

4<sup>th</sup> QUARTER and FY 2018 EARNINGS CALL PRESENTATION



THURSDAY JULY 19, 2018



## Forward-Looking Statements

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This presentation contains certain forward-looking statements. Such forward-looking statements are subject to various risks and uncertainties, including the conditions of the children's book and educational materials markets and acceptance of the Company's products in those markets, as well as other risks and factors identified from time to time in the Company's filings with the Securities and Exchange Commission. Actual results could differ materially from those currently anticipated.



## Regulation G

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Today's comments include references to certain non-GAAP financial measures as defined in Regulation G. The reconciliation of these non-GAAP financial measures with the relevant GAAP financial information and other information required by Regulation G is provided in the Company's earnings release, which is posted on the Company's investor relations website at [investor.scholastic.com](http://investor.scholastic.com).



## Richard Robinson

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Chief Executive Officer, President  
and Chairman



## Fiscal 2018 Highlights

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- **Scholastic 2020** on track to substantially increase operating income and improve organizational effectiveness through fiscal 2021
- Full year operating results met guidance for earnings per share, as adjusted, and free cash use:

Metric	Actual	Guidance
EPS, ex. one-times	\$1.43	\$1.35 - \$1.45
Free Cash Use	\$16.1 million	\$10 - \$20 million

- Strong strategies for core children's book, education and international businesses; lower effective tax rate as a result of tax reform; newly created SoHo retail space
- Introducing EBITDA target for comparing operating performance and value creation



## Fiscal 2018 Highlights

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- Transition year due to combined impact of *Harry Potter and the Cursed Child* in fiscal 2017 and higher *Scholastic 2020* related investments
- \$1.63 billion revenues with decline expected due to the prior year's best-selling Harry Potter titles. Excluding the impact of Harry Potter, fiscal 2018 trade sales were higher with top-sellers across all genres
- Excluding one-time, mostly non-cash items earnings per diluted share were \$1.43, towards the high end of guidance range
- Free cash use of \$16.1 million with higher capital spending on headquarters building and strategic technology initiatives with expectations to return to modest free cash flow in fiscal 2019
- Opportunistic share repurchases of \$27 million



## *Scholastic 2020 Plan Update*

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- Since beginning our technology transformation, we have built out a new enterprise architecture, lowering our ecommerce and web maintenance costs and realizing related labor savings. Highlights include:
  - Retirement of over half of Company's legacy systems
  - 95% of customer-facing applications are in the Cloud
  - New cloud-based ecommerce solutions with reduced operating costs and increased qualified traffic
  - Salesforce.com in Education and Book Fairs
  - Improved data-guided selling for education field and inside sales
  - Introduction of web-based business intelligence dashboards
  - Better information to drive reduced fulfillment and transportation costs
- Driving labor optimization, efficiencies in procurement, storage and distribution
- Expect \$10 million in operating cost savings in fiscal 2019 with focus on sustainable profitability



## Children's Book Publishing and Distribution

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- Exciting new **Trade** titles and growing core series like Dav Pilkey's *Dog Man* topping in the bestseller charts; fifth book, *Dog Man: Lord of the Fleas* to be released in August
- 20<sup>th</sup> Anniversary of the U.S. publication of *Harry Potter* in new fiscal year:
  - New anniversary editions of the original series with cover artwork by Brian Selznick
  - *Harry Potter: A History of Magic* companion book to upcoming exhibit at New-York Historical Society
  - *Fantastic Beasts: The Crimes of Grindelwald* an original screenplay by J.K. Rowling, to accompany the film's release in November
- Expect modest growth in **Book Clubs** with more titles tailored to early grades and student incentives to drive higher participation, while leveraging analytics and new ecommerce capabilities to reduce costs
- Targeted growth in **Book Fairs** in higher-value fair segments and continued roll-out of new POS system for greater efficiencies and lower costs







## Education

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- Revenues down 5% for the year due, in part, to a shift in customer buying patterns for leveled book room and guided reading products, partially offset by growth from newly-released *Scholastic Edge* program
- Expansion in core curriculum reading is a major part of growth strategy
- Launching *Scholastic Literacy*, a complete, balanced literacy program with print and digital features to meet the needs of K-6 students



- Exciting digital programs in the pipeline, both as components within *Scholastic Literacy* and as stand-alone subscription products – *Literacy Pro™* and *W.O.R.D.*, as well as *Ooka Island®*, a newly released an adaptive, game-based, foundational phonics skills program



## International

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- Solid year, with a robust list of new trade titles in Australia, Canada, the U.K. and Asia partially offsetting the expected decline in revenue as a result of strong sales of *Harry Potter* publishing in the Canadian and export channels
- Leveraging U.S. technology investments to improve profitability in our major markets and enable more rapid growth in Asia, as well as making focused investments in education and trade across all international markets
- In **Canada**, expect trade growth to be driven by new *Harry Potter* publishing, and book club performance improvement as a result of new ecommerce capabilities
- In the **UK**, expect continued strength in trade publishing and fairs
- In **Asia**, anticipate growth driven by new educational publishing, franchise schools in China, and in direct-to-consumer sales in light of increasing demand for English language instruction among a growing middle class



Kenneth Cleary

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Chief Financial Officer



# Income Statement

In \$ Millions (except per share)	Fourth Quarter 2018			Fourth Quarter 2017			Fiscal Year to Date 2018			Fiscal Year to Date 2017		
	As Reported	One-Time Items	Excluding One-Time Items	As Reported	One-Time Items	Excluding One-Time Items	As Reported	One-Time Items	Excluding One-Time Items	As Reported	One-Time Items	Excluding One-Time Items
	Revenues	\$496.2	\$0.0	\$496.2	\$499.6	\$0.0	\$499.6	\$1,628.4	\$0.0	\$1,628.4	\$1,741.6	\$0.0
Cost of goods sold <sup>1</sup>	209.0	(0.1)	208.9	213.2	-	213.2	744.6	(0.1)	744.5	814.5	(0.5)	814.0
Selling, general and administrative expenses <sup>2</sup>	199.5	(2.4)	197.1	203.5	(4.6)	198.9	763.6	(8.1)	755.5	781.4	(12.9)	768.5
Bad debt expense	1.6	-	1.6	1.7	-	1.7	9.5	-	9.5	11.0	-	11.0
Depreciation and amortization	12.0	-	12.0	10.1	-	10.1	43.9	-	43.9	38.7	-	38.7
Asset impairments <sup>3</sup>	0.2	(0.2)	(0.0)	6.8	(6.8)	-	11.2	(11.2)	-	6.8	(6.8)	-
Total operating costs and expenses	422.3	(2.7)	419.6	435.3	(11.4)	423.9	1,572.8	(19.4)	1,553.4	1,652.4	(20.2)	1,632.2
Operating income (loss)	\$73.9	\$2.7	\$76.6	\$64.3	\$11.4	\$75.7	\$55.6	\$19.4	\$75.0	\$89.2	\$20.2	\$109.4
Other components of net periodic (benefit) cost <sup>4</sup>	2.8	(2.3)	0.5	0.1	-	0.1	58.2	(57.3)	0.9	0.3	-	0.3
Interest (income) expense, net	(0.6)	-	(0.6)	(0.0)	-	(0.0)	(1.1)	-	(1.1)	1.0	-	1.0
Provision (benefit) for income taxes <sup>5</sup>	20.9	4.3	25.2	24.6	4.4	29.0	3.5	20.8	24.3	35.4	7.8	43.2
Earnings (loss) from continuing operations	\$50.8	\$0.7	\$51.5	\$39.6	\$7.0	\$46.6	(\$5.0)	\$55.9	\$50.9	\$52.5	\$12.4	\$64.9
Earnings (loss) from discontinued operations, net of tax	(0.0)	-	(0.0)	(0.2)	-	(0.2)	(0.0)	-	(0.0)	(0.2)	-	(0.2)
Net Income (loss)	\$50.8	\$0.7	\$51.5	\$39.4	\$7.0	\$46.4	(\$5.0)	\$55.9	\$50.9	\$52.3	\$12.4	\$64.7
Earnings (loss) per diluted share from continuing operations	1.43		1.45	1.11		1.31	(0.14)		1.43	1.48		1.83
Earnings (loss) per diluted share from discontinued operations, net of tax	(0.00)		(0.00)	(0.01)		(0.01)	(0.00)		(0.00)	(0.01)		(0.01)
Earnings (loss) per diluted share	1.43		1.45	1.10		1.30	(0.14)		1.43	1.47		1.82

- In the three and twelve months ended May 31, 2018, the Company recognized costs related to branch warehouse consolidation in Canada of \$0.1. In the twelve months ended May 31, 2017, the Company recognized pretax exit costs related to its software distribution business in Australia of \$0.5.
- In the three and twelve months ended May 31, 2018, the Company recognized pretax severance and stock compensation charges of \$2.4 and \$8.1, respectively. In the three and twelve months ended May 31, 2017, the Company recognized pretax severance expense as part of cost reduction programs of \$4.6 and \$12.9, respectively.
- In the three and twelve months ended May 31, 2018, the Company recognized a pretax impairment charge of \$0.2 related to book fair trucks. In the twelve months ended May 31, 2018, the Company recognized a pretax impairment charge of \$11.0 related to legacy building improvements. In the three and twelve months ended May 31, 2017, the Company recognized a pretax impairment charge related to certain website development assets of \$5.7 and certain legacy prepublication assets of \$1.1.
- In the three and twelve months ended May 31, 2018, the Company recognized pretax charges related to the settlement of the Company's domestic defined benefit pension plan of \$2.3 and \$57.3, respectively.
- In the three and twelve months ended May 31, 2018, the Company recognized a benefit for income taxes on one-time pretax charges of \$1.7 and \$26.5, respectively. In the three months ended May 31, 2018, the Company recognized a benefit for income taxes of \$2.6 and for the twelve months ended May 31, 2018, the Company recognized \$5.7 of income tax provision related to the remeasurement of the Company's U.S. deferred tax balance in connection with the passage of the Tax Cuts and Jobs Act of 2017. In the three and twelve months ended May 31, 2017, the Company recognized a benefit for income taxes on one-time pretax charges of \$4.4 and \$7.8, respectively.



# Segment Results

In \$ Millions (except per share)	Fourth Quarter 2018			Fourth Quarter 2017			Fiscal Year to Date 2018			Fiscal Year to Date 2017		
	As Reported	One-Time Items	Excluding One-Time Items	As Reported	One-Time Items	Excluding One-Time Items	As Reported	One-Time Items	Excluding One-Time Items	As Reported	One-Time Items	Excluding One-Time Items
	Children's Book Publishing and Distribution											
Revenue												
Book Clubs	\$58.7	\$0.0	\$58.7	\$59.5	\$0.0	\$59.5	\$224.3	\$0.0	\$224.3	\$235.8	\$0.0	\$235.8
Book Fairs	179.0	-	179.0	180.0	-	180.0	513.6	-	513.6	508.4	-	508.4
Consolidated Trade	45.8	-	45.8	43.3	-	43.3	223.6	-	223.6	307.9	-	307.9
Total revenue	283.5	-	283.5	282.8	-	282.8	961.5	-	961.5	1,052.1	-	1,052.1
Operating income (loss) <sup>1</sup>	50.3	0.2	50.5	51.9	-	51.9	105.6	0.2	105.8	143.1	-	143.1
Operating margin	17.7%		17.8%	18.4%		18.4%	11.0%		11.0%	13.6%		13.6%
Education												
Revenue	119.7	-	119.7	126.3	-	126.3	297.3	-	297.3	312.7	-	312.7
Operating income (loss) <sup>2</sup>	43.0	-	43.0	42.9	1.1	44.0	34.1	-	34.1	50.7	1.1	51.8
Operating margin	35.9%		35.9%	34.0%		34.8%	11.5%		11.5%	16.2%		16.6%
International												
Revenue	93.0	-	93.0	90.5	-	90.5	369.6	-	369.6	376.8	-	376.8
Operating income (loss) <sup>3</sup>	5.1	0.8	5.9	2.5	0.7	3.2	17.7	0.8	18.5	19.7	1.4	21.1
Operating margin	5.5%		6.3%	2.8%		3.5%	4.8%		5.0%	5.2%		5.6%
Corporate overhead <sup>4</sup>	\$24.5	(\$1.7)	\$22.8	\$33.0	(\$9.6)	\$23.4	\$101.8	(\$18.4)	\$83.4	\$124.3	(\$17.7)	\$106.6
Operating income (loss)	\$73.9	\$2.7	\$76.6	\$64.3	\$11.4	\$75.7	\$55.6	\$19.4	\$75.0	\$89.2	\$20.2	\$109.4

1. In the three and twelve months ended May 31, 2018, the Company recognized a pretax impairment charge associated with book fair trucks of \$0.2.
2. In the three and twelve months ended May 31, 2017, the Company recognized a pretax impairment charge associated with certain legacy prepublication assets of \$1.1.
3. In the three and twelve months ended May 31, 2018, the Company recognized pretax severance expense as part of cost reduction programs of \$0.7 and pretax costs associated with the consolidation of a Canadian book fair warehouse of \$0.1. In the three and twelve months ended May 31, 2017, the Company recognized pretax severance expense as part of cost reduction programs of \$0.7 and \$0.9, respectively. In the twelve months ended May 31, 2017, the Company recognized pretax exit costs related to its software distribution business in Australia of \$0.5.
4. In the three and twelve months ended May 31, 2018, the Company recognized pretax severance and stock compensation charges of \$1.7 and \$7.4, respectively. In the twelve months ended May 31, 2018, the Company recognized pretax impairment charges of \$11.0 related to legacy building improvements. In the three and twelve months ended May 31, 2017, the Company recognized a pretax impairment charge related to certain website development assets of \$5.7. In the three and twelve months ended May 31, 2017, the Company recognized pretax severance expense as part of cost reduction programs of \$3.9 and \$12.0, respectively.



## Free Cash Flow (Use) & Net Debt

In \$ Millions	<u>May 31, 2018</u>	<u>May 31, 2017</u>
Free cash flow (use) (3 month period ending) <sup>1</sup>	\$33.8	(\$9.5)
Free cash flow (use) (12 month period ending) <sup>1</sup>	(\$16.1)	\$48.8
Accounts receivable, net	\$204.9	\$199.2
Inventories, net	\$294.9	\$282.5
Accounts payable	\$198.9	\$141.2
Accrued royalties	\$34.6	\$34.2
Total debt	\$7.9	\$6.2
Cash and cash equivalents	\$391.9	\$444.1
Net debt <sup>2</sup>	(\$384.0)	(\$437.9)

1. Free cash flow (use) is defined by the Company as net cash provided by or used in operating activities (which includes royalty advances), reduced by spending on property, plant and equipment, prepublication, and production costs.
2. Net debt is defined by the Company as lines of credit and short-term debt plus long-term-debt, net of cash and cash equivalents.



## 3-Year Revenue Outlook

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- Projecting topline growth in Education and Trade, enabled by new publishing, and more targeted revenue growth in other businesses
  - Utilizing new transformative technology investments to launch products in a more efficient manner
  - Expanding our existing customer relationships and targeting new customers more effectively
- Setting a fiscal 2021 revenue target of **\$1.80 billion**, up from \$1.63 billion in fiscal 2018
- Expect moderate revenue growth in fiscal 2019 with an indicative **\$1.65** to **\$1.70** billion in revenues, with some acceleration in the outer years
- *Scholastic 2020* management framework refocusing energies on sustainable profitability through margin expansion, as a measure of efficiency, ahead of revenue growth



## 1-Year EBITDA and EPS Outlook

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- Greatest impact from Company's three-year initiatives will be reflected in future cash flows as measured by earnings before interest, taxes, depreciation and amortization
- Management believes this metric is useful as a measurement of performance and value creation as it removes the noise created by fluctuations in interest rates, tax rates, or levels of depreciation and amortization and other non-cash charges
- This new non-GAAP measure will be reconciled to Net Income in our supplemental financial tables
- Setting an EBITDA target for fiscal 2019 of **\$160** to **\$170** million, up from \$140.1 million, excluding one-time items, in fiscal 2018
- Expect fiscal 2019 earnings per diluted share in the range of **\$1.60** to **\$1.70**, up from EPS, excluding one-time items, of \$1.43 in fiscal 2018, reflecting the projected increase in operating income, as well as a reduction in the Company's effective tax rate





## Capital Investment Outlook

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- Expect to continue to make higher-than-normal levels of capital investment in technology innovation programs in conjunction with our *Scholastic 2020* plan
- Will impact both cash and earnings in fiscal 2019, as a portion of these investments will be expensed and impact operating margins
- Higher levels of depreciation from the building improvements and technology platforms now in service will partially offset the additional capital investment
- This outlook includes capital expenditures of **\$70 to \$80** million in fiscal 2019, compared to \$121.5 million in fiscal 2018
- With these investments, the Company is fully committed to improving operating margins using new *Scholastic 2020* work streams to leverage technology to improve marketing efficiency, lower costs, and improve business processes



## Questions & Answers

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### Participants

- Richard Robinson
- Kenneth Cleary
- Judy Newman, School Book Clubs and E-Commerce
- Satbir Bedi, Chief Technology Officer



