _____

Steel Excel Inc.

By: _____

Its: _____

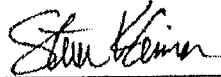
Wolverine Flagship Fund Trading Limited

By: _____

Its: _____

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Amendment.

Zazove Associates LLC

By: 
Its: Chief Operating Officer

Davis Selected Advisors

By: _____
Its: _____

Angelo Gordon

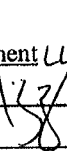
By: _____
Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____
Noel Nesser, CFO

Lazard Asset Management LLC, as agent on behalf of certain accounts
By: CM B. 4/23
Its: COO 

Steel Excel Inc.

By: _____
Its: _____

Wolverine Flagship Fund Trading Limited

By: _____
Its: _____

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Amendment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____

Noel Nesser, CFO

Lazard Asset Management

By: _____

Its: _____

Steel Excel Inc.

By:  _____

Its: Vice Chairman _____

Wolverine Flagship Fund Trading Limited

By: _____

Its: _____

One East Master L.P.

By: _____

Its: _____

One East Partners Opportunities Fund

By: _____

Its: _____

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Amendment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____

Noel Nesser, CFO

Lazard Asset Management

By: _____

Its: _____

Steel Excel Inc.

By: _____

Its: _____

Wolverine Flagship Fund Trading Limited

By:  _____

Its: COO / Director _____

One East Master L.P.

By: _____

Its: _____

One East Partners Opportunities Fund

By: _____

Its: _____

One East Master L.P.

By: B. Scott Reid

Its: Authorized Signatory

One East Partners Opportunities Fund

By: B. Scott Reid

Its: Authorized Signatory

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Amendment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____

Noel Nesser, CFO

Lazard Asset Management

By: _____

Its: _____

Steel Excel Inc.

By: _____

Its: _____

Wolverine Flagship Fund Trading Limited

By: _____

Its: _____

ANNEX A
TERM COMMITMENTS

LENDER	TERM COMMITMENT	PARTICIPATION %
Zazove Associates LLC	\$19,701,587.30	39.4%
Davis Selected Advisors	\$3,569,206.35	7.1%
Angelo Gordon	\$2,698,412.70	5.4%
R2 Investments, LDC	\$952,380.95	1.9%
Lazard Asset Management	\$2,701,587.50	5.4%
Steel Excel Inc.	\$3,779,682.54	7.6%
Wolverine Flagship Fund Trading Limited	\$5,470,476.19	10.9%
One East Master, L.P.	\$416,666.67	0.8%
One East Partners Opp. Fund	\$138,888.89	0.3%
Hudson Bay Capital	\$1,587,301.59	3.2%
LaGrange Capital	\$555,555.56	1.1%
SUBTOTAL:	\$41,571,746.23	79.9%
BACKSTOP FUNDING:	\$8,428,253.77	21.1%
TOTAL:	\$50,000,000.00	100%

BACKSTOP LENDERS	BACKSTOP COMMITMENT	BACKSTOP %
Zazove Associates LLC	\$797,317.46	9.46%
R2 Investments, LDC	\$297,619.05	3.53%
Steel Excel Inc.	\$7,333,317.26	87%
BACKSTOP SUBTOTAL:	\$8,428,253.77	

**JOINDER TO
JUNIOR DEBTOR-IN-POSSESSION FINANCING COMMITMENT**

The undersigned hereby acknowledges as of January 28, 2013 (the "Effective Date") that it has read and understands the Junior Debtor-in-Possession Commitment, dated as of January 23, 2013, as amended by that certain First Amendment to Junior Debtor-in-Possession Commitment, dated as of January 24, 2013 (as may be further amended, supplemented or otherwise modified from time to time, the "Commitment"), by and among the lenders set forth on the signature pages thereof (each, a "Lender" and together with such other lenders as may from time to time become a party to the Commitment pursuant to the terms and conditions of thereof, collectively, the "Lenders"), and agrees to be bound by the terms and conditions thereof as a "Lender", and shall be deemed a "Lender" under the terms of the Commitment with a Term Commitment of \$555,555.56 as of the Effective Date.

LaGrange Capital Administration

By: _____

Name: _____

Title: _____

**ACKNOWLEDGED AND AGREED,
AS OF THE DATE SET FORTH ABOVE**

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____

Noel Nesser, CFO

Lazard Asset Management

By: _____

Its: _____

Steel Excel Inc.

By: _____

Its: _____

Wolverine Flagship Fund Trading Limited

By: _____

Its: _____

**JOINDER TO
JUNIOR DEBTOR-IN-POSSESSION FINANCING COMMITMENT**

The undersigned hereby acknowledges as of January 28, 2013 (the "Effective Date") that it has read and understands the Junior Debtor-in-Possession Commitment, dated as of January 23, 2013, as amended by that certain First Amendment to Junior Debtor-in-Possession Commitment, dated as of January 24, 2013 (as may be further amended, supplemented or otherwise modified from time to time, the "Commitment"), by and among the lenders set forth on the signature pages thereof (each, a "Lender" and together with such other lenders as may from time to time become a party to the Commitment pursuant to the terms and conditions of thereof, collectively, the "Lenders"), and agrees to be bound by the terms and conditions thereof as a "Lender", and shall be deemed a "Lender" under the terms of the Commitment with a Term Commitment of \$1,587,301.59 as of the Effective Date.

Hudson Bay Distressed Master Fund LLC

By: _____

Name: Marc Sole

Title: Authorized Signatory

JUNIOR DEBTOR-IN-POSSESSION FINANCING COMMITMENT

This Term Sheet (the "Term Sheet"), dated as of January 23, 2013, sets forth certain terms and conditions pursuant which the undersigned Lenders (as defined below) are committed to provide a debtor-in-possession term credit facility to School Specialty, Inc., as debtor and debtor-in-possession (the "Borrower"), in connection with a pre-packaged plan of reorganization of the Borrower.

Each of the parties hereto acknowledges and agrees that, notwithstanding the terms set forth below, (1) the terms and conditions set forth below are non-binding in nature and do not create any contractual relationship between the parties; and (2) the final terms and conditions in connection with the Project shall be determined pursuant to final, binding agreements between the parties, including, without limitation, a debtor-in-possession term credit agreement by and among School Specialty, Inc., the Lenders and the Administrative Agent and Collateral Agent (the "DIP Credit Agreement").

Principal Terms of the Junior DIP Facility

- Borrower:** School Specialty, Inc., as debtor and debtor-in-possession in jointly-administered cases (together with the cases of its affiliated debtors and debtors-in-possession, the "Cases") pending as of the filing date (the "Filing Date") under chapter 11 of the United States Bankruptcy Code (11 U.S.C. §§ 101, et seq., "Bankruptcy Code") in the United States Bankruptcy Court for the District of Delaware ("Bankruptcy Court").
- Guarantors:** Borrowers' direct and indirect domestic subsidiaries.
- Lender(s):** Participating Holders of Convertible Notes appearing on the signature pages hereof (together with such other lenders as may from time to time become a party to the DIP Credit Agreement pursuant to the terms and conditions thereof, the "Lenders").
- Administrative Agent and Collateral Agent:** Wilmington Trust Company, or such other agent chosen by the Required Lenders.
- Required Lenders:** As used herein, "Required Lenders" shall mean Lenders representing 68% of the aggregate Term Loan Commitments of the Lenders.
- Term Commitments:** The Term Commitment of each Lender shall be the amounts set forth in Annex A, as modified pursuant to the Backstop Agreement.
- Backstop Agreement:** Together with the execution and delivery of this Term Sheet, certain Backstop Lenders shall execute and deliver the Backstop Agreement attached hereto as Annex D (the "Backstop Agreement"), wherein the Term Commitments of the Backstop Lenders set forth in Appendix A shall adjusted in accordance with the terms and conditions of the Backstop Agreement.
- Plan Support Agreement:** The Lenders shall enter into a plan support agreement in form and substance acceptable to the Lenders (the "Plan Support").

Agreement”), by and among the Borrower, on behalf of itself and its direct and indirect subsidiaries, and the Lenders, proposing a restructuring of all of the Borrower's outstanding obligations to be effectuated pursuant to a prepackaged chapter 11 plan of reorganization with the support of the Lenders.

Junior DIP Facility:

The Lenders will ratably provide the Borrower with debtor-in-possession term credit facility (the "Junior DIP Facility") with a maximum credit amount ("Maximum Credit Amount") of Fifty Million Dollars (US \$50,000,000).

The Junior DIP Facility shall be advanced to the Borrower in an "Initial Advance" of \$20,000,000 and "Subsequent Advances" as required by the Borrower for Permitted Uses.

Security and Priority:

Allowed administrative expense claims having priority pursuant to Section 364(c)(1) of the Bankruptcy Code over all administrative expense claims and unsecured claims against the Borrower, except that such claim shall be junior to any super-priority administrative expense claim granted to the lenders under the ABL DIP Facility.

Third lien on substantially all of the assets of the Borrower per §364(c)(3) of the Bankruptcy Code.

First Lien on Avoidance Actions (all claims and actions under §§502(d), 544, 545, 547, 549, 550, and 553 of the Bankruptcy Code and similar actions and proceeds thereof).

Interest Rate:

LIBOR (Floor 1.5) + 800 Basis Points + 300 Basis Points upon an Event of Default, calculated on the basis of a year of 360 days and the actual number of days elapsed.

Maturity Date:

The earliest of (i) May 30, 2013, (ii) the Equity Conversion (see below); (ii) the termination, following an Event of Default, of the DIP Credit Agreement; or (iv) the effective date of the plan of reorganization of the Borrower (the "Plan Effective Date").

The DIP Credit Agreement shall terminate upon the earliest of (i) acceleration of all of the outstanding Term Loans; (ii) February 28, 2013, unless each of the conditions to lending set forth in such agreement have been satisfied or waived on or prior to such date; (iii) the termination of the Plan Support Agreement pursuant to its terms; or (iv) the Equity Conversion.

Permitted Uses:

The proceeds of the Term Loans shall be used by the Borrower only in accordance with the Approved Budget, including to: (i) pay any accrued and unpaid fees and expenses in connection with the Cases and the transactions contemplated thereby, including, but not limited to the Backstop Fee, Professional Fees and Expenses, the Approved Lenders' Fees, and the Closing Fee; (ii) repay up to \$20,000,000 of the indebtedness outstanding under the existing

asset based credit facility (the "ABL Facility") or an asset based debtor-in-possession facility (the "ABL DIP Facility"); and (iii) provided there is no availability for draws under the ABL Facility, for Subsequent Advances to fund any of the foregoing, pay any amounts owed to Qualified Trade Creditors pursuant to Qualified Trade Agreements.

As used herein, "Qualified Trade Agreement" means an agreement by and between the Borrower and/or its subsidiaries and a Qualified Trade Creditor, in a form acceptable to the Required Lenders. "Qualified Trade Cr diteur" means a trade creditor of Borrower or any of its subsidiaries that (a) is a holder of an allowed claim, (b) prior to the Plan Effective Date, agrees in writing, by either making an election on its ballot, or prior thereto by stipulation in writing acceptable to the Borrower, to: (i) continue to provide substantially the same type and quantity of goods and/or services to the Borrower and/or its subsidiaries as it provided prior to the commencement date of the Cases (the "Commencement Date") for a minimum of two years after the Plan Effective Date at the same price or at other pricing and terms satisfactory to the Borrower, and (ii) provides for a minimum of two years after the Plan Effective Date unsecured trade credit to the Borrower and/or its subsidiaries on payment terms no less favorable than the greater of: (A) net 45 days and (B) the maximum trade terms such trade creditor made available to the Borrower and/or its subsidiaries during the 12 months prior to the Commencement Date.

Approved Budget

As used herein, "Approved Budget" means a rolling thirteen (13) week cash flow projection with respect to the Borrower and its subsidiaries, which shall be in form and substance satisfactory to all the Lenders in connection with the Initial Advance and the Required Lenders in connection with the Subsequent Advances. The Approved Budget will be updated weekly during the continuance of the Case.

Conditions Precedent to Lending:

As set forth on Annex B.

Events of Default:

The DIP Credit Agreement shall include such events of default applicable to the Borrower and their respective subsidiaries as are usual and customary for financings of this type, including, without limitation, the events of default listed on Annex C.

Remedies:

Upon an Event of Default, the Required Lenders or Administrative Agent may accelerate the Term Loans in whole or in part and enforce any other rights and remedies under the loan documents and applicable law, including, without limitation, acting upon the collateral securing the obligations of the Borrower to the Lenders.

Equity Conversion:

Upon the Plan Effective Date, the outstanding principal balance of the Term Loans of each Lender, and the accrued and unpaid interest thereon, shall convert into a number of shares of the Common Stock of the Borrower (which may include fractional shares rounded to four decimal places) equal to:

- (i) such Lender's Percentage; multiplied by
- (ii) the greater of (a) 75% of the total issued and outstanding shares of Common Stock as of the Plan Effective Date; and (b) (x) the aggregate Outstanding Balance of the Term Loans divided by (y) (I) the Plan Enterprise Value¹ less (II) the pro forma debt of the Borrower as of the Plan Effective Date.

Term Notes:

Each of the Lenders shall be issued a convertible term note (each, a "Term Note") in the face value of the outstanding principal amount of its term loans. Such Term Notes shall convert into the equity of the Borrower upon the Plan Effective Date.

Financial Covenants:

Minimum Liquidity Test as set forth in the ABL Facility or ABL DIP Facility.

Select Covenants:

Customary affirmative and negative covenants, warranties and representations for a junior DIP loan.

Other Fees

On the closing date contemplated under the DIP Credit Agreement (the "Closing Date"), the Borrower shall pay, or cause to be paid, to the Administrative Agent the approved Lenders' Fees and the Backstop Fee (as set forth in the Backstop Agreement) for the account of the persons set forth in writing by the Administrative Agent. The Approved Lenders' Fees and the Backstop Fee shall be due and payable on the Closing Date and not refundable under any circumstances.

Expiration:

This Term Sheet expires unless accepted by the Company by not later than January 25, 2013 at 5:00 pm E.S.T. If accepted, this Term Sheet shall continue in effect, subject to the provisions hereof, until one day after the Closing Date.

Counterpart Signatures:

This Agreement may be executed in any number of counterparts, each of which shall, collectively and separately, constitute one and the same agreement.

[Signature page follows.]

¹ Plan Enterprise Value to be adjusted to reflect the Borrower's then current Business Plan (i.e. EBITDA).

FINAL EXECUTION VERSION

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Commitment.

Zazove Associates LLC

By: 

Its: Chief Operating Officer

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: _____

Its: _____

Lazard Asset Management

By: _____

Its: _____

Steel Partners LLC

By: _____

Its: _____

Wolverine Asset Management

By: _____

Its: _____

One East Master L.P.

By: _____

Its: _____

FINAL EXECUTION VERSION

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Commitment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: Keith J. Salal

Its: Portfolio Manager

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: _____

Its: _____

Lazard Asset Management

By: _____

Its: _____

Steel Partners LLC

By: _____

Its: _____

Wolverine Asset Management

By: _____

Its: _____

One East Master L.P.

By: _____

Its: _____

FINAL EXECUTION VERSION

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Commitment.

Zazove Associates LLC

By: _____

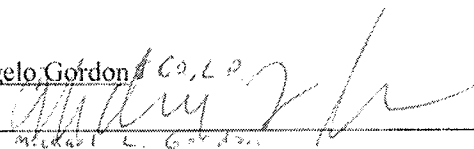
Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon & Co., L.P.

By:  _____
Michael L. Gordon

Its: Chief Operating Officer _____

R2 Investments, LDC

By: _____

Its: _____

Lazard Asset Management

By: _____

Its: _____

Steel Partners LLC

By: _____

Its: _____

Wolverine Asset Management

By: _____

Its: _____

One East Master L.P.

By: _____

Its: _____

FINAL EXECUTION VERSION

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Commitment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

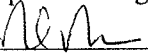
By: _____

Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By:  _____
Noel Nesser, CFO

Lazard Asset Management

By: _____

Its: _____

Steel Partners LLC

By: _____

Its: _____

Wolverine Flagship Fund Trading Limited

By: _____

Its: _____

FINAL EXECUTION VERSION

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Commitment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____
Noel Nesser, CFO

Lazard Asset Management, as agent on behalf of certain accounts
By: CMB-4.32
Its: COO 138

Steel Excel Inc.

By: _____

Its: _____

Wolverine Flagship Fund Trading Limited

By: _____

Its: _____

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FINAL EXECUTION VERSION

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Commitment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

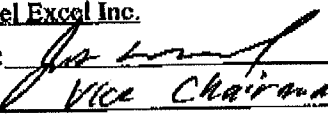
By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By: _____
Noel Nesser, CFOLazard Asset Management

By: _____

Its: _____

Steel Excel Inc.By:  _____Its: Vice ChairmanWolverine Flagship Fund Trading Limited

By: _____

Its: _____

FINAL EXECUTION VERSION

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Commitment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: _____

Its: _____

Lazard Asset Management

By: _____

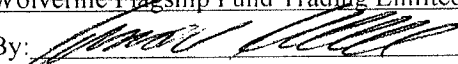
Its: _____

Steel Partners LLC

By: _____

Its: _____

Wolverine Flagship Fund Trading Limited

By:  _____

Its: CHIEF OPERATING OFFICER _____

One East Master L.P.

By: _____

Its: _____

FINAL EXECUTION VERSION

IN WITNESS WHEREOF, subject to the terms, limitations and conditions above, the undersigned parties acknowledge and agree as set forth above and in Annex A to this Commitment.

Zazove Associates LLC

By: _____

Its: _____

Davis Selected Advisors

By: _____

Its: _____

Angelo Gordon

By: _____

Its: _____

R2 Investments, LDC

By: _____

Its: _____

Lazard Asset Management

By: _____

Its: _____

Steel Partners LLC

By: _____

Its: _____

Wolverine Asset Management

By: _____

Its: _____

One East Master L.P.

By: B. Scott Reid

Its: Authorized Signatory

One East Partners Opportunities Fund

By: B. Scott Reel

Its: Authorized Signatory

ANNEX A
TERM COMMITMENTS

LENDER	TERM COMMITMENT	PARTICIPATION %
Zazove Associates LLC	\$19,701,587.30	39%
Davis Selected Advisors	\$3,569,206.35	7.1%
Angelo Gordon	\$2,698,412.70	5.4%
R2 Investments, LDC	\$952,380.95	1.9%
Lazard Asset Management	\$2,265,000*	6.4%*
Steel Excel Inc.	\$3,779,682.54	7.6%
Wolverine Flagship Fund Trading Limited	\$5,470,476.19	10.9%
One East Master, L.P.	\$416,666.67	.833%
One East Partners Opp. Fund	\$138,888.89	.278%
SUBTOTAL:	\$39,951,746.03	
BACKSTOP FUNDING:	\$10,048,253.97	20%
TOTAL:	\$50,000,000.00	100%
	<i>*Balance of \$959,444.44 for total Lazard Term Commitment \$3,224,444.44 subject to account beneficiary approvals due by not later than Jan. 24 5pm EST.</i>	

BACKSTOP LENDERS	BACKSTOP COMMITMENT	BACKSTOP %
Zazove Associates LLC	\$797,317.46	7.93%
R2 Investments, LDC	\$297,619.05	2.96%
Steel Excel Inc.	\$8,953,317.46	89.09%
BACKSTOP SUBTOTAL:	\$10,048,253.97	

ANNEX B
CONDITIONS TO LENDING

The conditions to the Initial Advance and the Subsequent Advances shall include, without limitation, the following:

- (i) an interim order of the Bankruptcy Court approving the DIP Credit Agreement, the Plan Support Agreement and the related loan documents in form and substance acceptable to the Lenders;
- (ii) all motions and other documents to be filed with and submitted to the Bankruptcy Court in connection with the approval of the DIP Credit Agreement (including, without limitation, the DIP Orders) shall be in form and substance satisfactory to the Required Lenders;
- (ii) there shall not be pending any litigation or other proceeding that has not been stayed under Section 362 of the Bankruptcy Code, the result of which could reasonably be expected to have a material adverse effect on the business, financial condition or prospects of the Borrower or the validity or enforceability of the rights of the Lender under the other loan documents, excluding any pending litigation under the Federal False Claims Act or similar applicable state statutes;
- (iv) the Administrative Agent shall have received duly executed and delivered copies of all of the loan documents;
- (v) the Administrative Agent shall have received an officer's certificate from the Borrower certifying the resolutions organizational documents, incumbencies and good standing of the Borrower;
- (vi) the Administrative Agent shall have received an officer's certificate from the Borrower certifying that each applicable condition to lending has been satisfied in accordance with the DIP Credit Agreement;
- (vii) the Administrative Agent shall have received the Approved Budget and such other supporting documents as may be reasonably requested by the Administrative Agent or any Lender;
- (viii) absence of any defaults or events of default under the DIP Credit Agreement, the other loan documents, the ABL Facility or the ABL DIP Facility;
- (ix) the proceeds of the Term Loans shall be applied by the Borrower in accordance with the Permitted Uses;
- (x) payment on the closing date of all fees payable to the Administrative Agent, the Lenders and their Affiliates;
- (xi) the materials furnished to the Administrative Agent by the Borrower to date, taken as a whole, shall have contained no misstatement of material fact and shall have omitted no material fact required to be stated in order to make the statements therein contained not misleading in light of the circumstances under which made;

- (xii) the Administrative Agent shall have received all documentation and other information required by bank regulatory authorities under applicable “know-your-customer” and anti-money laundering rules and regulations, including the USA Patriot Act
- (xiii) the Plan Support Agreement shall have been duly executed and delivered by the parties thereto, shall be in full force and effect and shall not have been amended, supplemented or otherwise modified without the prior written consent of the Required Lenders
- (xiv) no party to the Plan Support Agreement shall have breached the Plan Support Agreement in any manner that adversely affects the interests, rights or remedies of the Lenders, as determined in the sole discretion of the Required Lenders;
- (xv) the Administrative Agent shall have timely received a notice of borrowing;
- (xvi) evidence of Qualifying Trade Agreement with Qualified Trade Creditors to be paid from any proceeds of the Advance;
- (xvii) a certification from the Borrower to the effect that there is no default under the Plan Support Agreement; and
- (xviii) in relation of the Subsequent Advances, evidence that there is no availability under the ABL DIP Facility in connection with the proposed use of the proceeds of such Subsequent Advance (i.e. that the ABL DIP Facility is drawn up to the ABL DIP Facility Cap) and evidence of all the intended uses of such Subsequent Advance in accordance with the DIP Credit Agreement.

ANNEX C

EVENTS OF DEFAULT

Events of Default under the DIP Credit Agreement shall include, without limitation, the following:

- (i) failure to pay any principal of or interest on any Term Loan or Term Note (whether at stated maturity or due date, on demand, upon acceleration or otherwise);
- (ii) default in the performance, or breach of, any agreement or covenant (other than the covenant to obtain approval Plan Support Agreement) in the DIP Credit Agreement or any other loan document;
- (iii) except in accordance with the DIP Orders or the loan documents, or as otherwise permitted by the Required Lenders in writing, the Borrower shall fail to comply with the Approved Budget;
- (iv) except pursuant to a valid, binding and enforceable termination or release permitted under the loan documents and executed by the Administrative Agent or as otherwise expressly permitted under any loan document, (w) any provision of any loan document shall, at any time after the delivery of such loan document, fail to be valid and binding on, or enforceable against, any obligor party thereto, (x) any loan document purporting to grant a lien to secure any obligation shall, upon or at any time after the delivery of such loan document, fail to create a valid and enforceable lien on any collateral or such lien shall fail or cease to be a perfected lien with the priority required in the relevant loan document, (y) any subordination provision pertaining to subordinated debt shall, in whole or in part, terminate or otherwise fail or cease to be valid and binding on, or enforceable against, any holder of subordinated debt or any trustee or representative thereof, or (z) the Borrower or any affiliate thereof, shall assert that any of the events described in clause (x), (y) or (z) above shall have occurred or exist, or shall contest the validity or enforceability of any loan document, or of any such lien or subordination provision; or the perfection or priority of any such lien;
- (v) breach of any representation, warranty or certification when made or deemed made;
- (vi) the Borrower or any affiliate thereof is convicted of, or admits in writing its culpability for, a violation of (i) any criminal statute (or non-statutory Applicable Law relating to criminal offenses) in any jurisdiction constituting a felony offense or, whether or not a felony offense, an act of fraud, money laundering, larceny or similar offense or (ii) any statute or other Applicable Law, if forfeiture of, or the imposition of a Lien or other claim by any Person (other than the Collateral Agent) on or in respect of, any Collateral is a possible remedy or penalty that may lawfully be sought for such violation
- (vii) except to the extent permitted by the DIP Credit Agreement, the Borrower or its subsidiaries shall liquidate, dissolve, terminate or suspend its business operations or any substantial part thereof or otherwise fail to operate its business in the ordinary course, or shall sell all or a material part of its assets, or a material part of its property or business is taken, lost or impaired through condemnation or otherwise;
- (viii) a change of control not approved by the Lenders;

- (ix) any challenge by or on behalf of any person (including, without limitation, the Borrower or any official committee of creditors or equity security holders formed, appointed or approved pursuant to the Bankruptcy Code) to the validity of any loan document or the enforceability of any loan document strictly in accordance with the subject loan document's terms or which seeks to void, avoid, limit, or otherwise adversely affect any security interest created by or in any loan document or any payment made pursuant thereto;
- (x) the entry of an order that stays, modifies (in any manner adverse to any Lender), or reverses any interim order of final order of the Bankruptcy Court approving the Junior DIP Facility (each a "DIP Order") or which otherwise materially adversely affects the effectiveness of any DIP Order;
- (xi) the appointment of a trustee or of any examiner having expanded powers to operate all or any part of the Borrower's business, the conversion of any of the Cases to a case under chapter 7 of the Bankruptcy Code, or the liquidation or cessation of the business of the Borrower or any of its subsidiaries;
- (xii) the entry of any order providing relief from the automatic stay otherwise imposed by Section 362 of the Bankruptcy Code that permits any creditor to realize upon, or to exercise any right or remedy with respect to, any collateral in excess of \$200,000;
- (xii) the filing of any application by the Borrower of any super priority claim in any of the Cases which is pari passu with or senior to the priority of the claims of the Lenders pursuant to the Junior DIP Facility, or there shall arise any such super-priority claim under the Bankruptcy Code (other than permitted professional fees and expenses or permitted claims pursuant to the ABL DIP Facility), such application would result in the indefeasible repayment in full in cash of all obligations to the Lenders;
- (xiv) the entry of any order which provides adequate protection, or the granting by the Borrower of similar relief in favor of any one or more of pre-petition creditors, contrary to the terms and conditions of any DIP Order or the terms of the DIP Credit Agreement;
- (xv) the filing, without the prior written consent of the Required Lenders, of any sale motion under Section 363 of the Bankruptcy Code or any plan of reorganization or liquidation;
- (xiii) any of the motions, orders, and procedures regarding the sale of collateral or plan of reorganization of the Borrower are not in form and substance acceptable to the Administrative Agent or the Required Lenders;
- (xvi) the filing of a plan of reorganization in which all obligations to each Lender are not indefeasibly repaid in full in cash on or before the effective date of such plan; or
- (xvii) in the event of a filing of a plan of reorganization, failure by the Borrower to satisfy covenants and milestones regarding plan confirmation (after the lapse of any applicable cure periods), each as contemplated by the Approved Budget or otherwise agreed upon by the Administrative Agent and the Borrower.

ANNEX D
BACKSTOP AGREEMENT

Please see attached.

**BACKSTOP AGREEMENT TO
DEBTOR IN POSSESSION CREDIT AGREEMENT**

This BACKSTOP AGREEMENT TO DEBTOR IN POSSESSION CREDIT AGREEMENT (this "Agreement") is entered into on this 23rd day of January, 2013 by and among Zazove Associates LLC, R2 Investments, LDC, and Steel Partners LLC, as backstop lenders (each, a "Backstop Lender" and together with such other lenders as may from time to time become a party to this Agreement pursuant to the terms and conditions of Section 7 hereof collectively, the "Backstop Lenders") and School Specialty, Inc., a Wisconsin corporation ("School Specialty" or the "Borrower"), as debtor and debtor-in-possession, for the purpose of backstopping the Term Commitment Amount under that certain Debtor-in-Possession Credit Agreement (the "DIP Credit Agreement") to be entered into by and among the Backstop Lenders, each of the other lenders appearing on the signature pages thereof (collectively, the "Lenders"), the administrative agent and collateral agent on behalf of the Lenders and the Backstop Lenders (the "Agent"), and the Borrower as debtor and debtor-in-possession, in accordance with that certain Junior Debtor-in-Possession Financing Commitment dated January 23, 2013 (the "DIP Commitment"). Each of the Backstop Lenders and the Borrower shall be referred to herein as a "Party" and collectively, as the "Parties".

RECITALS:

- A. The Borrower, on behalf of itself and its direct and indirect subsidiaries (collectively, the "Subsidiaries"), intends to implement voluntary "pre-packaged" Chapter 11 cases (the "Chapter 11 Cases") under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"), with the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court"), whereby the Borrower shall continue to operate its business and manage its properties as a debtor and debtor-in-possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code.
- B. Pursuant to a prepackaged Chapter 11 plan of reorganization (the "Plan"), agreed to by the Lenders pursuant to a Plan Support Agreement, certain lenders have agreed to provide to the Borrower as debtor-in-possession lenders (the "DIP Lenders"), a term loan credit facility in accordance with the terms set forth in the DIP Credit Agreement of up to Fifty Million Dollars (\$50,000,000.00) in the aggregate to, among other purposes, fund the (x) working capital requirements of Borrower and its Subsidiaries during the pendency of the Chapter 11 Cases and (y) costs of restructuring.
- C. Borrower has agreed to secure all of its obligations under the Loan Documents by granting to Agent, for the benefit of Agent and Lenders, a junior third lien security interest in substantially of the existing and after-acquired property of the Borrower pursuant to Section 364(c)(3) of the Bankruptcy Code, and a super-priority administrative expense claim pursuant to Sections 364(c)(1) of the Bankruptcy Code, subject to the terms and conditions set forth in the Loan Documents.
- D. Capitalized terms used in this Agreement shall have the meanings ascribed to them in the DIP Credit Agreement, unless otherwise defined herein. Any Schedules or Exhibits

attached hereto or expressly identified to this Agreement (collectively, the "Schedules") are incorporated herein by reference, and taken together with this Agreement and the DIP Credit Agreement, shall constitute a single integrated agreement. These recitals shall be construed as part of this Agreement.

NOW, THEREFORE, in consideration of the premises herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties, intending to be legally bound, agree as follows:

1. Commitment. Subject to the terms and conditions herein set forth, in addition to any amount it is obligated to fund as a Term Commitment pursuant to the DIP Credit Agreement, each Backstop Lender hereby severally, but not jointly, agrees to fund such additional amounts as necessary to ensure that the Term Commitment Amount of \$50,000,000 is fully funded on the Closing Date, provided however that, with respect to each Backstop Lender, such amounts shall not exceed the amounts shown on Schedule A to this Agreement for such Backstop Lender (each, a "Backstop Commitment"). Schedule A is hereby incorporated and made a part of this Commitment. Each Backstop Commitment amount shown on Schedule A shall be funded on the Closing Date by payment directly to the Agent pursuant to the terms and conditions of the DIP Credit Agreement.

2. Fees. On the Closing Date, the Backstop Lenders, for the ratable account of each Backstop Lender, shall receive from the Borrower via the Agent a fee (the "Backstop Fee") in the amount of 2.5% of the aggregate Backstop Commitments set forth on Schedule A, which amount shall be allocated to the Backstop Lenders based upon the ratable percentage of Term Loans funded by such parties pursuant to the Backstop Commitments under this Agreement. The Backstop Fee shall be due and payable by the Borrower on the Closing Date and not refundable under any circumstances.

3. Conditions to Funding. The obligation of each Backstop Lender to fund the amounts due under paragraph 1 of this Agreement shall be subject to the conditions to lending set forth in the DIP Commitment and DIP Credit Agreement. For the avoidance of doubt, the effectiveness of this Agreement shall be subject to entry of the interim order by the Bankruptcy Court entered into within three (3) business days of the commencement of the Chapter 11 Cases, in form, scope and substance acceptable to the Required Lenders, approving, on an interim basis, the Borrower's entering into and performing its obligations under the DIP Credit Agreement, the Plan Support Agreement and the other Loan Documents and giving legal recognition of priority of the Agent's Liens on the Collateral.

4. Effect of Funding. Immediately upon funding of the respective Backstop Commitments under this Agreement, (a) the Agent shall accrete to each Backstop Lender's respective Term Loans and Term Note the additional amounts funded and the records in respect of the Term Loans, (b) the amount of each Term Note and each Backstop Lender's Term Commitment shall be appropriately adjusted by the Agent, and (c) each Backstop Lender shall have all rights and remedies under the DIP Credit Agreement with respect to its Term Commitment (as adjusted pursuant to this Agreement) for all purposes under the DIP Credit Agreement, the Plan Support Agreement and the Plan.

5. Representations and Warranties. Each Party, severally and not jointly, represents, covenants, warrants and agrees to each other Party, only as to itself and not as to each of the others, that the following statements, as applicable, are true, correct and complete as of the date hereof:

- a. Power and Authority. It has all requisite corporate, partnership, limited liability company power and authority to enter into this Agreement and to carry out the transactions contemplated hereby, and to perform its obligations hereunder.
- b. Due Organization. Except for the Creditors' Committee and the Equity Committee, it is duly organized, validly existing and in good standing under the laws of its state of organization and it has the requisite power and authority to execute and deliver this Agreement and to perform its obligations hereunder.
- c. Authorization. The execution and delivery of this Agreement and the performance of its obligations hereunder have been duly authorized by all necessary corporate, partnership or limited liability company action on its part; provided, however, that the authority of the Debtors, the Creditors' Committee, and the Equity Committee to enter into this Agreement is subject to Bankruptcy Court approval.
- d. No Impediment. The execution, delivery and performance of this Agreement does not and shall not (i) violate any provision of law, rule or regulation applicable to it or any of its subsidiaries, (ii) violate its certificate of incorporation, bylaws or other organizational documents or those of any of its subsidiaries, (iii) conflict with, result in a breach of or constitute (with due notice or lapse of time or both) a default under any material contractual obligation to which it or any of its subsidiaries is a party, or (iv) require any registration or filing with, consent or approval of, or notice to, or other action to, with or by, any federal, state or other governmental authority or regulatory body (other than the approval of the Bankruptcy Court, as applicable).

6. Modification of Agreement. This Agreement may not be modified, altered, amended or supplemented except by an agreement in writing signed by the Parties.

7. Joinder. Subject to the terms and conditions set forth in the DIP Credit Agreement, any Person may become a Backstop Lender under this Agreement upon:

- a. the execution of a joinder to this Agreement in the form attached hereto as Exhibit A (the "Backstop Joinder"); or an assignment certificate in substantially the form of Exhibit B hereto (the "Assignment Certificate"), as applicable;
- b. if the Plan Support Agreement is then in effect, the execution of a joinder to such Plan Support Agreement (the "PSA Joinder"), unless such Person is already a party to such agreement; and
- c. if the DIP Credit Agreement is then in effect, satisfaction of each of the conditions to such Person becoming a Lender under the DIP Credit Agreement

pursuant to the terms and conditions thereof, unless such Person is a Lender under such agreement.

Notwithstanding anything to the contrary set forth herein, no Person may become a Backstop Lender under this Agreement if such Person is not permitted to become a Lender pursuant to the DIP Credit Agreement.

8. Transfer. Any Backstop Lender (the "Transferor") may assign, convey or otherwise transfer, in whole or in part, to any Person (the "Transferee") its respective rights, obligations, title and interest in this Agreement, provided that the following conditions are satisfied:

- a. such Transferee is not prohibited from becoming a Lender pursuant to the DIP Credit Agreement;
- b. all conditions to the Assignment of the Term Commitment pursuant to the DIP Credit Agreement by the Transferor to the Transferee have been satisfied pursuant to the terms thereof;
- c. unless such Transferee is a Lender, such Transferee executes a PSA Joinder;
- d. unless such Transferee is a Backstop Lender, such Transferee executes a Backstop Joinder;
- e. delivery to the other Parties hereto of any assignment, transfer or conveyance agreement in relation of the assignment duly executed and delivered by the Backstop Lender and the Transferee; and
- f. the Transferor and the Transferee shall execute and deliver to the other Parties hereto an Assignment Certificate.

9. Governing Law. THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK APPLICABLE TO CONTRACTS MADE AND TO BE PERFORMED IN SUCH STATE AND THE APPLICABLE SECTIONS OF THE BANKRUPTCY CODE. By its execution and delivery of this Agreement, each of the Parties hereto hereby irrevocably and unconditionally agrees for itself that any legal action, suit or proceeding against it with respect to any matter under or arising out of or in connection with this Agreement or for recognition or enforcement of any judgment rendered in any such action, suit or proceeding, shall be brought in the Bankruptcy Court. By execution and delivery of this Agreement, each of the Parties hereto hereby irrevocably accepts and submits itself to the exclusive jurisdiction of such court, generally and unconditionally, with respect to any such action, suit or proceeding.

10. Cooperation. Each Party shall cooperate with the other Parties to do or cause to be done all things as may be reasonably necessary or desirable to confirm and carry out and to effectuate fully the intent and purpose of this Agreement and shall not take any action contrary to the essential intent and principles of this Agreement.

11. Successors and Assigns. This Agreement is intended to bind and inure to the benefit of the Parties and their respective successors, assigns (including, but not limited to, Transferees under Section 8 above), heirs, executors, administrators and representatives.

12. No Third Party Beneficiaries. Unless expressly stated herein, this Agreement shall be solely for the benefit of the Parties hereto and no other person or entity shall be a third-party beneficiary hereof.

13. Several Obligations. Except as otherwise provided herein, the obligations of the Parties hereunder are several and not joint.

14. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall, collectively and separately, constitute one and the same agreement.

15. Jurisdiction. Any dispute regarding this Agreement shall be finally determined by the Bankruptcy Court on an expedited basis and all parties agree to waive appeal rights with respect to such determinations.

16. Prior Negotiations. This Agreement (together with all exhibits) constitutes the entire understanding of the Parties with respect to the subject matter hereof. No representations, oral or written, other than those set forth herein may be relied on by any Party in connection with the subject matter hereof.

17. Expiration. This Backstop Agreement shall expire immediately upon expiration of the DIP Commitment.

[Remainder of page intentionally left blank.]

IN WITNESS WHEREOF, the Parties have executed this Agreement as of the date first written above.

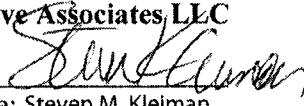
BORROWER:

**School Specialty Inc.,
as debtor and debtor-in-possession**

By: _____
Name:
Title:

BACKSTOP LENDERS:

Zazove Associates LLC

By: 
Name: Steven M. Kleiman
Title: Chief Operating Officer

Steel Partners LLC

By: _____
Name:
Title:

R2 Investments LDC

By: _____
Name:
Title:

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IN WITNESS WHEREOF, the Parties have executed this Agreement as of the date first written above.

BORROWER:

**School Specialty Inc.,
as debtor and debtor-in-possession**

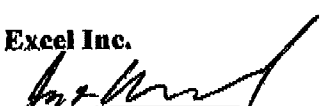
By: _____
Name:
Title:

BACKSTOP LENDERS:

Zazove Associates LLC

By: _____
Name:
Title:

Steel Excel Inc.

By: 
Name: *JACK HOWARD*
Title: *Vice Chairman*

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager
By: Scepter Holdings, Inc., Its General Partner
By: _____
Noel Nesser, CFO

Signature Page to Backstop Agreement

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IN WITNESS WHEREOF, the Parties have executed this Agreement as of the date first written above.

BORROWER:

**School Specialty Inc.,
as debtor and debtor-in-possession**

By: _____

Name:

Title:

BACKSTOP LENDERS:

Zazove Associates LLC

By: _____

Name:

Title:

Steel Partners LLC

By: _____


Name:

Title:

R2 Investments, LDC

By: Amalgamated Gadget L.P., as its Investment Manager

By: Scepter Holdings, Inc., Its General Partner

By:  _____

Noel Nesser, CFO

SCHEDULE A
BACKSTOP COMMITMENTS

BACKSTOP LENDERS	BACKSTOP COMMITMENT	BACKSTOP %
Zazove Associates LLC	\$798,412.70	7.93%
R2 Investments, LDC	\$297,619.05	2.96%
Steel Partners LLC	\$8,953,317.46	89.09%
BACKSTOP SUBTOTAL:	\$10,048,253.97	

EXHIBIT A

FORM OF BACKSTOP JOINDER

The undersigned hereby acknowledges as of [], 2013 (the "Effective Date") that it has read and understands the Backstop Agreement, dated as of January __, 2013 (as may be amended, supplemented or otherwise modified from time to time, the "Agreement"), by and among Zazove Associates LLC, R2 Investments, LDC, and Steel Partners LLC, as backstop lenders (each, a "Backstop Lender" and together with such other lenders as may from time to time become a party to the Agreement pursuant to the terms and conditions of Section 7 hereof collectively, the "Backstop Lenders") and School Specialty, Inc., a Wisconsin corporation ("School Specialty" or the "Borrower"), as debtor and debtor-in-possession, and agrees to be bound by the terms and conditions thereof as a "Backstop Lender", and, subject to the terms and conditions of Section 7, shall be deemed a "Backstop Lender" under the terms of the Agreement with a Backstop Commitment of \$[] as of the Effective Date.

[]

By: _____

Name: _____

Title: _____

ACKNOWLEDGED AND AGREED, AS OF THE DATE SET FORTH ABOVE

SCHOOL SPECIALTY, INC., a Wisconsin corporation,
as debtor and debtor-in-possession

By: _____

Name: _____

Title: _____

[BACKSTOP LENDERS]

By: _____

Name: _____

Title: _____

EXHIBIT B

FORM OF ASSIGNMENT CERTIFICATE

Reference is made to that certain Backstop Agreement dated as of 18th day of January, 2013 by and among Zazove Associates LLC, R2 Investments, LDC, and Steel Partners LLC, as backstop lenders (each, a "Backstop Lender" and collectively, the "Backstop Lenders") and each of the lenders appearing on the signature pages hereof, together with such other lenders as may from time to time become a party to this Agreement pursuant to the terms and conditions of Section 7 hereof (collectively, the "Lenders") and School Specialty, Inc., a Wisconsin corporation ("School Specialty" or the "Borrower"), as debtor and debtor-in-possession. The capitalized terms defined in the Agreement and not otherwise defined herein are used herein as therein defined.

[] ("Assignor") and [] ("Assignee") agree as follows:

1. Assignor hereby assigns to Assignee and Assignee hereby purchases and assumes from Assignor the Backstop Commitment of \$[] (the "Assigned Commitment"), together with an interest in the Agreement corresponding to the Assigned Commitment. Subject to the terms and conditions of the DIP Credit Agreement, this Agreement shall be effective as of the date hereof (the "Effective Date"). From and after the Effective Date, Assignee hereby expressly assumes, and undertakes to perform, all of Assignor's obligations in respect of the Assigned Commitment, and all Terms Loans which would otherwise be funded by Assignor account in respect of the Assigned Commitment on or after the Effective Date.
2. Assignor (a) represents to Assignee that as of the date hereof; prior to giving effect to this assignment, its Backstop Commitment is \$[]; (b) makes no representation or warranty and assumes no responsibility with respect to any statements, warranties or representations made in or in connection with the Credit Agreement or the execution, legality, validity, enforceability, genuineness, sufficiency or value of the Credit Agreement or any other instrument or document furnished pursuant thereto, other than that Assignor is the legal and beneficial owner of the interest being assigned by it hereunder and that such interest is free and clear of any adverse claim; and (c) makes no representation or warranty and assumes no responsibility with respect to the financial condition of the Borrower or the performance by the Borrower of its obligations under the Loan Documents. Assignor is attaching the Note[s] held by it and requests that the Administrative Agent exchange such Note[s] for new Notes payable to Assignee [and Assignor] and the Borrower shall duly execute and deliver such new Notes.
3. Assignee (a) represents and warrants to the Administrative Agent, the Assignor and the other Lenders that (i) it is legally authorized to enter into this Assignment Certificate; (ii) from and after the Effective Date, it shall be bound by the provisions of the Agreement and, to the extent of the Assigned Commitment, shall have the obligations of a Backstop Lender thereunder;

(iii) the Assignment evidenced hereby will not result in a non-exempt "prohibited transaction" under Section 406 of ERISA; and (iv) is not prohibited from becoming a "Lender" under DIP Credit Agreement pursuant to the terms and conditions thereof; (b) confirms that it has received copies of the Agreement and such other loan documents and information as it has deemed appropriate to make its own credit analysis and decision to enter into this Assignment Certificate; (c) agrees that it shall, independently and without reliance upon Assignor and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under the loan documents; and (d) agrees that it will observe and perform all obligations that are required to be performed by it as a "Backstop Lender" under the Agreement.

4. This Assignment Certificate shall be governed by the laws of the State of New York without giving effect to any conflict of law principles (but giving effect to federal laws relating to national banks to the extent applicable). If any provision is found to be invalid under Applicable Law, it shall be ineffective only to the extent of such invalidity and the remaining provisions of this Assignment Certificate shall remain in full force and effect.

5. Each notice or other communication hereunder shall be in writing, shall be sent by messenger, by telecopy or facsimile transmission, or by first-class mail, shall be deemed given when sent and shall be sent as follows:

- a. If to Assignee, to the following address (or to such other address as Assignee may designate from time to time):

[]

- b. if to Assignor, to the following address (or to such other address as Assignor may designate from time to time):

[]

[Remainder of page intentionally left blank.]

IN WITNESS WHEREOF, this Assignment Certificate is executed as of the date first set forth above.

ASSIGNEE

[]

By: _____

Name: _____

Title: _____

ASSIGNOR

[]

By: _____

Name: _____

Title: _____

**ACKNOWLEDGED AND AGREED,
AS OF THE DATE SET FORTH ABOVE**

SCHOOL SPECIALTY, INC., a Wisconsin corporation,
as debtor and debtor-in-possession

By: _____

Name: _____

Title: _____

Exhibit A

DIP Term Sheet Comparison

	Bayside Proposal	Convertible Notes Proposal
Amount	<ul style="list-style-type: none"> ▶ \$144.66 million <ul style="list-style-type: none"> • \$50.00 million DIP (\$25.00 million on interim basis) • \$67.00 million Prepetition Term Loan (plus \$2.61 million of accrued interest) • \$25.05 Make-Whole payment 	<ul style="list-style-type: none"> ▶ \$50.00 million DIP
Priority	<ul style="list-style-type: none"> ▶ Senior secured super-priority claim with same relative priority as Prepetition Term Loan <ul style="list-style-type: none"> • Bayside DIP Liens are junior to the ABL DIP Liens with respect to the ABL collateral • ABL DIP Liens are junior to the Bayside DIP Liens with respect to the Term Loan collateral 	<ul style="list-style-type: none"> ▶ Third lien on all assets, subordinated to ABL Facility and Bayside Term Loan <ul style="list-style-type: none"> • First Lien on Avoidance Actions • Super-priority administrative claim, subordinated to ABL DIP super-priority administrative claim
Interest Rate	<ul style="list-style-type: none"> ▶ Non-Default Rate: L + 1400bps (LIBOR Floor: 150bps) ▶ Default Rate: +300bps ▶ Total Cash Interest Through April 27: \$0.96 million 	<ul style="list-style-type: none"> ▶ Non-Default Rate: L + 800bps (LIBOR Floor: 150bps) ▶ Total Cash Interest Through April 27: \$0.59 million
Fees	<ul style="list-style-type: none"> ▶ Commitment Fee: \$1.00 million ▶ Closing Fee: \$500.00K ▶ Unused Line Fee: 1.00% ▶ Administrative Agency Fee: \$150.00K ▶ Termination / Break Up Fee: 3.00% (\$1.50 million) ▶ Total Fees Due at Closing: \$1.65 million 	<ul style="list-style-type: none"> ▶ Commitment Fee: \$0.00 ▶ Closing Fee: \$0.00 ▶ Unused Line Fee: 0.00% ▶ Administrative Agency Fee: \$28.50K ▶ Backstop Fee: \$26.72K ▶ Total Fees Due at Closing: \$55.22K
Treatment at Exit	<ul style="list-style-type: none"> ▶ Roll up of DIP Facility and Prepetition Term Loan including Make-Whole; used as currency to bid for the Company in a 363 asset sale 	<ul style="list-style-type: none"> ▶ Will convert to equity along with 100% of convertible subordinated debentures as part of a comprehensive plan of reorganization
Total Cost Through April 27 ⁽¹⁾	<ul style="list-style-type: none"> ▶ \$2.66 million 	<ul style="list-style-type: none"> ▶ \$0.87 million

(1) Includes unused line fees.

CERTIFICATE OF SERVICE

I hereby certify that on January 29, 2013, I caused a copy of the foregoing *Objection of the Steering Committee of Convertible Noteholders of School Specialty, Inc. to Debtors Motion of Debtors' for Entry of Interim and Final Orders (I) Authorizing Debtors (A) to Obtain Postpetition Financing Pursuant to 11 U.S.C. §§ 105, 361, 362, 364(c)(1), 364(c)(2), 364(c)(3), 364(d)(1), 364(e) and 507 and (B) to Utilize Cash Collateral Pursuant to 11 U.S.C. § 363, (C) to Grant Priming Liens and Superpriority Claims to the DIP Lenders, (D) to Provide Adequate Protection to Prepetition Secured Parties Pursuant to 11 U.S.C. §§ 361, 362, 363 and 364, and (E) to Repay in Full Amounts Owed in Connection with the Prepetition Secured Loans or Otherwise Converting the Prepetition Secured Obligation into Postpetition Secured Obligations; (II) Scheduling Final Hearing Pursuant to Bankruptcy Rules 4001(a) and (c); and (III) Granting Related Relief* to be served upon the following on the attached service list in the manner indicated.

/s/ Thomas F. Driscoll III

Thomas F. Driscoll III (#4703)

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Maris J. Kandestin, Esquire
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