

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended November 30, 1999 Commission File No. 0-19860

SCHOLASTIC CORPORATION  
(Exact name of Registrant as specified in its charter)

Delaware 13-3385513  
(State or other jurisdiction of (IRS Employer Identification No.)  
incorporation or organization)

555 Broadway, New York, New York 10012  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (212) 343-6100

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of each class -----	Number of shares outstanding as of December 31, 1999 -----
Common Stock, \$.01 par value	15,829,079
Class A Stock, \$.01 par value	828,100

SCHOLASTIC CORPORATION  
FORM 10-Q FOR THE QUARTERLY PERIOD ENDED NOVEMBER 30, 1999  
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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

SCHOLASTIC CORPORATION  
 CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS - UNAUDITED  
 (amounts in millions, except per share data)

	Three months ended November 30,		Six months ended November 30,	
	1999	1998	1999	1998
Revenues	\$ 507.8	\$ 403.2	\$ 687.8	\$ 553.4
Operating costs and expenses:				
Cost of goods sold	236.8	187.3	345.1	273.0
Selling, general and administrative expenses	185.0	153.6	284.8	236.5
Depreciation	4.7	4.2	9.3	8.2
Goodwill and trademark amortization	1.3	1.5	2.2	2.9
Non-recurring charge	8.5	--	8.5	--
Total operating costs and expenses	436.3	346.6	649.9	520.6
Operating income	71.5	56.6	37.9	32.8
Interest expense, net	5.7	5.4	10.1	9.9
Income before income taxes	65.8	51.2	27.8	22.9
Provision for income taxes	24.5	19.5	10.1	8.7
Net income	\$ 41.3	\$ 31.7	\$ 17.7	\$ 14.2
Net income per Class A and Common Share:				
Basic	\$ 2.49	\$ 1.94	\$ 1.07	\$ 0.87
Diluted	\$ 2.30	\$ 1.81	\$ 1.06	\$ 0.86

See accompanying notes

SCHOLASTIC CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEET  
(amounts in millions, except per share data)

	November 30, 1999	May 31, 1999	November 30, 1998
	(Unaudited)		(Unaudited)
<b>ASSETS</b>			
Current Assets:			
Cash and cash equivalents	\$ 7.8	\$ 5.9	\$ 3.6
Accounts receivable less allowance for doubtful accounts	250.7	136.4	191.4
Inventories	301.8	227.4	236.1
Deferred taxes	41.9	41.8	41.9
Prepaid and other deferred expenses	32.1	22.7	26.5
<b>Total current assets</b>	<b>634.3</b>	<b>434.2</b>	<b>499.5</b>
Property, plant and equipment, net	159.1	149.1	141.3
Prepublication costs	98.7	95.3	85.1
Other assets and deferred charges	154.0	163.7	171.6
<b>Total assets</b>	<b>\$1,046.1</b>	<b>\$ 842.3</b>	<b>\$ 897.5</b>
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>			
Current Liabilities:			
Lines of credit	\$ 19.5	\$ 18.0	\$ 19.4
Accounts payable	155.4	97.0	103.1
Accrued royalties	39.6	23.7	24.2
Deferred revenue	35.6	6.7	36.9
Other accrued expenses	77.7	66.4	68.0
<b>Total current liabilities</b>	<b>327.8</b>	<b>211.8</b>	<b>251.6</b>
Noncurrent Liabilities:			
Long-term debt	312.9	248.0	286.8
Other noncurrent liabilities	22.9	21.1	24.1
<b>Total noncurrent liabilities</b>	<b>335.8</b>	<b>269.1</b>	<b>310.9</b>
Stockholders' Equity:			
Class A Stock, \$.01 par value	0.0	0.0	0.0
Common Stock, \$.01 par value	0.2	0.2	0.2
Additional paid-in capital	216.9	212.3	207.5
Accumulated other comprehensive loss:			
Foreign currency translation adjustment	(6.2)	(5.7)	(4.7)
Retained earnings	209.2	191.4	168.8
Less shares of Common Stock held in treasury	(37.6)	(36.8)	(36.8)
<b>Total stockholders' equity</b>	<b>382.5</b>	<b>361.4</b>	<b>335.0</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$1,046.1</b>	<b>\$ 842.3</b>	<b>\$ 897.5</b>

See accompanying notes

SCHOLASTIC CORPORATION  
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS - UNAUDITED  
(amounts in millions)

	Six months ended	
	November 30,	
	1999	1998
Net cash (used in) / provided by operating activities	\$ (10.4)	\$ 3.2
Cash flows used in investing activities:		
Prepublication costs	(23.8)	(16.3)
Additions to property, plant and equipment	(16.4)	(11.4)
Royalty advances	(12.0)	(11.3)
Production costs	(5.1)	(10.9)
Business and trademark acquisition-related payments	0.0	(11.7)
Other	(0.4)	(1.5)
Net cash used in investing activities	(57.7)	(63.1)
Cash flows provided by/(used in) financing activities:		
Borrowings under Loan Agreement and Revolver	192.2	158.2
Repayments of Loan Agreement and Revolver	(127.4)	(112.1)
Borrowings under lines of credit	32.3	34.9
Repayments of lines of credit	(30.3)	(25.0)
Other	3.2	2.4
Net cash provided by financing activities	70.0	58.4
Net increase/(decrease) in cash and cash equivalents	1.9	(1.5)
Cash and cash equivalents at beginning of period	5.9	5.1
Cash and cash equivalents at end of period	\$ 7.8	\$ 3.6

See accompanying notes

## 1. Basis of Presentation

The accompanying condensed consolidated financial statements have not been audited, but reflect those adjustments consisting of normal recurring items which management considers necessary for a fair presentation of financial position, results of operations and cash flow. These financial statements should be read in conjunction with the consolidated financial statements and related notes in the 1998/1999 Annual Report to Stockholders.

The Company's business is closely correlated to the school year. Consequently, the results of operations for the six months ended November 30, 1999 and 1998 are not necessarily indicative of the results expected for the full year. Due to the seasonal fluctuations that occur, the November 30, 1998 consolidated balance sheet is included for comparative purposes.

Certain prior year amounts have been reclassified in the accompanying condensed consolidated financial statements to conform to the current year presentation.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates and assumptions. Significant estimates that affect the financial statements include, but are not limited to, book returns, recoverability of inventory, recoverability of advances to authors, amortization periods, recoverability of prepublication and film production costs and recoverability of other long-lived assets.

## 2. Recent Accounting Principles

Effective May 31, 1999, the Company adopted Statement of Financial Accounting Standards No. 131 (SFAS 131), "Disclosures About Segments of an Enterprise and Related Information." This statement requires that public business enterprises report certain information about operating segments in financial statements of the enterprise issued to shareholders. It also requires that public business enterprises report certain information about their products and services, the geographic areas in which they operate, and their major customers. The required disclosures are presented in Note 3 included herein.

The Financial Accounting Standards Board issued, in June 1998, Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 requires all derivatives to be recorded on the balance sheet at fair value and establishes special accounting for the following three different types of hedges: hedges of changes in the fair value of assets, liabilities, or firm commitments (fair value hedges); hedges of the variable cash flows of forecasted transactions (cash flow hedges); and hedges of foreign currency exposures of net investments in foreign operations. Though the accounting treatment and criteria for each of the three types of hedges is unique, they all result in offsetting changes in fair values or cash flows of both the hedge and the hedged item recognized in earnings or in accumulated comprehensive income in the same period. Changes in the fair value of derivatives that do not meet the criteria of one of these three categories of hedges are included in income. The Company is required to adopt the provisions of SFAS 133 in the first quarter of fiscal 2002.

3. Segment Information

The Company is a global children's publishing and media company with operations in the United States, the United Kingdom, Canada, Australia, New Zealand, Mexico, Hong Kong and India and distributes its products and services through a variety of channels, including book clubs, book fairs and trade.

The Company's operations are categorized in the following four segments: Children's Book Publishing and Distribution; Educational Publishing; Media, Licensing and Advertising and International. Such segment classification reflects the nature of products and services consistent with the method by which the Company's chief operating decision-maker assesses operating performance and allocates resources.

The following tables set forth the Company's segment information for the quarter and six-month periods ended November 30, 1999 and 1998:

	Children's Book Publishing and Distribution	Educational Publishing	Media, Licensing and Advertising	Total Domestic	International	Overhead (1)	Consolidated
-----							
Three months ended November 30, 1999							
-----							
Revenues	\$ 353.1	\$ 51.4	\$ 40.6	\$ 445.1	\$ 62.7	\$ 0.0	\$ 507.8
Depreciation	0.9	0.3	0.3	1.5	0.8	2.4	4.7
Amortization (2)	3.4	6.9	3.6	13.9	0.5	0.0	14.4
Royalty advance expense	4.9	0.5	0.8	6.2	0.3	0.0	6.5
Segment profit/(loss) (3)	94.8	(4.5)	(1.6)	88.7	5.4	(22.6)	71.5
Expenditures for long-lived assets (5)	8.0	2.8	3.4	14.2	1.2	5.3	20.7

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Three months ended November 30, 1998							
-----							
Revenues	\$ 259.8	\$ 46.6	\$ 35.3	\$ 341.7	\$ 61.5	\$ 0.0	\$ 403.2
Depreciation	0.9	0.2	0.2	1.3	0.8	2.1	4.2
Amortization (2)	3.1	5.8	6.0	14.9	0.6	0.0	15.5
Royalty advance expense	6.3	0.4	0.5	7.2	0.6	0.0	7.8
Segment profit/(loss) (3)	64.3	(3.4)	0.7	61.6	4.5	(9.5)	56.6
Expenditures for long-lived assets (5)	5.7	6.7	4.7	17.1	1.9	1.3	20.3

SCHOLASTIC CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED  
 (amounts in millions, except per share data)

3. Segment Information (continued)

	Children's Book Publishing and Distribution	Educational Publishing	Media, Licensing and Advertising	Total Domestic	International	Overhead (1)	Consolidated
-----							
Six months ended November 30, 1999							
Revenues	\$ 432.3	\$ 107.2	\$ 49.5	\$ 589.0	\$ 98.8	\$ 0.0	\$ 687.8
Depreciation	1.8	0.5	0.5	2.8	1.7	4.8	9.3
Amortization (2)	6.8	13.9	5.2	25.9	0.8	0.0	26.7
Royalty advance expense	9.1	0.6	1.0	10.7	0.8	0.0	11.5
Segment profit/(loss) (3)	80.1	(5.7)	(8.7)	65.7	0.7	(28.5)	37.9
Segment assets	470.5	196.0	77.5	744.0	135.5	166.6	1,046.1
Long-lived assets (4)	94.7	98.2	27.1	220.0	55.8	111.8	387.6
Expenditures for long-lived assets (5)	19.0	17.6	9.4	46.0	2.3	9.0	57.3

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 Six months ended  
 November 30, 1998

Revenues	\$ 307.6	\$ 110.1	\$ 41.4	\$ 459.1	\$ 94.3	\$ 0.0	\$ 553.4
Depreciation	1.6	0.4	0.4	2.4	1.6	4.2	8.2
Amortization (2)	6.2	11.9	7.5	25.6	1.2	0.0	26.8
Royalty advance expense	9.4	0.5	0.5	10.4	0.6	0.0	11.0
Segment profit/(loss) (3)	45.0	11.2	(5.6)	50.6	(0.3)	(17.5)	32.8
Segment assets	367.0	171.2	48.6	586.8	157.8	152.9	897.5
Long-lived assets (4)	97.9	86.3	25.2	209.4	58.5	96.0	363.9
Expenditures for long-lived assets (5)	18.2	11.1	12.2	41.5	5.4	3.0	49.9

(1) Overhead includes unallocated domestic corporate-related items and as it relates to the segment profit/(loss), expenses not allocated to reportable segments including costs related to the management of corporate assets, net interest expense and provision for income taxes. Unallocated assets are principally comprised of deferred income taxes and property, plant and equipment related to the Company's headquarters in the metropolitan New York area and its National Service Operation located in the Jefferson City, Missouri area.

(2) Includes amortization of goodwill, intangible assets, and prepublication and production costs.

(3) Segment profit/(loss) represents earnings before interest and taxes.

(4) Includes property, plant and equipment, prepublication costs, goodwill and trademarks, royalty advances and production costs.

(5) Includes purchases of property, plant and equipment, investments in prepublication and production costs, and royalty advances.

4. Debt

Long-term debt consisted of the following:

	November 30, 1999	May 31, 1999	November 30, 1998
Loan Agreement and Revolver	\$ 74.8	\$ 10.0	\$ 48.4
7% Notes due 2003, net of discount	124.8	124.8	124.8
Convertible Subordinated Debentures	110.0	110.0	110.0
Other debt	3.4	3.4	3.7
<b>Total debt</b>	<b>313.0</b>	<b>248.2</b>	<b>286.9</b>
Less current portion	(0.1)	(0.2)	(0.1)
<b>Total long-term debt</b>	<b>\$ 312.9</b>	<b>\$ 248.0</b>	<b>\$ 286.8</b>

Loan Agreement. The Company and Scholastic Inc. (a wholly-owned subsidiary) are joint and several borrowers under a loan agreement with certain banks which was amended and restated effective August 11, 1999 (the "Loan Agreement"). The Loan Agreement, which expires August 11, 2004, provides for aggregate borrowings of up to \$170.0 (with a right in certain circumstances to increase it to \$200.0) including the issuance of up to \$10.0 in letters of credit with \$1.0 outstanding for the three and six-month periods ended November 30, 1999. Interest under this facility is either at the prime rate or 0.325% to 0.90% over LIBOR (as defined). There is a commitment fee ranging from 0.10% to 0.30% on the facility and a utilization fee ranging from 0.05% to 0.15% if borrowings exceed 33.0% of the total facility. The amounts charged vary based upon the Company's credit ratings. At the Company's current credit ratings, the spread over LIBOR, commitment fee and utilization fee are 0.475%, 0.150% and 0.075%, respectively. The Loan Agreement contains certain financial covenants related to debt and interest coverage ratios (as defined) and limits dividends and other distributions.

Revolver. The Company and Scholastic Inc. are joint and several borrowers under a Revolving Loan Agreement (the "Revolver") with SunTrust Bank, which was amended and restated effective November 10, 1999 and provides for revolving credit loans of up to \$40.0 and expires on August 11, 2004. The Revolver has certain financial covenants related to debt and interest coverage ratios (as defined) and limits dividends and other distributions.

7% Notes due 2003. In December 1996, the Company issued \$125.0 of 7% Notes due 2003 (the "Notes"). The Notes are unsecured and unsubordinated obligations of the Company and will mature on December 15, 2003. The Notes are not redeemable prior to maturity. Interest on the Notes is payable semi-annually on December 15 and June 15 of each year.

Convertible Subordinated Debentures. In August 1995, the Company sold \$110.0 of 5.0% Convertible Subordinated Debentures due August 15, 2005 (the "Debentures") under Regulation S and Rule 144A of the Securities Act of 1933. Interest on the Debentures is payable semi-annually on August 15 and February 15 of each year. The Debentures are redeemable at the option of the Company, in whole, but not in part, at any time on or after August 15, 1998 at 100% of the principal amount plus accrued interest. Each Debenture is convertible, at the holder's option, any time prior to maturity, into Common Stock of the Company at a conversion price of \$76.86 per share.



#### 5. Contingencies

The Company and certain officers have been named as defendants in litigation which alleges, among other things, violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, resulting from purportedly materially false and misleading statements to the investing public concerning the financial condition of the Company. On December 14, 1998, an order was entered granting the Company's motion to dismiss plaintiffs' complaint. In dismissing the complaint, the court held that plaintiffs failed to state a claim upon which relief can be granted and granted plaintiffs leave to amend the complaint. Pursuant to that order, plaintiffs filed a Second Amended Consolidated Complaint, on or about February 16, 1999, alleging substantially similar claims against the Company and one of its officers. The Company filed a motion to dismiss the complaint on April 16, 1999. The Company continues to believe that the litigation is without merit and will continue to vigorously defend against it.

On February 1, 1999, two subsidiaries of the Company commenced an action in the Supreme Court of the State of New York in New York County against Parachute Press, Inc. ("Parachute"), the licensor of certain publication and nonpublication rights to the Goosebumps(R) series, certain affiliated Parachute companies and R.L. Stine, individually, alleging material breach of contract and fraud in connection with the agreements under which such Goosebumps rights are licensed to the Company. The issues in the case are also, in part, the subject of two litigations commenced by Parachute following repeated notices from the Company to Parachute of material breaches by Parachute of the agreements under which such rights are licensed and the exercise by the Company of its contractual remedies under the agreements. The first Parachute action, in which two subsidiaries of the Company are defendants and counterclaim plaintiffs, was commenced in the federal court for the Southern District of New York on November 14, 1997 and was dismissed for lack of subject matter jurisdiction on January 29, 1999. Parachute filed an appeal of the dismissal. The second Parachute action was filed contemporaneously with the filing of the Company's complaint on February 1, 1999 in the Supreme Court of the State of New York in New York County. In its two complaints, and in its counterclaims, Parachute alleges that the exercise of contractual remedies by the Company was improper and seeks declaratory relief and unspecified damages for, among other claims, alleged breaches of contract and acts of unfair competition. Damages sought by Parachute include the payment of a total of approximately \$36.1 of advances over the term of the contract (of which approximately \$15.3 had been paid at the time the first Parachute litigation began) and payments of royalties set-off by Scholastic against amounts claimed by the Company. The Company is seeking declaratory relief and damages for, among other claims, breaches of contract, fraud and acts of unfair competition. Damages sought by the Company include repayment by Parachute of a portion of the \$15.3 advance already paid. Discovery, which has been consolidated for the litigations, has commenced. The Company intends to vigorously pursue its claims against Parachute and the other named defendants and to vigorously defend its position against the new lawsuit and the appeal. The Company does not believe that this dispute will have a material adverse effect on its financial condition.

The Company is also engaged in various legal proceedings incident to its normal business activities. In the opinion of the Company, none of such proceedings is material to the consolidated financial position of the Company.

6. Comprehensive Income

The following table sets forth comprehensive income for the periods indicated:

	Three months ended November 30,		Six months ended November 30,	
	1999	1998	1999	1998
Net income	\$ 41.3	\$ 31.7	\$ 17.7	\$ 14.2
Other comprehensive income/(loss):				
Foreign currency translation adjustment net of provision or benefit for income taxes	(0.1)	0.3	(0.3)	0.1
Comprehensive income	\$ 41.2	\$ 32.0	\$ 17.4	\$ 14.3

7. Earnings Per Share

Basic earnings per share are computed by dividing net earnings by the weighted-average number of shares outstanding during the period. Diluted earnings per share are calculated to give effect to potentially dilutive stock options and convertible debentures that were outstanding during the period. The following table summarizes the reconciliation of the numerators and denominators for the Basic and Diluted earnings per share ("EPS") computations:

	Three months ended November 30,		Six months ended November 30,	
	1999	1998	1999	1998
Net income for Basic EPS	\$ 41.3	\$ 31.7	\$ 17.7	\$ 14.2
Effect of convertible debt	0.8	0.9	1.7	--(1)
Net income for Diluted EPS	\$ 42.1	\$ 32.6	\$ 19.4	\$ 14.2
Weighted-average shares for Basic EPS	16.5	16.3	16.5	16.3
Effect of stock options	0.4	0.3	0.4	0.3
Effect of convertible debt	1.4	1.4	1.4	--(1)
Weighted-average shares for Diluted EPS	18.3	18.0	18.3	16.6
Net income per Class A and Common Share:				
Basic	\$ 2.49	\$ 1.94	\$ 1.07	\$ 0.87
Diluted	\$ 2.30	\$ 1.81	\$ 1.06	\$ 0.86

(1) For the six months ended November 30, 1998, the effect of the 5.0% Convertible Subordinated Debentures on the weighted-average shares outstanding for diluted EPS was anti-dilutive and not included in the calculation.

8. Non-Recurring Charge

The operating results for the quarter included a non-recurring charge primarily related to the establishment of a litigation reserve following an adverse decision in a lawsuit which was received on December 10, 1999. The case, Scholastic Inc. and Scholastic Productions, Inc. v. Robert Harris and Harris Entertainment, Inc., involves stock appreciation rights allegedly granted to Mr. Harris in 1990 in connection with a joint venture formed primarily to produce motion pictures. Although the Company disagrees with the judge's decision and intends to appeal, the Company has recorded \$6.7 million to fully reserve with respect to the case. The \$8.5 million charge also includes an unrelated non-recurring expense of \$1.8 million relating to the liquidation of certain stock options.

Results of Operations - Consolidated

Revenues for the quarter ended November 30, 1999 increased approximately 26% to \$507.8 million from \$403.2 million in the comparable quarter of the prior fiscal year. For the six months ended November 30, 1999, revenues increased approximately 24% to \$687.8 million from \$553.4 million in the prior fiscal year period. This increase in revenue for both the three and six month periods was driven primarily by the Company's Children's Book Publishing and Distribution segment, which was up 36% over the prior year quarter and 41% over the prior year-to-date period. This segment accounted for 69% and 63% of the Company's revenues for the three and six-month periods ended November 30, 1999, respectively, as compared to 65% and 56%, respectively, in the corresponding prior fiscal year periods.

As a percentage of sales, cost of goods sold remained a constant percentage for the three and six-month periods ended November 30, 1999 relative to the comparable periods of the prior fiscal year. Selling, general and administrative expenses as a percentage of revenue were down approximately 1% for the three and six-month periods ended November 30, 1999 to 37% and 41%, respectively, as compared to the same periods in the prior fiscal year. This decrease reflects the impact of lower promotional spending levels in the Children's Book Publishing and Distribution segment, where revenue growth outpaced promotional spending needs combined with the Company's cost-cutting/margin improvement plan. This benefit was partially offset by increased spending in the Educational Publishing and Media, Licensing and Advertising segments related to sampling expense for the Texas reading adoption and the Company's continued investment in Internet initiatives, respectively. Operating expenses for the quarter included a non-recurring charge of \$8.5 million primarily related to the establishment of a litigation reserve following an adverse decision in a lawsuit. The case, which the Company intends to appeal, involves stock appreciation rights allegedly granted in connection with a joint venture formed primarily to produce motion pictures. The special charge also includes an unrelated non-recurring expense of \$1.8 million relating to the liquidation of certain stock options.

The operating profit for the quarter ended November 30, 1999, excluding the non-recurring charge, increased 41% to \$80.0 million from a profit of \$56.6 million in the same quarter of the prior fiscal year. Including the non-recurring charge, operating profit improved 26% in the current quarter compared to the same period in the prior year. Operating profit for the six-month period ended November 30, 1999, excluding the non-recurring charge, was up 41% to \$46.4 million when compared to the same period in the prior year. After the charge, year-to-date operating profit was up approximately 16% to \$37.9 million from \$32.8 million in the prior year period. These increases reflect the benefit of increased sales in Children's Book Publishing and Distribution primarily due to strong trade sales, led by the Harry Potter(TM) and Pokemon(TM) books and a variety of successful series published by the Company, strong results in book clubs and fairs and the impact of cost-cutting/margin improvement plans across the Company.

Net income for the quarter ended November 30, 1999, including the non-recurring charge, increased 30% to \$41.3 million, or \$2.30 per diluted share, compared to net income of \$31.7 million, or \$1.81 per diluted share, in the comparable quarter of the prior year. Net income, excluding the non-recurring charge, increased 47% to \$46.6 million or \$2.59 per diluted share for the quarter when compared to the same period in the prior fiscal year.

Results of Operations - Segments

Children's Book Publishing and Distribution

The Company's Children's Book Publishing and Distribution segment includes the publication and distribution in the United States of children's books through its school-based book club (including home continuity programs), book fair and trade channels.

(in millions)	Three months ended November 30,		Six months ended November 30,	
	1999	1998	1999	1998
Revenue	\$ 353.1	\$ 259.8	\$ 432.3	\$ 307.6
Operating profit	94.8	64.3	80.1	45.0
Operating margin	26.8%	24.7%	18.5%	14.6%

Revenues in the Children's Book Publishing and Distribution segment for the second quarter of fiscal 2000 were up 36% to \$353.1 million from \$259.8 million in the comparable quarter of the prior fiscal year. Year-to-date revenues were up 41% at \$432.3 million compared to the same period of the prior year. As a result, operating results improved approximately 47% to \$94.8 million for the quarter and improved approximately 78% for the six months ended November 30, 1999 when compared to the same period in the prior fiscal year. The increased revenue reflects the impact of continued strong trade sales volume of Scholastic properties including three Harry Potter books and the Animorphs(R), Dear America(TM), Royal Diaries, Pokemon(TM) and EverWorld(TM) series. Additionally, revenues in both the Company's book clubs and book fairs were up approximately 17% over the prior year quarter. Results in both book clubs and book fairs benefited from continuing improvements in marketing, infrastructure and product selection. This resulted in a higher level of book club orders, increased fair count and higher revenue per book club order and per book fair.

Educational Publishing

The Company's Educational Publishing segment includes the publication and distribution of K-12 textbooks, supplemental materials (including professional books), classroom magazines and instructional technology for core and supplemental use in schools and libraries in the United States.

(in millions)	Three months ended November 30,		Six months ended November 30,	
	1999	1998	1999	1998
Revenue	\$ 51.4	\$ 46.6	\$ 107.2	\$ 110.1
Operating profit/(loss)	(4.5)	(3.4)	(5.7)	11.2
Operating margin	*	*	*	10.2%

\* not meaningful

Revenues in the Educational Publishing segment for the quarter increased approximately 10% to \$51.4 million with an operating loss of \$4.5 million as compared to revenues of \$46.6 million and operating loss of \$3.4 million in the comparable quarter of the prior fiscal year. Revenues for the quarter reflect the impact of continued sales of Scholastic Literacy Place(R) combined with initial sales of the new Read 180!(TM) reading intervention software. The operating loss for the quarter reflects the impact of increased sampling costs in the fiscal 2000 quarter related to the Texas reading adoption combined with certain expenses related to the rollout of the Read 180! software. On a year-to-date basis, revenues for the

## SCHOLASTIC CORPORATION

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&amp;A")

## Results of Operations - Segments (continued)

period ended November 30, 1999 declined approximately 3% to \$107.2 million, from \$110.1 million for the comparable period of the prior fiscal year reflecting the impact of higher order levels for Scholastic Literacy Place in the first quarter of fiscal 1999, related to the California reading adoption. The next major state adoption is in Texas, with product shipments expected in the summer of 2000. The year-to-date operating loss for the period ended November 30, 1999 reflects the impact of the decreased sales levels combined with increased costs of sampling for the Texas reading adoption in the summer of 2000 and certain costs related to the rollout of the company's Read 180! software

## Media, Licensing and Advertising

The Company's Media, Licensing and Advertising segment includes the production and the distribution by the Company's United States-based operations of entertainment products (including television programming, videos and motion pictures), Internet services and CD-ROM-based products and Scholastic-branded licensed properties, as well as advertising and promotional activities.

(in millions)	Three months ended November 30,		Six months ended November 30,	
	1999	1998	1999	1998
Revenue	\$ 40.6	\$ 35.3	\$ 49.5	\$ 41.4
Operating (loss)/profit	(1.6)	0.7	(8.7)	(5.6)
Operating margin	*	2.0%	*	*

\* not meaningful

Media, Licensing and Advertising revenues increased 15% to \$40.6 million in the second quarter of fiscal 2000 as compared to the prior year quarter. For the six months ended November 30, 1999, revenues increased approximately 20% to \$49.5 million from \$41.4 million for the same period of the prior fiscal year. For the quarter ended November 30, 1999, the segment recognized an operating loss of \$1.6 million as compared to a profit of \$0.7 million in the same period of the prior fiscal year. On a year-to-date basis, operating losses grew 55% to \$8.7 million from an operating loss of \$5.6 million in the same period of the prior fiscal year. These results reflect the benefit of increased magazine advertising sales which were more than offset by the Company's increased Internet-related expenditures.

## International

The International segment consists of the distribution of products and services outside the United States by the Company's operations located in the United Kingdom, Canada, Australia, New Zealand, Mexico, Hong Kong and India.

(in millions)	Three months ended November 30,		Six months ended November 30,	
	1999	1998	1999	1998
Revenue	\$ 62.7	\$ 61.5	\$ 98.8	\$ 94.3
Operating profit/(loss)	5.4	4.5	0.7	(0.3)
Operating margin	8.6%	7.3%	0.7%	*

\* not meaningful

Results of Operations - Segments (continued)

International revenues for the quarter ended November 30, 1999 increased approximately 2% to \$62.7 million compared to \$61.5 million for the same period in the prior fiscal year. Revenue improvements in Australia and Canada in the book club and trade businesses were offset by continued weakness in the United Kingdom book club, trade and book fair businesses. On a year-to-date basis, revenues increased approximately 5% to \$98.8 million compared to \$94.3 million in the prior fiscal year period. This improvement reflects strong performance in the Canadian operation in the book club and trade businesses and in Australia in the book club and software businesses, which were offset by weak sales in the United Kingdom. Operating profit improved 20% over the prior year period to \$5.4 million for the quarter, reflecting the impact of revenue improvements and cost containment efforts. For the six months ended November 30, 1999, operating profit improved \$1.0 million to \$0.7 million from a loss of \$0.3 million, reflecting primarily the net impact of revenue improvements when compared to the same period in the prior fiscal year.

Seasonality

The Company's book clubs, book fairs and most of its magazines operate on a school-year basis; therefore, the Company's business is highly seasonal. As a consequence, the Company's revenues in the first and third quarters of the fiscal year are lower than its revenues in the other two fiscal quarters, and the Company generally experiences a substantial loss from operations in the first quarter. Typically, book club and book fair revenues are proportionately larger in the second quarter of the fiscal year, while revenues from the sale of instructional materials are larger in the first quarter.

Liquidity and Capital Resources

For the June through October time period, the Company experiences negative cash flow due to the seasonality of its business. Historically, as a result of the Company's business cycle, borrowings have increased during June, July and August and generally have peaked in September or October, and have been at the lowest point in May.

The Company's cash and cash equivalents increased by \$1.9 million during the six-month period ended November 30, 1999, compared to a decrease of \$1.5 million during the comparable period in the prior fiscal year.

The Company used \$10.4 million of cash from operating activities during the six-month period ended November 30, 1999 versus generating \$3.2 million in the comparable period of the prior fiscal year. Improvements in operating results were more than offset by increased inventory and accounts receivable requirements. Inventory levels increased to support higher revenues and accelerated purchasing in order to enhance customer service and to reduce Year 2000 risks.

Cash used in investing activities was \$57.7 million and \$63.1 million for the six months ended November 30, 1999 and 1998, respectively. Investing activities consisted primarily of prepublication cost expenditures, capital expenditures, royalty advances and production cost expenditures. Business and trademark acquisition-related payments for the prior fiscal year were related to the acquisition of certain assets of Pages Book Fairs, Inc. Prepublication cost expenditures increased \$7.5 million to \$23.8 million for the six months ended November 30, 1999 over the comparable period of the prior year largely due to the planned revision to Scholastic Literacy Place and the initial spending on the Company's new

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Liquidity and Capital Resources (continued)

Read 180! program. Capital expenditures increased \$5.0 to \$16.4 million in the current year reflecting the construction of a new office facility. Royalty advances increased \$0.7 million for the six months ended November 30, 1999 over the same period in the prior fiscal year to \$12.0 million. Production cost expenditures decreased \$5.8 million to \$5.1 million for the six months ended November 30, 1999 when compared to the same period in the prior fiscal year, due to a reduction in the number of shows being produced.

Financing

The Company maintains two unsecured credit facilities which provide for aggregate borrowings of up to \$210.0 million (with a right, in certain circumstances, to increase to \$240.0 million), including the issuance of up to \$10.0 million in letters of credit. The Company uses these facilities for various purposes including the funding of seasonal cash flow needs and other working capital requirements. At November 30, 1999, the Company had \$74.8 million in borrowings outstanding under these facilities at a weighted-average interest rate of 6.2%.

The Loan Agreement was amended and restated on August 11, 1999, principally to extend the expiration date of the facility to August 11, 2004 and expand the facility from \$135.0 million to \$170.0 million (with a right, in certain circumstances, to increase to \$200.0 million). In addition, on November 10, 1999, the Company amended and restated the Revolver to increase the amount available thereunder to \$40.0 million and extend its expiration to be concurrent with the Loan Agreement.

In addition, unsecured lines of credit available to the Company's United Kingdom, Canadian and Australian operations totaled \$39.7 million at November 30, 1999. These lines are used primarily to fund working capital needs in those countries. At November 30, 1999, \$19.5 million in borrowings were outstanding under these lines at a weighted-average interest rate of 6.0%.

The Company believes its existing cash position, combined with funds generated from operations and funds available under the two credit facilities and other lines of credit will be sufficient to finance its ongoing working capital requirements for the remainder of the fiscal year.

Acquisitions

In the ordinary course of business, the Company explores domestic and international expansion opportunities, including potential niche and strategic acquisitions. As part of this process, the Company engages with interested parties in discussions concerning possible transactions. The Company will continue to evaluate such opportunities and prospects.

Year 2000 Readiness Disclosure

The Company's Year 2000 program, which was commenced in July 1997 and is administered by internal staff, assisted by outside consultants, consists of the following three components relating to the Company's operations: (i) information technology ("IT") computer systems and applications which may be impacted by the Year 2000 problem and the actions related thereto, (ii) non-IT systems and equipment which include embedded technology which may be impacted by the Year 2000 problem and actions related thereto and (iii) third party suppliers and customers with which the Company has material



Year 2000 Readiness Disclosure (continued)

relationships and which could adversely affect the Company if such parties fail to be Year 2000 compliant and the actions related thereto. The general phases common to all three components of the Company's Year 2000 program are: Assessment, Remediation, Testing, Contingency Planning, and Implementation.

The progress and historical costs to date of the three components of the Company's Year 2000 program for principal systems, applications or issues affected by the Year 2000 is as follows:

The Company completed its Year 2000 Readiness Program on a timely basis and has experienced no significant problems to date in its internal operations or with its material third party vendors with the date change to the Year 2000. The Company does not anticipate any significant problems in its internal operations or with its material third party vendors in connection with its Year 2000 readiness.

**IT Systems and Applications.** The principal IT systems and applications of the Company affected by Year 2000 issues included order entry, purchasing, distribution and financial reporting. Issues related to vendor supplied software include financial reporting and certain infrastructure and operating system software. Excluding normal system upgrades, the Company estimates that total costs for conversion and testing of new or modified IT systems and applications will aggregate approximately \$12.0 million through fiscal 2000, of which \$9.2 million was incurred through November 30, 1999.

**Non-IT Systems and Equipment.** The principal non-IT systems and equipment of the Company incorporating embedded technology affected by Year 2000 issues included security systems, phone systems, business machines, computers and distribution systems. The Company estimates the total costs for modifying or replacing new systems and equipment in this area will be approximately \$0.2 million through fiscal 2000, of which \$0.1 million was incurred through November 30, 1999.

**Material Third Party Relationships.** Material third party supplier relationships affected by Year 2000 issues relate primarily to printing, paper supplies, distribution, fulfillment, licensing and financial services. Substantially all of the Company's principal suppliers have reported that they have initiated Year 2000 programs and such suppliers have not brought to the Company's attention nor has the Company experienced any problems which would materially and adversely impact the Company's operations taken as a whole. The Company developed contingency plans with respect to its principal third party suppliers. No single customer or small group of customers are material to the Company's financial condition.

Including the costs set forth above for IT systems and applications, the Company estimates that total program costs for implementing its Year 2000 program will be approximately \$12.2 million, of which total program costs through November 30, 1999 have been \$9.3 million. These costs include costs related to the matters described above, as well as consulting and other expenses related to infrastructure and facilities enhancements necessary to prepare the Company for the Year 2000. The costs also include expenses related to internal staff.

All statements regarding Year 2000 Readiness are "Year 2000 Readiness Disclosures" as defined by the Year 2000 Information and Readiness Disclosure Act of October 19, 1998.

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Non-Recurring Charge

The quarter included a non-recurring charge primarily related to the establishment of a litigation reserve following an adverse decision in a lawsuit originally filed in January, 1995. The case, Scholastic Inc. and Scholastic Productions, Inc. v. Robert Harris and Harris Entertainment, Inc., involves stock appreciation rights allegedly granted to Mr. Harris in 1990 in connection with a joint venture formed primarily to produce motion pictures. Although the Company disagrees with the judge's decision and intends to appeal, the Company has recorded \$6.7 million to fully reserve with respect to the case. The \$8.5 million charge also includes an unrelated non-recurring expense of \$1.8 million relating to the liquidation of certain stock options.

Forward Looking Statements

This Report on Form 10-Q contains forward-looking statements, which are subject to various risks and uncertainties, including the conditions of the children's book and instructional materials markets and acceptance of the Company's products within those markets and other risks and factors identified in the Company's Report on Form 10-K for the fiscal year ended May 31, 1999.

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The Company has operations in various foreign countries. In the normal course of business, these operations are exposed to fluctuations in currency values. Management does not consider the impact of currency fluctuations to represent a significant risk. The Company does not generally enter into derivative financial instruments for material amounts, nor are such instruments used for speculative purposes.

Market risks relating to the Company's operations result primarily from changes in interest rates. The majority of the Company's long-term debt bears interest at a fixed rate. However, the fair market value of the fixed rate debt is sensitive to changes in interest rates. The Company is subject to the risk that market interest rates will decline and the interest rates under the fixed rate debt will exceed the then prevailing market rates. The Company does not generally utilize interest rate derivative instruments to manage its exposure to interest rate changes.

As of November 30, 1999, the balance outstanding under the facilities which have variable rates was \$94.3 million, at a weighted-average interest rate of 6.2%. A 15% increase or decrease in the average cost of the Company's variable rate debt under the facility would not have a significant impact on the Company's results of operations.

Additional information relating to the Company's outstanding financial instruments is included in Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

PART II - OTHER INFORMATION

SCHOLASTIC CORPORATION

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Stockholders of the Company was held on September 15, 1999 (the "Meeting"). The following sets forth the results of the proposals presented at the Meeting voted upon by the stockholders of the Company entitled to vote thereon:

Holders of the 828,100 shares of Class A Stock (comprising all outstanding shares of Class A Stock) unanimously voted in favor of:

- o Setting the number of directors constituting the Board of Directors at thirteen until the next annual meeting of the stockholders;
- o Electing Richard Robinson, Rebeca M. Barrera, Helen V. Benham, Charles T. Harris III, Andrew S. Hedden, Mae C. Jemison, Linda B. Keene, Olaf Olafsson, Augustus K. Oliver and Richard M. Spaulding as directors to serve until the next annual meeting of stockholders and until their successors are duly elected and qualified;
- o Ratifying the appointment of Ernst & Young LLP as independent auditors for the fiscal year ending May 31, 2000; and
- o Approving the Scholastic Corporation Executive Performance Incentive Plan.

With respect to all matters voted on by the holders of the Class A Stock at the meeting, broker non-votes were not applicable since no shares are held by brokers.

Holders of the Common Stock elected the following three nominees as directors to serve until the next annual meeting of stockholders and until their successors are duly elected and qualified. Votes cast by holders of the Common Stock were as follows:

Nominee	For	Withheld
Ramon C. Cortines	13,125,227	16,239
Peter Mayer	13,125,532	15,934
John G. McDonald	13,125,352	16,114

With respect to the matter voted on by the holders of the Common Stock, abstentions or broker non-votes were not applicable.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit Number	Description of Document
10.7	Scholastic Corporation Management Stock Purchase Plan, Amended and Restated, effective as of December 15, 1999
27.1	Financial Data Schedule for the six months ended November 30, 1999

(b) Reports on Form 8-K filed during the quarter: none.

SCHOLASTIC CORPORATION  
SIGNATURES

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

SCHOLASTIC CORPORATION  
(Registrant)

Date: January 14, 2000

/s/ Richard Robinson  
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Richard Robinson  
Chairman of the Board,  
President, Chief Executive  
Officer and Director

Date: January 14, 2000

/s/ Kevin J. McEnery  
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Kevin J. McEnery  
Executive Vice President and  
Chief Financial Officer

SCHOLASTIC CORPORATION  
FORM 10-Q FOR QUARTERLY PERIOD ENDED NOVEMBER 30, 1999  
EXHIBIT INDEX

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Exhibit Number -----	Description of Document -----
10.7	Scholastic Corporation Management Stock Purchase Plan, Amended and Restated, effective as of December 15, 1999
27.1	Financial Data Schedule for the quarter ended November 30, 1999

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Scholastic Corporation Management Stock Purchase Plan  
(Amended and Restated Effective December 15, 1999)

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SCHOLASTIC CORPORATION  
MANAGEMENT STOCK PURCHASE PLAN  
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Effective January 1, 1999  
Amended and Restated December 15, 1999

SCHOLASTIC CORPORATION  
MANAGEMENT STOCK PURCHASE PLAN  
(Amended and Restated Effective December 15, 1999)

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SCHOLASTIC CORPORATION  
MANAGEMENT STOCK PURCHASE PLAN  
(Amended and Restated Effective December 15, 1999)

ARTICLE 1 - INTRODUCTION

The purpose of the Scholastic Corporation Management Stock Purchase Plan (the "Plan") is to provide equity incentive compensation to selected management employees of Scholastic Corporation and its Affiliates. Participants in the Plan receive restricted stock units at a discount in lieu of a portion or all of their bonus awards under the Company's annual incentive plan. Under certain circumstances, the restricted stock units convert into shares of Common Stock. The Company believes that the Plan creates a means to provide deferred compensation to such selected management employees and to raise the level of stock ownership in the Company by such employees thereby strengthening the mutuality of interests between such employees and the Company's stockholders.

ARTICLE 2 - DEFINITIONS

- 2.1 AFFILIATE - (i) any corporation, partnership, limited liability company or other entity as to which the Company possesses a direct or indirect ownership interest of at least fifty (50) percent or which possesses a direct or indirect ownership interest of at least 50% in the Company including, without limitation, any subsidiary corporation (as defined in Section 424(f) of the Code) and parent corporation (as defined in Section 424(e) of the Code) and (ii) any other entity in which the Company or any of its Affiliates has a material equity interest, as determined by the Committee.
- 2.2 AWARD DATE - the first business day after the end of the fiscal quarter in which a Bonus for a year is paid or otherwise would have been paid.
- 2.3 AWARD VALUE - the Fair Market Value of a share of Common Stock on the Award Date.
- 2.4 BENEFICIARY - a Beneficiary or Beneficiaries designated by the Participant under Article 9.
- 2.5 BONUS - a Participant's annual award for a Fiscal Year under the Company's Annual Incentive Plan.
- 2.6 BOARD OF DIRECTORS - the Board of Directors of the Company or the Executive Committee of such Board of Directors.
- 2.7 CAUSE - any of the following: (i) any act or acts by the Participant constituting a felony under the laws of the United States, any state



thereof, or any political subdivision thereof, (ii) the Participant's willful and continued failure to perform the duties assigned to him or her as an employee or consultant of the Company or Affiliate; (iii) any material breach by the Participant of any employment or consulting agreement with the Company or Affiliate; (iv) dishonesty, gross negligence or malfeasance by the Participant in the performance of his or her duties as an employee or consultant of the Company or Affiliate or any conduct by the Participant which involves a material conflict of interest

with any business of the Company or Affiliate; or (v) the taking or knowingly omitting to take any other action or actions in the performance of the Participant's duties as an employee or consultant of the Company or Affiliate without informing appropriate members of management to whom such Participant reports, which action or actions, in the determination of the Committee, have caused or substantially contributed to the material deterioration in the business of the Company and its Affiliates, taken as a whole.

- 2.8 CODE - the Internal Revenue Code of 1986, as amended from time to time.
- 2.9 COMMITTEE - the committee of the Board of Directors authorized to administer the Plan. To the extent that no Committee exists which has the authority to administer the Plan, the functions of the Committee shall be exercised by the Board of Directors. The Committee shall consist of two or more non-employee directors, each of whom is intended to be, to the extent required by Rule 16b-3, a "non-employee director" as defined in Rule 16b-3. If for any reason the appointed Committee does not meet the requirements of Rule 16b-3, such noncompliance shall not affect the validity of any grants of RSUs hereunder, interpretations or other actions of the Committee.
- 2.10 COMMON STOCK OR STOCK - Common Stock of the Company, par value \$.01 per share.
- 2.11 COMPANY - Scholastic Corporation, a corporation organized under the laws of the State of Delaware (or any successor).
- 2.12 COST - the cost of purchasing an RSU under the Plan as of an Award Date, as determined by the Committee in its sole discretion, but in no event less than eighty-five (85%) percent of the lowest Fair Market Value of a share of Common Stock during the fiscal quarter immediately preceding the Award Date. The cost shall be established as of the applicable Award Date and shall remain in effect unless modified by the Committee at least thirty (30) days prior to the applicable Award Date. Effective as of the effective date of the Plan until modified by the Committee, the Cost shall be eighty-five (85%) percent of the lowest Fair Market Value of a share of Common Stock during the fiscal quarter immediately preceding the Award Date.
- 2.13 DEFERRAL PERIOD - a period of time (expressed in whole years) not less than three years beginning on an Award Date as specified by the Participant in his or her Subscription Agreement with respect to RSUs awarded on that Award Date; provided, however, that the Committee may establish, in its sole discretion, a fixed date as the end of the Deferral Period or fixed period specified with respect to RSUs awarded on that Award Date.
- 2.14 DISABILITY - complete and permanent inability by reason of illness or accident to perform the duties of the occupation at which the Participant was employed when such disability commenced, as determined by the Committee based on medical evidence available to it.
- 2.15 EXCHANGE ACT - the Securities Exchange Act of 1934, as amended.
- 2.16 FAIR MARKET VALUE - unless otherwise required by any applicable provision of the Code or any regulations issued thereunder, as of any date, the last sales price reported for the

Common Stock on the applicable date: (i) as reported on the principal national securities exchange on which it is then traded or the NASDAQ Stock Market, Inc. or (ii) if not traded on any such national securities exchange or the NASDAQ Stock Market, Inc. as quoted on an automated quotation system sponsored by the National Association of Securities Dealers, Inc. If the Common Stock is not readily tradable on a national securities exchange, the NASDAQ Stock Market, Inc. or any automated quotation system sponsored by the National Association of Securities Dealers, Inc., its Fair Market Value shall be set in good faith by the Committee.

- 2.17 FISCAL YEAR - the fiscal year of the Company.
- 2.18 FOREIGN JURISDICTION - any jurisdiction outside of the United States including, without limitation, countries, states, provinces and localities.
- 2.19 PARTICIPANT - a management employee of the Company or any Affiliate who satisfies the eligibility requirements under Article 5 of the Plan and elects to participate in the Plan in accordance with its terms.
- 2.20 PLAN - the Scholastic Corporation Management Stock Purchase Plan, as amended from time to time.
- 2.21 PLAN YEAR - the Fiscal Year, except that the first Plan Year shall be the short year beginning on the effective date of the Plan and ending on May 31, 1999.

- 2.22 RETIREMENT - termination of employment with the Company and all Affiliates on or after age fifty-five (55).
- 2.23 RULE 16B-3 - means Rule 16b-3 promulgated under Section 16(b) of the Exchange Act or any successor provision.
- 2.24 RSU - a unit of measurement equivalent to one share of Common Stock but with none of the attendant rights of a stockholder of a share of Common Stock, including the right to vote (if any); except that an RSU shall have the dividend right described in Article 8. The fair market value of an RSU on any date shall be deemed to be the Fair Market Value of a share of Common Stock on that date.
- 2.25 SUBSCRIPTION AGREEMENT - an agreement executed by a Participant setting forth his or her election to defer receipt of a portion or all of his or her Bonus for the Deferral Period and to authorize the Company to credit such amount to the Plan in order to purchase an award of RSU. A Subscription Agreement shall contain such provisions, consistent with the provisions of the Plan, as may be established from time to time by the Company or Committee.

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#### ARTICLE 3 - SHARES RESERVED

The aggregate number of shares of Common Stock reserved for issuance pursuant to the Plan or with respect to which RSUs may be granted shall be 150,000, subject to adjustment as provided in Article 10 hereof.

Such number of shares may be set aside out of the authorized but unissued shares of Common Stock not reserved for any other purpose, or out of issued shares of Common Stock acquired for and held in the treasury of the Company. If any RSU awarded under the Plan is forfeited, terminated or canceled for any reason, the share of Common Stock relating to such RSU shall again be available under the Plan. If Common Stock has been exchanged by a Participant as full or partial payment to the Company for withholding taxes or otherwise or if the number of shares of Common Stock otherwise deliverable has been reduced for withholding, the number of shares exchanged or reduced shall again be available under the Plan.

#### ARTICLE 4 - ADMINISTRATION

- 4.1 The Plan shall be administered by the Committee. The Committee may select an administrator or any other person to whom its duties and responsibilities hereunder may be delegated. The Committee shall have full power and authority, subject to the provisions of the Plan, to promulgate such rules and regulations as it deems necessary for the proper administration of the Plan, to interpret the provisions and supervise the administration of the Plan, and to take all actions in connection therewith or in relation thereto as it deems necessary or advisable. The Committee may adopt special guidelines and provisions for persons who are residing in, or subject to the laws of, Foreign Jurisdictions to comply with applicable tax and securities laws. All interpretations and determinations of the Committee shall be made in its sole and absolute discretion based on the Plan document and shall be final, conclusive and binding on all parties with respect to all matters relating to the Plan.
- 4.2 The Committee may employ such legal counsel, consultants, brokers and agents as it may deem desirable for the administration of the Plan and may rely upon any opinion received from any such counsel or consultant and any computation received from any such consultant, broker or agent. The Committee may, in its sole discretion, designate an agent to administer the Plan, keep records, send statements of account to Participants and to perform other duties relating to the Plan, as the Committee may request from time to time. The Committee may adopt, amend or repeal any guidelines or requirements necessary for the delivery of the Common Stock.
- 4.3 The Company shall, to the fullest extent permitted by law and the Certificate of Incorporation and By-laws of the Company and, to the extent not covered by insurance, indemnify each director, officer or employee of the Company and its Affiliates (including the heirs, executors, administrators and other personal representatives of such person) and each member of the Committee against all expenses, costs, liabilities and losses (including attorneys' fees, judgments, fines, excise taxes or penalties, and amounts paid or to be paid in settlement) actually and reasonably incurred by such person in connection with any

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threatened, pending or actual suit, action or proceeding (whether civil, criminal, administrative or investigative in nature or otherwise) in which such person may be involved by reason of the fact that he or she is or was serving this Plan in any capacity at the request of the Company, except in instances where any such person engages in willful neglect or fraud. Such right of indemnification shall include the right to be paid by the Company for expenses incurred or reasonably anticipated to be incurred in defending any such suit, action or proceeding in advance of its disposition; provided, however, that the payment of expenses in advance of the settlement or final disposition of a suit, action or proceeding shall be made only upon delivery to the Company of an undertaking by or on behalf of such person to repay all amounts so advanced if it is ultimately determined that such person is not entitled to be indemnified hereunder. Such indemnification shall be in addition to any rights of indemnification the person may have as a director, officer or employee or under the Certificate of Incorporation of the Company or the By-Laws of the Company.

Expenses incurred by the Committee or the Board in the engagement of any such counsel, consultant or agent shall be paid by the Company.

#### ARTICLE 5 - ELIGIBILITY

Management employees of the Company and its Affiliates as designated by the Committee shall be eligible to participate in the Plan. Eligibility for participation in the Plan shall be determined by the Committee in its sole discretion. The Committee may, in its sole discretion, designate, on a prospective basis, any Participant in the Plan as ineligible to receive awards of RSUs pursuant to Article 6 of the Plan.

#### ARTICLE 6 - PURCHASES

##### 6.1 GENERAL.

Each Participant shall be entitled to elect to receive up to one hundred (100%) percent of his or her Bonus as an award of RSU. As of the applicable Award Date, RSUs shall be awarded to Participants and credited to accounts held under the Plan on behalf of Participants on a book entry basis calculated in the manner provided under Section 6.3.

##### 6.2 VOLUNTARY PURCHASES.

No later than the last day of the first quarter of each Fiscal Year, each Participant may elect to receive up to one hundred (100%) percent of his or her Bonus for that Fiscal Year as an award of RSUs by completing a Subscription Agreement. Notwithstanding the foregoing, for the first Plan Year, a Participant may elect to participate in the Plan for that Plan Year no later than the date set by the Committee in its sole discretion pursuant to procedures set by the Committee. If an employee of the Company or an Affiliate first becomes eligible to participate hereunder during a Plan Year, such employee may elect to participate in the Plan for that Plan Year pursuant to procedures established by the Committee (solely with respect to the PRO RATA portion of the Bonus earned after the Subscription Agreement is executed and delivered to the Company). The Subscription Agreement shall provide that the Participant elects to receive RSUs in lieu of a specified portion of his or her Bonus. Such portion may be expressed as:

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- (a) a specified percentage of up to one hundred (100%) percent (in whole percentages) of the Participant's actual Bonus amount;
- (b) a specified dollar amount, up to one hundred (100%) percent of the Participant's actual Bonus amount; or
- (c) the lesser of the amount specified in Section 6.2(a) or (b).

Amounts specified pursuant to any of the methods set forth herein are entirely contingent on, and are limited to, the amount of Bonus actually awarded. Each Subscription Agreement, in addition, shall specify a Deferral Period with respect to the RSUs to which it pertains. The Committee may, in its sole discretion, permit the Deferral Period with respect to the RSUs to which it pertains to be changed upon one year's notice to the Committee. Other than with respect to the first Plan Year or with respect to an employee of the Company or an Affiliate who first becomes eligible to participate hereunder during a Plan Year, Subscription Agreements must be received by the Company no later than the last day of the first quarter of the Fiscal Year for which such Bonus amount will be determined. With respect to any Plan Year, an election to receive RSUs in lieu of a portion or all of a Bonus hereunder pursuant to a Subscription Agreement is irrevocable on and after the date the Subscription Agreement must be submitted to the Company and is valid solely for the Plan Year to which the election relates. If no new Subscription Agreement is timely made with respect to any subsequent Plan Year, the Bonus earned in such Plan Year shall not be deferred under the Plan.

##### 6.3 AWARDS OF RSUS.

The Company shall award RSUs to each Participant's account under the Plan on the Award Date. Each Participant's account shall be credited with a number of RSUs (in whole and fractional RSUS) determined by dividing (a) the amount of the Participant's Bonus to be received as an award of RSUS in accordance with the Participant's Subscription Agreement and the methodology under Section 6.2 by (b) the Cost of a share of Common Stock on the Award Date.

#### ARTICLE 7 - VESTING AND PAYMENT OF RSUS

##### 7.1 VESTING.

A Participant shall be fully vested in each RSU three years after the Award Date pertaining to that RSU (provided that the Participant is continuously employed (including any period during which the Participant is on a leave of absence, either paid or unpaid, which is approved by the Committee, or any other break in employment which is approved by the Committee) by the Company or any Affiliate for such years) or, if earlier, upon death while employed, Disability while employed or Retirement. The Committee may, in its sole discretion, accelerate (in whole or part) the time at which any such RSUs may be vested, based on such factors, if any, as the Committee shall determine in its sole discretion.

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##### 7.2 PAYMENT ON OR AFTER VESTING.

With respect to each vested RSU, the Company shall issue to the Participant one share of Common Stock and/or cash in lieu of any fractional RSU as soon as practicable after the end of the Deferral Period

specified in the Participant's Subscription Agreement pertaining to such RSU, or, if earlier, the Participant's termination of employment with the Company and its Affiliates or the termination of the Plan.

### 7.3 PAYMENT PRIOR TO VESTING.

(a) VOLUNTARY TERMINATION; TERMINATION FOR CAUSE. If a Participant voluntarily terminates his or her employment with the Company and its Affiliates for reasons other than death, Disability or is involuntarily terminated by the Company or an Affiliate for Cause, the Participant's nonvested RSUs shall be canceled, and he or she shall receive as soon as practicable after his or her termination of employment with the Company and its Affiliates a cash payment equal to the lesser of:

- i) an amount equal to the number of those nonvested RSUs awarded on each Award Date multiplied by the respective Cost of those RSUs; or
- ii) an amount equal to the number of those nonvested RSUs awarded on each Award Date multiplied by the Fair Market Value of a share of Common Stock on the date of the Participant's termination of employment with the Company and its Affiliates.

(b) INVOLUNTARY TERMINATION. If a Participant's employment is terminated by the Company or an Affiliate for any reason other than Cause, the Participant's nonvested RSUs shall be canceled and he or she shall receive payment as soon as practicable following his or her termination of employment with the Company and its Affiliates as described below:

- i) The number of nonvested RSUs awarded on each Award Date shall be multiplied by a fraction, the numerator of which is the number of full years that the Participant was employed by the Company or any Affiliate after that Award Date and the denominator of which is three; and the Participant shall receive the resulting number of such RSUs in shares of Common Stock, with any fractional RSU paid in cash.
- ii) With respect to the Participant's remaining nonvested RSUs, the Participant shall receive cash in an amount equal to the lesser of: (A) the number of such nonvested RSUs awarded on each Award Date multiplied by the respective Cost of those RSUs; or (B) the number of those nonvested RSUs awarded on each Award Date multiplied by the Fair Market Value of a share of Common Stock on the date of the Participant's termination of employment with the Company and its Affiliates.

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(c) COMMITTEE'S DISCRETION. The Committee shall have complete discretion to determine the circumstances of a Participant's termination of employment with the Company and its Affiliates, including whether the same results from voluntary termination, Disability, Retirement, death or termination by the Company for or not for Cause, and the Committee's determination shall be final and binding on all parties and not subject to review or challenge by any Participant or other person.

### ARTICLE 8 - DIVIDEND EQUIVALENT AMOUNTS

Whenever dividends (other than dividends payable only in shares of Common Stock) are paid with respect to shares of Common Stock, each Participant shall be paid an amount in cash equal to the number of his or her vested RSUs multiplied by the dividend value per share. Dividends (other than dividends payable only in shares of Common Stock) shall not be credited or paid with respect to each Participant's nonvested RSUs.

### ARTICLE 9 - DESIGNATION OF BENEFICIARY

A Participant may designate one or more Beneficiaries to receive payments or shares of Common Stock in the event of his or her death. A designation of Beneficiary shall apply to a specified percentage of a Participant's entire interest in the Plan. Such designation, or any change therein, must be in writing in a form acceptable to the Company and shall be effective upon receipt by the Company. If there is no effective designation of Beneficiary, or if no Beneficiary survives the Participant, the Participant's estate shall be deemed to be the Beneficiary.

### ARTICLE 10 - ADJUSTMENTS

In the event of a stock dividend, stock split, reverse stock split, combination or reclassification of shares, recapitalization, merger, consolidation, exchange, spin-off or otherwise which affects Common Stock, the Committee shall make appropriate equitable adjustments in:

- (a) the number or kind of shares of Common Stock or securities with respect to which RSUs shall thereafter be granted;
- (b) the number and kind of shares of Common Stock remaining subject to outstanding RSUs;
- (c) the number of RSUs credited to each Participant; and
- (d) the method of determining the value of RSUs.

ARTICLE 11 - AMENDMENT OR TERMINATION OF PLAN

The Company reserves the right to amend, terminate or freeze the Plan at any time, by action of its Board of Directors (or a duly authorized committee thereof) or the Committee,

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provided that no such action shall adversely affect a Participant's rights under the Plan with respect to RSUs awarded and vested before the date of such action. No amendment shall be effective unless approved by the stockholders of the Company if stockholder approval of such amendment is required to comply with any applicable law, regulation or stock exchange rule. Upon termination of the Plan, any vested RSU shall be paid in accordance with Section 7.2 of the Plan and any nonvested RSU shall be canceled and paid in accordance with Section 7.3(b) of the Plan except that such amount shall be paid as soon as administratively practicable following the Plan termination. Upon freezing of the Plan, all vested RSUs awarded prior to freezing shall continue to be held under the Plan until the Deferral Period expires and all nonvested RSUs awarded prior to freezing shall vest or become canceled in accordance with the terms of the Plan.

ARTICLE 12 - MISCELLANEOUS PROVISIONS

12.1 NO DISTRIBUTION; COMPLIANCE WITH LEGAL REQUIREMENTS.

The Committee may require each person acquiring shares of Common Stock under the Plan to represent to and agree with the Company in writing that such person is acquiring the shares without a view to distribution thereof. No shares of Common Stock shall be issued until all applicable securities law and other legal and stock exchange requirements have been satisfied. The Committee may require the placing of such stop-orders and restrictive legends on certificates for Common Stock as it deems appropriate.

12.2 WITHHOLDING.

Participation in the Plan is subject to any required tax withholding on wages or other income of the Participant in connection with the Plan. Each Participant agrees, by entering the Plan, that the Company or the Affiliate employing the Participant shall have the right to deduct any federal, state or local income taxes or other taxes, in its sole discretion, from any amount payable to the Participant under the Plan or from any payment of any kind otherwise due to the Participant. Upon the vesting of the RSU, prior to the issuance or delivery of shares of Common Stock or the payment of any cash hereunder, a Participant shall pay all required withholding to the Company and, if applicable, an Affiliate. Without limiting the generality of the foregoing, any withholding obligation with regard to any Participant may be satisfied by: (i) reducing the number of shares of Common Stock otherwise deliverable to the Participant; (ii) subject to the Committee's prior consent, any method approved by the Committee which may include the Participant delivering shares of Common Stock already owned for at least six months (or such other period to avoid an accounting charge against the Company's earnings) and held free and clear of all encumbrances to the Company; or (iii) by the Participant paying cash directly to the Company.

12.3 NOTICES; DELIVERY OF STOCK CERTIFICATES.

Any notice required or permitted to be given by the Company or the Committee pursuant to the Plan shall be deemed given when personally delivered or deposited in the United States mail, registered or certified, postage prepaid, addressed to the Participant at the last address shown for the Participant on the records of the Company. Delivery of stock certificates to persons entitled to receive them under the Plan shall be deemed effected for all purposes when the Company or a share transfer agent of the Company shall have

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deposited such certificates in the United States mail, addressed to such person at his/her last known address on file with the Company.

12.4 NONTRANSFERABILITY OF RIGHTS

During a Participant's lifetime, any payment or issuance of shares under the Plan shall be made to him or her otherwise than by will or the laws of descent and distribution. No RSU or other interest under the Plan shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, garnishment, execution, levy or charge, and any attempt by a Participant or any Beneficiary under the Plan to do so shall be void. No interest under the Plan shall in any manner be liable for or subject to the debts, contracts, liabilities, engagements or torts of a Participant or Beneficiary entitled thereto.

12.5 OBLIGATIONS UNFUNDED AND UNSECURED.

The Plan shall at all times be entirely unfunded, and no provision shall at any time be made with respect to segregating assets of the Company (including Common Stock) for payment of any amounts or issuance of any shares of Common Stock hereunder. No Participant or other person shall own any interest in any particular assets of the Company or any Affiliate (including Common Stock) by reason of the right to receive payment under the Plan, and any Participant or other person shall have only the rights of a general unsecured creditor of the Company with respect to any rights under the Plan. Nothing contained in this Plan and no action taken pursuant to the provisions of this Plan shall create or be construed to create a trust of any kind, or a fiduciary relationship amongst the Company, any Affiliate, the Committee, and the Participants, their designated Beneficiaries or any other person. Any funds which may be invested under the provisions of this Plan shall continue for all purposes

to be part of the general funds of the Company and no person other than the Company shall by virtue of the provisions of this Plan have any interest in such funds. If the Company decides to establish any accrued reserve on its books against the future expense of benefits payable hereunder, or if the Company establishes a rabbi trust under this Plan, such reserve or trust shall not under any circumstances be deemed to be an asset of the Plan.

12.6 GOVERNING LAW.

The Plan is established in order to provide deferred compensation to a select group of management and highly compensated employees within the meanings of Sections 201(2) and 301(a)(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). To the extent legally required, the Code and ERISA shall govern the Plan and, if any provision hereof is in violation of any applicable requirement thereof, the Company reserves the right to retroactively amend the Plan to comply therewith. To the extent not governed by the Code and ERISA, the terms of the Plan shall be governed, construed, administered and regulated in accordance with the laws of Delaware. In the event any provision of this Plan shall be determined to be illegal or invalid for any reason, the other provisions shall continue in full force and effect as if such illegal or invalid provision had never been included herein.

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12.7 CLAIMS PROCEDURE

A Participant or Beneficiary shall make any claim (and, in the case of the denial of such claim, any appeal) in writing to the Committee or such other person designated by the Committee in accordance with the claims procedure established by the Committee, which is intended to comply with the claims procedure provided under ERISA and U.S. Department of Labor Regulation ss. 2560.503- 1.

12.8 RULE 16B-3

To the extent required, the Plan is intended to comply with Rule 16b-3 and the Committee shall interpret and administer the provisions of the Plan in a manner consistent therewith. If a management employee is designated by the Committee to participate hereunder, any election to receive an award of RSUs shall be deemed approved by such Committee and shall be deemed an exempt purchase under Rule 16b-3. Any provisions inconsistent with Rule 16b-3 shall be inoperative and shall not affect the validity of the Plan.

12.9 NO EMPLOYMENT RIGHTS.

The establishment and operation of this Plan shall not confer any legal rights upon any Participant or other person for a continuation of employment, nor shall it interfere with the rights of the Company or Affiliate to discharge any employee and to treat him or her without regard to the effect which that treatment might have upon him or her as a Participant or potential Participant under the Plan.

12.10 SEVERABILITY OF PROVISIONS.

If any provision of the Plan shall be held invalid or unenforceable, such invalidity or unenforceability shall not affect any other provisions hereof, and the Plan shall be construed and enforced as if such provisions had not been included.

12.11 CONSTRUCTION.

The use of a masculine pronoun shall include the feminine, and the singular form shall include the plural form, unless the context clearly indicates otherwise. The headings and captions herein are provided for reference and convenience only, shall not be considered part of the Plan, and shall not be employed in the construction of the Plan.

12.12 EFFECTIVE DATE OF PLAN.

The Plan is adopted, effective upon January 1, 1999, subject to approval of the stockholders of the Company as provided under applicable law, regulation or stock exchange rule.

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MAY-31-2000  
NOV-30-1999  
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1.06