FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **2007-12-04** | Period of Report: **2007-10-27**
SEC Accession No. 0001193125-07-258100

(HTML Version on secdatabase.com)

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SCHOOL SPECIALTY INC

CIK:**1055454**| IRS No.: **390971239** | State of Incorp.:**WI** | Fiscal Year End: **0430**
Type: **10-Q** | Act: **34** | File No.: **000-24385** | Film No.: **071281496**
SIC: **5000** Durable goods

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 OCTOBER 27, 2007.

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

FOR THE TRANSITION PERIOD FROM ______ TO ______

Commission File Number: 000-24385

SCHOOL SPECIALTY, INC.
(Exact Name of Registrant as Specified in its Charter)

Wisconsin	**39-0971239**
(State or Other Jurisdiction of Incorporation)	**(IRS Employer Identification No.)**

W6316 Design Drive
Greenville, Wisconsin
(Address of Principal Executive Offices)

54942
(Zip Code)

(920) 734-5712
(Registrant' s Telephone Number, including Area Code)

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 by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

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

Class	Outstanding at November 30, 2007
Common Stock, $0.001 par value	20,235,349

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SCHOOL SPECIALTY, INC.

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FOR THE QUARTERLY PERIOD ENDED OCTOBER 27, 2007

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PART I – FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Unaudited Financial Statements

SCHOOL SPECIALTY, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Data)

	October 27, 2007 (unaudited)	April 28, 2007 (audited)	October 28, 2006 (unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	$4,611	$2,386	$9,077
Accounts receivable, less allowance for doubtful accounts of $6,190, $4,801 and $4,263, respectively	198,826	65,900	168,063
Inventories	142,134	177,319	123,281
Deferred catalog costs	12,668	14,848	12,636
Prepaid expenses and other current assets	17,454	18,398	19,146
Deferred taxes	10,344	10,201	6,260
Total current assets	386,037	289,052	338,463
Property, plant and equipment, net	76,532	77,345	79,381
Goodwill	544,245	534,488	549,094
Intangible assets, net	179,631	183,660	198,772

Development costs and other	25,013	26,334	27,977
Total assets	$1,211,458	$1,110,879	$1,193,687
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Current maturities−long-term debt	$133,609	$133,590	$133,571
Accounts payable	51,704	77,794	55,427
Accrued income taxes	32,580	-	26,159
Accrued compensation	19,677	14,709	16,732
Deferred revenue	6,965	5,464	4,937
Other accrued liabilities	33,517	23,392	24,175
Total current liabilities	278,052	254,949	261,001
Long-term debt−less current maturities	311,528	293,139	288,937
Deferred taxes	55,903	50,101	51,989
Other liabilities	850	145	145
Total liabilities	646,333	598,334	602,072
Commitments and contingencies			
Shareholders' equity:			

Preferred stock, $0.001 par value per share, 1,000,000 shares authorized; none outstanding	–	–	–
Common stock, $0.001 par value per share, 150,000,000 shares authorized; 23,589,151, 23,310,461 and 23,069,001 shares issued, respectively	24	23	23
Capital paid-in excess of par value	376,431	367,068	358,133
Treasury stock, at cost−3,380,802, 2,126,121 and 1,068,121 shares, respectively	(121,419)	(76,508)	(36,526)
Accumulated other comprehensive income	29,515	17,763	17,763
Retained earnings	280,574	204,199	252,222
Total shareholders' equity	565,125	512,545	591,615
Total liabilities and shareholders' equity	$1,211,458	$1,110,879	$1,193,687

See accompanying notes to condensed consolidated financial statements.

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

	For the Three Months Ended		For the Six Months Ended	
	October 27, 2007	October 28, 2006	October 27, 2007	October 28, 2006
Revenues	$392,919	$371,225	$779,432	$748,296
Cost of revenues	225,378	216,404	438,523	425,564
Gross profit	167,541	154,821	340,909	322,732
Selling, general and administrative expenses	99,711	97,890	199,856	196,729
Operating income	67,830	56,931	141,053	126,003
Other (income) expense:				
Interest expense	4,955	5,634	10,287	11,776
Interest income	(6)	(23)	(14)	(58)
Other	2,507	2,508	3,716	3,560
Income before provision for income taxes	60,374	48,812	127,064	110,725
Provision for income taxes	23,418	19,168	49,528	43,336
Earnings from continuing operations	36,956	29,644	77,536	67,389
Earnings (loss) from operations of discontinued School Specialty Media business unit, net of income taxes	(402)	(442)	(661)	(1,320)

Net income	$ 36,554	$ 29,202	$ 76,875	$ 66,069
Weighted average shares outstanding:				
Basic	20,434	22,212	20,784	22,548
Diluted	20,966	22,898	21,366	23,213
Basic earnings per share of common stock:				
Earnings from continuing operations	$ 1.81	$ 1.33	$ 3.73	$ 2.99
Earnings (loss) from discontinued operations	(0.02)	(0.02)	(0.03)	(0.06)
Total	$ 1.79	$ 1.31	$ 3.70	$ 2.93
Diluted earnings per share of common stock:				
Earnings from continuing operations	$ 1.76	$ 1.29	$ 3.63	$ 2.90
Earnings (loss) from discontinued operations	(0.02)	(0.01)	(0.03)	(0.05)
Total	$ 1.74	$ 1.28	$ 3.60	$ 2.85

See accompanying notes to condensed consolidated financial statements.

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

	For the Six Months Ended	
	October 27, 2007	October 28, 2006
Cash flows from operating activities:		
Net income	$76,875	$66,069
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and intangible asset amortization expense	12,480	12,860
Amortization of development costs	5,748	3,695
Amortization of debt fees and other	1,016	495
Share-based compensation expense	2,844	2,355
Deferred taxes	5,659	4,199
(Gain) loss on disposal of property, plant and equipment	(8)	274
Changes in current assets and liabilities (net of assets acquired and liabilities assumed in business combinations):		
Change in amounts sold under receivables securitization, net	–	–
Accounts receivable	(131,668)	(107,518)
Inventories	35,382	33,578
Deferred catalog costs	2,180	8,503

Prepaid expenses and other current assets	959	8,547
Accounts payable	(25,788)	(19,412)
Accrued liabilities	50,446	36,781
Net cash provided by operating activities	36,125	50,426
Cash flows from investing activities:		
Additions to property, plant and equipment	(7,530)	(11,123)
Investment in intangible and other assets	–	(102)
Investment in product development costs	(5,443)	(4,739)
Proceeds from disposal of property, plant and equipment	33	932
Net cash used in investing activities	(12,940)	(15,032)
Cash flows from financing activities:		
Proceeds from bank borrowings	405,700	679,400
Repayment of debt and capital leases	(387,292)	(674,099)
Purchase of treasury stock	(44,911)	(36,526)
Proceeds from exercise of stock options	4,840	2,525
Excess income tax benefit from exercise of stock options	703	–
Payment of debt fees and other	–	(20)

Net cash used in financing activities	(20,960)	(28,700)
Net increase in cash and cash equivalents	2,225	6,694
Cash and cash equivalents, beginning of period	2,386	2,403
Cash and cash equivalents, end of period	$4,611	$9,097
Supplemental disclosures of cash flow information:		
Interest paid	$10,365	$10,854
Income taxes paid	$7,422	$10,204

See accompanying notes to condensed consolidated financial statements.

SCHOOL SPECIALTY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In thousands, except per share amounts)

NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (which are normal and recurring in nature) considered necessary for a fair presentation have been included. The balance sheet at April 28, 2007 has been derived from the Company' s audited financial statements for the fiscal year ended April 28, 2007. For further information, refer to the consolidated financial statements and notes thereto included in the Company' s Annual Report on Form 10-K for the fiscal year ended April 28, 2007.

Amounts previously reported in Note 12 – Segment Information, under the caption Identifiable Assets, have been reclassified to conform to the current year presentation which reflects substantially all accounts receivable as segment assets rather than corporate assets. In addition, all income and expense items previously reported have been restated to conform to the presentation of Continuing Operations, based on the classification of School Specialty Media ("SSM") as a Discontinued Operation. See Note 4.

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. Under the standard, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity is engaged. SFAS No. 157 will be effective for the Company at the beginning of fiscal 2009 (April 27, 2008), although early adoption is permitted. The Company is currently evaluating the financial statement impact, if any, of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Options for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items generally on an instrument-by-instrument basis at fair value that are not currently required to be measured at fair value. SFAS No. 159 is intended to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 does not change requirements for recognizing and measuring dividend income, interest income or interest expense. SFAS No. 159 is effective for the Company at the beginning of fiscal 2009 (April 27, 2008), although early adoption is permitted. If the Company elects to adopt SFAS No. 159 early, it would need to concurrently early adopt the provisions of SFAS No. 157. The Company is currently evaluating the provisions of SFAS No. 159.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements ("SAB 108"). SAB 108 provides guidance on how to evaluate prior period financial statement misstatements for purposes of assessing their materiality in the current period. If the prior period effect is material to the current period, then the prior period is required to be corrected. Correcting prior year financial statements would not require an amendment of prior year financial statements, but such corrections would be made the next time the Company files the prior year financial statements. SAB 108 allows a one-time transitional cumulative effect adjustment to retained earnings for corrections of prior period misstatements required under this statement. SAB 108 was effective for the Company at the beginning of fiscal 2008. The adoption of SAB 108 did not have an impact on the Company' s results of operations or financial position.

SCHOOL SPECIALTY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In thousands, except per share amounts)

NOTE 3 – INCOME TAXES

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The provisions of FIN 48 were effective for the Company at the beginning of fiscal 2008. As a result of the adoption of FIN 48, the Company recognized a $500 increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the fiscal 2008 beginning balance of retained earnings.

The Company files income tax returns with the U.S., various U.S. states, and foreign jurisdictions. The most significant tax return the Company files is with the U.S. The Company' s tax returns are no longer subject to examinations by the U.S. for fiscal years before 2005. The Company has various state tax audits and appeals in process at any given time. It is not anticipated that any adjustments resulting from tax examinations or appeals would result in a material change to the Company' s financial position or results of operations.

The balance of the Company' s gross liability for unrecognized income tax benefits subsequent to the recording of the $500 upon adoption of FIN 48 effective April 29, 2007, was $912, all of which would impact the effective tax rate if recognized. The Company does not expect any material changes in the amount of unrecognized tax benefits within the next twelve months. The Company classifies accrued interest and penalties related to unrecognized tax benefits as income tax expense in the consolidated statements of operations. The amounts of accrued interest and penalties included in the liability for uncertain tax positions are not material.

NOTE 4 – DISCONTINUED OPERATION

On April 12, 2007, the Company' s Board of Directors authorized the Company' s management to proceed with the sale and ultimate disposition of the Company' s SSM business unit, which was previously reported as a component of the Specialty segment. Based upon this action, the Company recorded an asset impairment charge during the fourth quarter of fiscal 2007 of $29,000. The charge included the write-off of SSM' s goodwill of $13,051 and intangible assets of $10,410. In addition, the Company wrote down the carrying value of SSM' s product development costs by $3,639 and other assets by $1,900. The Company also recorded a $26,600 impairment charge related to SSM in the fourth quarter of fiscal 2006 at the initial onset of deteriorating financial performance and revised expected future results of the business unit. The $26,600 charge included the write-off of goodwill of $25,600 and a reduction in the carrying value of product development costs of $1,000. In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the Company has reflected the impairment charges and operations related to SSM as discontinued operations in the accompanying condensed consolidated statements of operations for all periods presented. The accompanying condensed consolidated balance sheets include the following assets and liabilities of SSM at October 27, 2007, April 28, 2007 and October 28, 2006:

	October 27, 2007	April 28, 2007	October 28, 2006
Accounts receivable	$2,805	$3,174	$3,366
Inventory	6,060	6,109	5,718
Prepaid catalog and other current assets	3,358	3,402	3,864

Property, plant and equipment, net	219	185	488
Goodwill and other intangible assets, net	–	–	23,792
Product development costs	3,680	2,839	6,895
Total assets	$ 16,122	$15,709	$ 44,123
Total current liabilities	$ 836	$772	$ 965

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SCHOOL SPECIALTY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In thousands, except per share amounts)

The following table illustrates the amounts of revenues and earnings (losses) reported in discontinued operations in the accompanying condensed consolidated statements of operations:

	For the Three Months Ended		For the Six Months Ended	
	October 27, 2007	October 28, 2006	October 27, 2007	October 28, 2006
Revenues	$ 5,020	$ 7,447	$ 10,367	$ 15,775
Earnings (loss) from discontinued operations before income taxes	(653)	(719)	(1,074)	(2,146)
Provision for (benefit from) income taxes	(251)	(277)	(413)	(826)
Earnings (loss) from discontinued operations, net of income taxes	$ (402)	$ (442)	$ (661)	$ (1,320)

NOTE 5 – SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

Changes in shareholders' equity during the six months ended October 27, 2007 were as follows:

Shareholders' equity balance at April 28, 2007	$512,545
Adoption of FIN 48 impact on beginning retained earnings	(500)
Net income	76,875
Share-based compensation	2,844
Issuance of common stock in conjunction with stock option exercises	4,840
Tax benefit on option exercises	1,680
Purchase of treasury shares	(44,911)

Foreign currency translation adjustment	11,752
Shareholders' equity balance at October 27, 2007	$565,125

Comprehensive income for the periods presented in the condensed consolidated statement of operations was as follows:

	For the Three Months Ended		For the Six Months Ended	
	October 27, 2007	October 28, 2006	October 27, 2007	October 28, 2006
Net income	$ 36,554	$ 29,202	$ 76,875	$ 66,069
Foreign currency translation adjustment	7,385	820	11,752	3,071
Total comprehensive income	$ 43,939	$ 30,022	$ 88,627	$ 69,140

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SCHOOL SPECIALTY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In thousands, except per share amounts)

NOTE 6 – EARNINGS PER SHARE

Earnings Per Share

The following information presents the Company' s computations of basic earnings per share ("basic EPS") and diluted earnings per share ("diluted EPS") for the periods presented in the condensed consolidated statements of operations:

	Income (Numerator)	Shares (Denominator)	Per Share Amount
Three months ended October 27, 2007:			
Basic EPS	$ 36,554	20,434	$ 1.79
Effect of dilutive stock options	–	532	
Diluted EPS	$ 36,554	20,966	$ 1.74
Three months ended October 28, 2006:			
Basic EPS	$ 29,202	22,212	$ 1.31
Effect of dilutive stock options	–	686	
Diluted EPS	$ 29,202	22,898	$ 1.28

	Income (Numerator)	Shares (Denominator)	Per Share Amount
Six months ended October 27, 2007:			
Basic EPS	$ 76,875	20,784	$ 3.70

Effect of dilutive stock options	–	582	
Diluted EPS	$ 76,875	21,366	$ 3.60
Six months ended October 28, 2006:			
Basic EPS	$ 66,069	22,548	$ 2.93
Effect of dilutive stock options	–	665	
Diluted EPS	$ 66,069	23,213	$ 2.85

The Company had 1,251 additional stock options outstanding during the three and six months ended October 27, 2007, that were not included in the computation of diluted EPS because they were anti-dilutive. The Company had 875 additional stock options outstanding during the three and six months ended October 28, 2006, that were not included in the computation of diluted EPS because they were anti-dilutive.

NOTE 7 – SHARE-BASED COMPENSATION EXPENSE

Employee Stock Plans

The Company has two share-based employee compensation plans. On June 10, 1998, the Company' s Board of Directors approved the School Specialty, Inc. 1998 Stock Incentive Plan (the "1998 Plan") and on August 27, 2002 the Company' s Board of Directors approved the School Specialty, Inc. 2002 Stock Incentive Plan (the "2002 Plan"). Both plans have been approved by the Company' s shareholders. The purpose of the 1998 Plan and the 2002 Plan is to provide directors, officers, key employees and consultants with additional incentives by increasing their ownership interests in the Company. Under the 1998 Plan, the maximum number of options available for grant is equal to 20% of the Company' s outstanding common stock. Under the 2002 Plan, the maximum number of shares available for grant is 1,500 shares.

SCHOOL SPECIALTY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In thousands, except per share amounts)

A summary of option activity during the three months ended October 27, 2007 follows:

	Options Outstanding		Options Exercisable	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Balance at April 28, 2007	2,990	$ 25.62	1,975	$ 20.00
Granted	82	35.85		
Exercised	(279)	17.37		
Canceled	(70)	36.22		
Balance at October 27, 2007	2,723	$ 26.49	1,795	$ 21.08

The following table details supplemental information regarding stock options outstanding at October 27, 2007:

	Weighted Average Remaining Contractual Term	Aggregate Instrinsic Value
Options outstanding	4.71 years	$23,562
Options vested and expected to vest	4.54 years	23,542
Options exercisable	2.66 years	23,399

Options granted are generally exercisable beginning one year from the date of grant in cumulative yearly amounts of twenty-five percent of the shares granted and generally expire ten years from the date of grant. Options granted to directors and non-employee officers of the Company vest over a three year period, twenty percent after the first year, fifty percent (cumulative) after the second year and one hundred percent (cumulative) after the third year. The Company has historically issued new shares of common stock to settle shares due upon option exercise. For the three and six months ended October 27, 2007, approximately 196 and 279 new shares, respectively, were issued upon the exercise of stock options.

During the first six months of 2008, the Company granted 73 non-vested stock unit ("NSU") awards to certain members of the Company' s management, which were subject to shareholder approval of the amended and restated 2002 Plan. The NSUs are performance-based and vest at the end of a three-year cycle and will result in a payment if targeted metrics are achieved at a threshold level or above. The NSUs will be paid in Company common stock with payouts ranging from 80% of the target number of shares if performance is at the threshold level up to 200% of the target number of shares if performance is at or above the maximum level. The approximate fair value of awards granted during the second quarter is $2,646 provided the metrics are achieved at the target level. The Company is recognizing share-based compensation expense related to NSU awards on a straight-line basis over the vesting period adjusted for changes in the expected level of performance. During the three and six months ended October 27, 2007, the Company recognized $233 ($143, net of tax) and $441 ($270, net of tax), respectively, of expense related to NSU awards.

The Company adopted SFAS No. 123(R), *Share-Based Payment*, using the modified prospective application transition method effective with the beginning of fiscal 2007.

During the three months ended October 27, 2007 and October 28, 2006, the Company recognized $1,341 ($1,108 related to stock options and $233 related to NSU awards) and $1,141 (entirely related to stock options), respectively, in share-based compensation expense which is reflected in selling, general and administrative expenses in the accompanying condensed statements of operations. During the six months ended October 27, 2007 and October 28, 2006, the Company recognized $2,844 ($2,403 related to stock

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SCHOOL SPECIALTY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In thousands, except per share amounts)

options and $441 related to NSU awards) and $2,355 (entirely related to stock options), respectively, in share-based compensation expense which is reflected in selling, general and administrative expenses in the statement of operations. The income tax benefit recognized related to share-based compensation expense was $430 and $914 for the three and six months ended October 27, 2007, respectively, and $304 and $611 for the three and six months ended October 28, 2006, respectively. The Company recognizes share-based compensation expense on a straight-line basis over the vesting period of each award.

As of October 27, 2007, total unrecognized share-based compensation expense related to stock options was $10,533, net of estimated forfeitures, which the Company expects to recognize over a weighted average period of approximately 2.57 years.

The weighted average fair value of options granted during the three months ended October 27, 2007 and October 28, 2006 was $13.03 and $13.61, and $13.25 and $18.44 for the six months ending October 27, 2007 and October 28, 2006, respectively. The fair value of options is estimated on the date of grant using the Black-Scholes single option pricing model with the following weighted average assumptions:

	For the Three Months Ended		For the Six Months Ended	
	October 27, 2007	October 28, 2006	October 27, 2007	October 28, 2006
Average-risk free interest rate	4.34 %	4.77 %	4.87 %	4.93 %
Expected dividend yield	–	–	–	–
Expected volatility	29.13 %	34.14 %	29.38 %	34.50 %
Expected term	5.5 years	5.5 years	5.5 years	5.5 years

	For the Three Months Ended		For the Six Months Ended	
	October 27, 2007	October 28, 2006	October 27, 2007	October 28, 2006
Total intrinsic value of stock options exercised	$ 3,544	$ 1,069	$ 5,192	$ 1,287
Cash received from stock option exercises	$ 3,530	$ 2,015	$ 4,840	$ 2,525
Income tax benefit from the exercise of stock options	$ 1,317	$ 318	$ 1,680	$ 388

NOTE 8 – GOODWILL AND OTHER INTANGIBLE ASSETS

The following tables present details of the Company’ s intangible assets, excluding goodwill:

	Gross Value	Accumulated Amortization	Net Book Value
October 27, 2007			
Amortizable intangible assets:			
Customer relationships (10 to 17 years)	$36,358	$(12,267)	$24,091
Publishing rights (15 to 25 years)	105,010	(10,829)	94,181
Non-compete agreements (3.5 to 10 years)	8,655	(5,311)	3,344
Tradenames and trademarks (10 to 30 years)	3,034	(440)	2,594
Order backlog and other (less than 1 to 13 years)	3,702	(1,678)	2,024
Total amortizable intangible assets	156,759	(30,525)	126,234
Non-amortizable intangible assets:			
Perpetual license agreement	12,700	–	12,700
Tradenames and trademarks	40,697	–	40,697
Total non-amortizable intangible assets	53,397	–	53,397
Total intangible assets	$210,156	$(30,525)	$179,631

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SCHOOL SPECIALTY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In thousands, except per share amounts)

	Gross Value	Accumulated Amortization	Net Book Value
April 28, 2007			
Amortizable intangible assets:			
Customer relationships (10 to 17 years)	$36,014	$(11,012)	$25,002
Publishing rights (15 to 25 years)	105,010	(8,519)	96,491
Non-compete agreements (3.5 to 10 years)	8,576	(4,728)	3,848
Tradenames and trademarks (10 to 30 years)	3,034	(360)	2,674
Order backlog and other (less than 1 to 13 years)	3,666	(1,418)	2,248
Total amortizable intangible assets	156,300	(26,037)	130,263
Non-amortizable intangible assets:			
Perpetual license agreement	12,700	–	12,700
Tradenames and trademarks	40,697	–	40,697
Total non-amortizable intangible assets	53,397	–	53,397
Total intangible assets	$209,697	$(26,037)	$183,660

	Gross Value	Accumulated Amortization	Net Book Value

October 28, 2006

Amortizable intangible assets:			
Customer relationships (10 to 17 years)	$39,488	$(10,615)	$28,873
Publishing rights (15 to 25 years)	105,010	(6,210)	$98,800
Non-compete agreements (3.5 to 10 years)	8,702	(4,286)	$4,416
Copyrighted materials (23 years)	7,100	(669)	$6,431
Tradenames and trademarks (10 to 30 years)	4,434	(412)	$4,022
Order backlog and other (less than 1 to 13 years)	3,666	(1,148)	$2,518
Total amortizable intangible assets	168,400	(23,340)	145,060
Non-amortizable intangible assets:			
Perpetual license agreement	12,700	–	12,700
Tradenames and trademarks	41,012	–	41,012
Total non-amortizable intangible assets	53,712	–	53,712
Total intangible assets	$222,112	$(23,340)	$198,772

The Company engaged a third party to assist the Company in the valuation of the intangible assets acquired in the August 2005 acquisition of Delta Education LLC (“Delta”). During the second quarter of fiscal 2007, the valuation was finalized with an adjustment being recorded to increase the intangible assets acquired by $38,544, with an offsetting decrease to goodwill. Details of Delta’ s acquired intangible assets, which are deductible for tax purposes, are as follows:

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	Final as of April 28, 2007		Preliminary as of April 29, 2006	
	Allocated Value	Amortizable Life	Allocated Value	Amortizable Life
Acquired Intangibles				
Amortizable intangibles:				
Publishing rights	$105,010	15 to 25 years	$33,200	10 years
Non-compete agreements	1,600	5 years	–	
Backlog and other	1,514	<1 to 13 years	–	
Customer relationships	–		31,100	15 years
Total	108,124		64,300	
Non-amortizable intangibles:				
Tradenames and trademarks	38,890	N/A	44,170	N/A
Total acquired intangibles	$147,014		$108,470	

Intangible amortization expense included in selling, general and administrative expense for the three months ended October 27, 2007 and October 28, 2006 was $2,141 and $2,613, respectively, and $4,325 and $4,939 for the six months ended October 27, 2007 and October 28, 2006, respectively.

Intangible amortization expense for each of the five succeeding fiscal years and the remainder of fiscal 2008 is estimated to be:

Fiscal 2008 (six months remaining)	$4,285

Fiscal 2009	8,326
Fiscal 2010	8,223
Fiscal 2011	7,910
Fiscal 2012	7,742
Fiscal 2013	7,353

The following information presents changes to goodwill during the period beginning October 28, 2006 through October 27, 2007:

	Balance at October 28, 2006	Fiscal 2007 Acquisitions	Adjustments	Balance at April 28, 2007	Fiscal 2008 Acquisitions	Adjustments	Balance at October 27, 2007
Segment							
Specialty	$383,951	$ –	$(14,606)	$369,345	$ –	$ 9,757	$379,102
Essentials	165,143	–	–	165,143	–	–	165,143
Total	$549,094	$ –	$(14,606)	$534,488	$ –	$ 9,757	$544,245

The Specialty segment adjustments during the period October 28, 2006 to April 28, 2007 of $(14,606) are comprised of $(13,051) impairment charges related to the School Specialty Media business unit, $(1,692) of purchase price adjustments for the finalization of the valuation of intangible and other assets and liabilities acquired from Delta, $100 for a deferred purchase payment related to the acquisition of Premier Science, and $37 of foreign currency translation adjustments.

The Specialty segment adjustments during the six months ended October 28, 2007 of $9,757 are comprised entirely of foreign currency translation adjustments.

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NOTE 9 – PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	October 27, 2007	April 28, 2007	October 28, 2006
Land	$502	$502	$502
Projects in progress	9,412	3,976	12,055
Buildings and leasehold improvements	33,609	33,182	33,218
Furniture, fixtures and other	82,574	81,541	67,829
Machinery and warehouse equipment	44,979	44,371	44,718
Total property, plant and equipment	171,076	163,572	158,322
Less: Accumulated depreciation	(94,544)	(86,227)	(78,941)
Net property, plant and equipment	$76,532	$77,345	$79,381

Depreciation expense for the three months ended October 27, 2007 and October 28, 2006 was $4,032 and $3,734, respectively, and $8,155 and $7,457 for the six months ended October 27, 2007 and October 28, 2006, respectively.

NOTE 10 – DEBT

On February 1, 2006, the Company entered into an Amended and Restated Credit Agreement that matures on February 1, 2011 and provides for a $350,000 revolving loan and an available $100,000 incremental term loan. Interest accrues at a rate of, at the Company' s option, either a Eurodollar rate plus an applicable margin of up to 1.75%, or the lender' s base rate plus an applicable margin of up to 0.50%. The Company also pays a commitment fee on the revolving loan of up to 0.375% on unborrowed funds. The Amended and Restated Credit Agreement is secured by substantially all of the assets of the Company and contains certain financial covenants, including a consolidated total and senior leverage ratio, a consolidated fixed charges coverage ratio and a limitation on consolidated capital expenditures. The Company was in compliance with these covenants at October 27, 2007. The effective interest rate under the credit facility for the second quarter of fiscal 2008 was 8.82%, which includes amortization of the loan origination fees of $78 and commitment fees on unborrowed funds of $177. The effective interest rate under the credit facility for the second quarter of fiscal 2007 was 7.14%, which includes amortization of the loan origination fees of $64 and commitment fees on unborrowed funds of $98. As of October 27, 2007, $96,200 was outstanding on the revolving loan, and no borrowings were made or outstanding on the term loan during the first six months of fiscal 2008.

During 2003, the Company sold an aggregate principal amount of $133,000 of convertible subordinated notes due in 2023. The Company used the total net proceeds from the offering of $128,999 to repay a portion of the debt outstanding under the Company' s credit facility. The notes carry an annual interest rate of 3.75% until August 1, 2010, at which time the notes will cease bearing interest and the original principal amount of each note will commence increasing daily by the annual rate of 3.75%. Depending on the market price of the notes, the Company will make additional payments of interest commencing August 1, 2008. The notes became convertible into shares of the Company' s common stock at an initial conversion price of $40.00 per share during fiscal 2006 and are recorded as a current liability. Holders of the notes may surrender the notes for conversion at any time from October 1, 2005 until July 31, 2023. Holders that exercise their right to convert the notes will receive up to the accreted principal amount in cash, with the balance of the conversion obligation, if any, to be satisfied in shares of Company common stock or cash, at the Company' s discretion. No notes have been converted into cash or shares of common stock as of October 27, 2007. The notes can be redeemed at the option of the Company no earlier than August 7, 2008.

On November 22, 2006, the Company sold $200,000 of convertible subordinated debentures due 2026. The debentures are unsecured, subordinated obligations of the Company, pay interest at 3.75% per annum on each May 30th and November 30th, and are convertible upon satisfaction of certain conditions. In connection with any such

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conversion, the Company will deliver cash equal to the lesser of the aggregate principal amount of debentures to be converted or the Company' s total conversion obligation, and will deliver, at its option, cash or shares of its common stock in respect of the remainder, if any, of its conversion obligation. The initial conversion rate is .0194574 shares per $1 principal amount of debentures, which represents an initial conversion price of approximately $51.39 per share. The debentures are redeemable at the Company' s option on or after November 30, 2011. On November 30, 2011, 2016 and 2021 and upon the occurrence of certain circumstances, holders will have the right to require the Company to repurchase all or some of the debentures.

NOTE 11 – SECURITIZATION OF ACCOUNTS RECEIVABLE

The Company and certain of its U.S. subsidiaries entered into an agreement (the "Receivables Facility") in November 2000 with a financial institution whereby it sells on a continuous basis an undivided interest in all eligible trade accounts receivable. Pursuant to the Receivables Facility, the Company formed New School, Inc. ("NSI"), a wholly-owned, special purpose, bankruptcy-remote subsidiary. As such, the assets of NSI will be available first and foremost to satisfy the claims of the creditors of NSI. NSI was formed for the sole purpose of buying and selling receivables generated by the Company and certain subsidiaries of the Company. NSI does not meet the conditions of a qualifying Special Purpose Entity and therefore the results of NSI have been included in the Company' s consolidated results for financial reporting purposes. Under the Receivables Facility, the Company and certain subsidiaries transfer without recourse all their accounts receivables to NSI. NSI, in turn, has sold and, subject to certain conditions, may from time to time sell an undivided interest in these receivables. The Company receives a fee from the financial institution that approximates fair value for billing and collection functions, which remain the responsibility of the Company. The Receivables Facility has been amended to extend its expiration to January 31, 2008 and it may be extended further with the financial institution' s consent. In addition, the facility was amended to permit advances up to $175,000 from July 1 through November 30 of each year, and advances up to $75,000 from December 1 through June 30 of each year. The Company' s retained interests in the receivables sold are recorded at fair value, which approximates cost, due to the short-term nature of the receivables sold.

This two-step transaction is accounted for as a sale of receivables under the provision of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. At October 27, 2007, April 28, 2007, and October 28, 2006, respectively, $50,000 was advanced for accounts receivables sold under the accounts receivable securitization and, accordingly, that amount of accounts receivable has been removed from our condensed consolidated balance sheets. Costs associated with the sale of receivables, primarily related to the discount and loss on sale, were $2,508 and $2,519 for the three months ended October 27, 2007 and October 28, 2006, respectively, and $3,717 and $3,570 for the six months ended October 27, 2007 and October 28, 2006, respectively, and are included in other expenses in the accompanying condensed consolidated statement of operations. Supplemental information related to the accounts receivable securitization transactions is provided below. Proceeds under accounts receivable securitization and collections as servicer of receivables sold have been netted in the accompanying condensed consolidated statements of cash flows under the caption, "Change in amounts sold under receivables securitization, net."

	Six Months Ended	
	October 27, 2007	October 28, 2006
Proceeds under accounts receivable securitization	$349,042	$377,766
Collections as servicer of receivables sold	(349,042)	(377,766)

Retained interest in accounts receivable at end of period	$200,638	$169,204
Cash flows from retained interests	306,811	278,031

NOTE 12 – SEGMENT INFORMATION

The Company' s business activities are organized around two principal business segments, Specialty and Essentials, and operate principally in the United States, with limited Specialty segment operations in Canada. Both internal and

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external reporting conform to this organizational structure, with no significant differences in accounting policies applied. The Company evaluates the performance of its segments and allocates resources to them based on revenue growth and profitability. Products supplied within the Specialty segment primarily target specific educational disciplines, such as art, industrial arts, physical education, sciences and early childhood. This segment also supplies student academic planners, videos, DVDs, published educational materials and sound presentation equipment. Products supplied within the Essentials segment include consumables (consisting of classroom supplies, instructional materials, educational games, art supplies and school forms), school furniture and indoor and outdoor equipment. Intercompany eliminations represent intercompany sales between our Specialty and Essentials segments, and the resulting profit recognized on such intercompany sales. All intercompany transactions have been eliminated.

	Three Months Ended		Six Months Ended	
	October 27, 2007	October 28, 2006	October 27, 2007	October 28, 2006
Revenues:				
Specialty	$236,743	$203,211	$464,882	$412,679
Essentials	160,129	172,072	326,260	346,923
Corporate and intercompany eliminations	(3,953)	(4,058)	(11,710)	(11,306)
Total	$392,919	$371,225	$779,432	$748,296
Operating income (loss) and income before provision for income taxes:				
Specialty	$57,783	$42,007	$118,032	$92,385
Essentials	20,400	22,660	45,542	49,624
Corporate and intercompany eliminations	(10,353)	(7,736)	(22,521)	(16,006)
Operating income	67,830	56,931	141,053	126,003
Interest expense and other	7,456	8,119	13,989	15,278

Income before provision for income taxes	$60,374	$48,812	$127,064	$110,725

	October 27, 2007	**October 28, 2006**
Identifiable assets (as of quarter end):		
Specialty	$837,147	$790,933
Essentials	318,849	321,072
Corporate and intercompany eliminations	39,340	37,559
Total assets of continuing segments	1,195,336	1,149,564
Discontinued operations	16,122	44,123
Total	$1,211,458	$1,193,687

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	Three Months Ended		Six Months Ended	
	October 27, 2007	October 28, 2006	October 27, 2007	October 28, 2006
Depreciation and amortization of intangible assets and development costs:				
Specialty	$ 5,250	$ 5,058	$ 11,369	$ 10,254
Essentials	778	852	1,564	1,693
Corporate	2,016	1,502	4,059	2,936
Total continuing segments	8,044	7,412	16,992	14,883
Discontinued operations	656	963	1,236	1,672
Total	$ 8,700	$ 8,375	$ 18,228	$ 16,555
Expenditures for property, plant and equipment, intangible and other assets and development costs:				
Specialty	$ 2,206	$ 1,937	$ 4,266	$ 4,024
Essentials	24	2	38	8
Corporate	3,595	4,317	6,318	10,848
Total continuing segments	5,825	6,256	10,622	14,880
Discontinued operations	780	558	2,351	1,084

Total	$ 6,605	$ 6,814	$ 12,973	$ 15,964

NOTE 13 – COMMITMENTS AND CONTINGENCIES

Various claims and proceedings arising in the normal course of business are pending against the Company. The results of these matters are not expected to have a material adverse effect on the Company' s consolidated financial position, results of operations or cash flows.

ITEM 2. Management' s Discussion and Analysis of Financial Condition and Results of Operation ("MD&A")

Overview

School Specialty is an education company that provides innovative and proprietary products, programs, and services to help educators engage and inspire students of all ages and abilities. Through each of our leading brands, we design, develop, and provide preK-12 educators with the latest and very best curriculum, supplemental learning resources, and classroom basics. Working in collaboration with educators, we reach beyond the scope of textbooks to help teachers, guidance counselors, and school administrators ensure that every student reaches his or her full potential.

Our business is subject to seasonal fluctuations. Our historical revenues and profitability have been dramatically higher in the first two quarters of our fiscal year, primarily due to increased shipments to customers coinciding with the start of each school year. Due to variations in the timing of shipments within this season primarily as a result of changes or delays in school start dates, the Company views a year-over-year comparison of the first six months of the fiscal year to be a more meaningful analysis than year-over-year comparative results for the first or second quarters on an individual basis.

During the first six months of fiscal 2008, revenues increased 4.2% over the first six months of fiscal 2007, and gross margin improved 60 basis points. These improvements are primarily related to strong revenues from state adoptions of our science curriculums and organic growth within the Specialty segment, offset by a decline in revenues within the Essentials segment which was mostly attributable to a reduction in revenue from reconstruction of schools in Louisiana, the elimination of a catalog and the decision to not pursue low-margin bid business. The increased concentration of revenues coming from the Specialty segment, which provides higher margin producing proprietary products, resulted in the increase in overall gross margin percentage.

Selling, general and administrative expenses ("SG&A") decreased 70 basis points as a percent of revenues in the first six months of fiscal 2008 as compared to the first six months of fiscal 2007. The decrease reflects a more significant increase in revenues as compared to an incremental increase in SG&A that has been controlled through supply-chain efficiencies and other cost reduction efforts.

Operating income increased 11.9% and earnings from continuing operations increased 15.1% in the first six months of fiscal 2008 as compared to the first six months of fiscal 2007.

During the fourth quarter of fiscal 2007, the Company' s Board of Directors authorized the sale and ultimate disposition of the School Specialty Media ("SSM") business unit. The Company has classified SSM as a discontinued operation in the accompanying condensed consolidated statements of operations and in this discussion of results of operations for all periods presented. Net income for the first six months of fiscal 2008 increased 16.4%, and includes a net of tax loss of $0.7 million in the first six months of fiscal 2008 as compared to net of tax loss of $1.3 million in the first six months of fiscal 2007 from the operations of SSM.

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Results of Continuing Operations

The following table sets forth various items as a percentage of revenues for the three and six months ended October 27, 2007 and October 28, 2006:

	Three Months Ended		Six Months Ended	
	October 27, 2007	October 28, 2006	October 27, 2007	October 28, 2006
Revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	57.4	58.3	56.3	56.9
Gross profit	42.6	41.7	43.7	43.1
Selling, general and administrative expenses	25.4	26.4	25.6	26.3
Operating income	17.3	15.3	18.1	16.8
Interest expense, net	1.3	1.5	1.3	1.5
Other expense	0.6	0.6	0.5	0.5
Income before provision for income taxes	15.4	13.2	16.3	14.8
Provision for income taxes	6.0	5.2	6.4	5.8
Earnings from continuing operations	9.4 %	8.0 %	9.9 %	9.0 %

Three Months Ended October 27, 2007 Compared to Three Months Ended October 28, 2006

Revenues

Revenues increased 5.8% from $371.2 million for the three months ended October 28, 2006 to $392.9 million for the three months ended October 27, 2007. Specialty segment revenues increased 16.5% from $203.2 million for the three months ended October 28, 2006 (which includes $4.2 million of intersegment revenues) to $236.7 million for the three months ended October 27, 2007 (which includes $4.1 million of intersegment revenues). The growth in Specialty segment revenues was primarily related to revenue from state adoptions of the Company' s science curriculum offerings of approximately $29 million in the quarter, partially offset by a $2 million decline in mass-merchant retail sales. Essentials segment revenues, which are comprised solely of third-party revenues, decreased 6.9% from $172.1 million for the three months ended October 28, 2006 to $160.1 million for the three months ended October 27, 2007. The decline in Essentials segment revenues was primarily related to a reduction in revenue from the decline in reconstruction activity of schools in Louisiana as compared to the prior year.

Gross Profit

Gross profit increased 8.2% from $154.8 million for the three months ended October 28, 2006 to $167.5 million for the three months ended October 27, 2007. The increase in gross profit was due primarily to the 5.8% increase in revenues along with a shift in revenue mix towards the higher margin Specialty segment.

Gross margin increased 90 basis points from 41.7% for the three months ended October 28, 2006 to 42.6% for the three months ended October 27, 2007. The increase in gross margin was primarily related to a higher concentration of revenue from the higher margin Specialty segment, which comprised 59.2% (net of intersegment revenues) of total revenues for the three months ended October 27, 2007, versus 53.6% (net of intersegment revenues) of total revenues for the three months ended October 28, 2006.

Specialty segment gross profit increased $17.4 million from $101.5 million for the three months ended October 28, 2006 to $118.9 million for the three months ended October 27, 2007 and gross margin increased from 49.9% to 50.2%. This increase in gross profit was related to the increased revenues plus the 30 basis point improvement in the gross margin. The increase in the gross margin was related to revenue mix within the segment.

Essentials segment gross profit decreased $4.3 million from $53.1 million for the three months ended October 28, 2006 to $48.8 million for the three months ended October 29, 2007 and gross margin declined 40 basis points from 30.9% to 30.5%. The decline in gross margin was primarily driven by the product mix within the Essentials segment as the revenue decline was primarily in consumables, which have higher gross margins than furniture products.

Selling, General and Administrative Expenses

SG&A includes selling expenses, the most significant of which are sales wages and commissions; operations expenses, which includes customer service, warehouse and out-bound freight costs on shipments from our distribution centers; catalog costs; general administrative overhead, which includes information systems, accounting, legal and human resources; and depreciation and intangible asset amortization expense.

As a percent of revenue, SG&A decreased 100 basis points from 26.4% of revenues for the three months ended October 28, 2006 to 25.4% of revenues for the three months ended October 27, 2007. SG&A increased $1.8 million to $99.7 million in the second quarter of fiscal 2008 from $97.9 million in the second quarter of fiscal 2007.

SG&A attributable to the combined Specialty and Essentials segments was relatively flat in the quarter and Corporate SG&A increased approximately $2.2 million. The increase in Corporate SG&A was due to increased depreciation and information technology infrastructure costs as a result the prior year initial implementation of the Company' s new enterprise resource planning ("ERP") system along with additional costs directed toward the Company' s direct marketing and product management initiatives.

Specialty segment SG&A increased $1.6 million from $59.5 million for the three months ended October 28, 2006 to $61.1 million for the three months ended October 27, 2007, and decreased 350 basis points as a percent of revenues from 29.3% to 25.8% over this same period.

The decrease in SG&A as a percentage of revenue was primarily due to supply chain efficiencies and the leverage of increased sales on the non-variable SG&A costs offset by incremental costs to support the increase in revenues.

Essentials segment SG&A decreased $2.1 million from $30.5 million for the three months ended October 28, 2006 to $28.4 million for the three months ended October 27, 2007. The decrease in SG&A was a result of decreased variable costs such as order fulfillment costs as a result of decreased revenues within the segment. SG&A as a percent of revenue remained consistent at 17.7% as improvements in supply chain operations were offset by the base of non-variable costs in comparison to lower revenues.

Interest Expense

Net interest expense decreased $0.6 million from $5.6 million for the three months ended October 28, 2006 to $5.0 million for the three months ended October 27, 2007. The decrease in interest expense was primarily due to an overall reduction in the Company' s effective borrowing rate as a result of the $200 million convertible debenture offering in the third quarter of fiscal 2007 at an interest rate of 3.75%, offset by an overall increase in average outstanding borrowings. Average outstanding borrowings have increased over the prior year to support an increase in working capital in the second quarter of fiscal 2008 as compared to fiscal 2007, and to fund share repurchases made by the Company since the beginning of fiscal 2007, largely offset by cash provided by operating activities during the past twelve months.

Other Expense

Other expense, which primarily consists of the discount and loss on the accounts receivable securitization, remained consistent at $2.5 million for the second quarter of both fiscal 2008 and fiscal 2007.

Provision for Income Taxes

Provision for income taxes increased $4.2 million primarily due to increased pre-tax income offset to some extent by a reduction in the effective income tax rate for the quarter. The effective income tax rate decreased to 38.8% for the three months ended October 27, 2007 from 39.3% for the three months ended October 28, 2006. The decrease in the effective income tax rate is primarily due to the reduced impact of the tax treatment of incentive stock options under SFAS 123(R) in the second quarter of fiscal 2008. The effective income tax rate exceeds the federal statutory rate of 35% primarily due to the impact of state income taxes and foreign income which is taxed at a higher rate.

Six Months Ended October 27, 2007 Compared to Six Months Ended October 28, 2006

Revenues

Revenues increased 4.2% from $748.3 million for the six months ended October 28, 2006 to $779.4 million for the six months ended October 27, 2007. The increase in revenues was due to the growth in the Specialty segment which was offset to some extent by a revenue decline in the Essentials segment.

Specialty segment revenues increased 12.6% from $412.7 million (which includes $11.7 million of intersegment revenues) to $464.9 million (which includes $12.0 million of intersegment revenues). The growth in Specialty segment revenues was primarily related to approximately $43 million of revenue from state adoptions of the Company' s science curriculum and organic growth in the other core Specialty businesses, partially offset by an approximate $7 million decline in the mass-merchant retail business which the Company considers non-core.

Essentials segment revenues (which are comprised solely of third-party revenues) decreased 6.0% from $346.9 million for the six months ended October 28, 2006 to $326.3 million for the six months ended October 27, 2007. The decrease primarily was attributable to the a decline in the activity in Louisiana related to school rebuilding projects following Hurricane Katrina, the decision to not pursue low-margin bid business, and the decision to eliminate an unproductive catalog.

Gross Profit

Gross profit increased 5.6% from $322.7 million for the six months ended October 28, 2006 to $340.9 million for the six months ended October 27, 2007. Gross margin improved 60 basis points from 43.1% for the six months ended October 28, 2006 to 43.7% for the six months ended October 27, 2008. The increase in gross profit was due to an increase in revenues. The improved gross margins related to a shift in the product mix towards the Specialty segment. Specialty segment revenues accounted for 58.1% (net of intersegment revenues) in the first six months of fiscal 2008, up from 53.6% (net of intersegment revenues) for the first six months of fiscal 2007.

Specialty segment gross profit increased $26.5 million from $211.1 million for the six months ended October 28, 2006 to $237.6 million for the six months ended October 27, 2007 due to the incremental revenues. Gross margins were 51.1% for both the first six months of fiscal 2008 and fiscal 2007.

Gross profit of the Essentials segment declined $7.3 million from $112.0 million for the first six months of fiscal 2007 to $104.8 million for the first six months of fiscal 2008. This decrease was attributable primarily to the revenue decline. Gross margin for the Essentials segment was down 20 basis points from 32.3% for the six months ended October 28, 2006 to 32.1% for the six months ended October 28, 2007. The decrease in gross margin was primarily driven by the product mix within the Essentials segment as the revenue from direct shipments, which carry a lower gross margin than products fulfilled through the Company' s distribution centers, comprised a higher percentage of the total Essentials segment revenues for the fiscal six months of fiscal 2008 as compared to the first six months of fiscal 2007.

Selling, General and Administrative Expenses

SG&A decreased 70 basis points, as a percent of revenues, from $196.7 million or 26.3% of revenues for the six months ended October 28, 2006 to $199.9 million or 25.6% of revenues for the six months ended October 27, 2007. The increase in SG&A primarily resulted from the incremental variable costs associated with the incremental revenues of $31.1 million. SG&A associated with the Specialty and Essentials segments decreased a combined $2.4 million and Corporate SG&A increased by $5.5 million. The increase in Corporate SG&A was due to increased depreciation and information technology infrastructure costs as a result of the prior year initial implementation of the Company' s new ERP system along with additional costs directed toward the Company' s direct marketing and product management initiatives.

Specialty segment SG&A increased $0.8 million from $118.7 million for the six months ended October 28, 2006 to $119.5 million for the six months ended October 27, 2007. This increase was due to the incremental Specialty segment revenues. SG&A decreased 310 basis points as of percent of revenues from 28.8% to 25.7%. This decrease was primarily attributable to supply chain efficiencies and reduced catalog costs.

Essentials segment SG&A decreased $3.2 million from $62.4 million for the six months ended October 28, 2006 to $59.2 million for the six months ended October 27, 2007. This decrease was primarily due to decreased supply chain expenses consistent with decreased revenues and supply chain efficiencies. SG&A as a percent of revenues increased from 18.0% in the first six months of fiscal 2007 to 18.2% in the first six months of fiscal 2008. This increase is attributable to the fixed SG&A costs being absorbed by a smaller revenue base.

Interest Expense

Net interest expense decreased $1.5 million from $11.8 million to $10.3 million. The decrease in interest expense was primarily due to an overall reduction in the Company' s effective borrowing rate as a result of the $200 million convertible debenture offering in the third quarter of fiscal 2007 at an interest of 3.75%, offset by an overall increase in average outstanding borrowings. Average borrowings have increased over the prior year to support an increase in working capital in the first six months of fiscal 2008 as compared to fiscal 2007, and to fund share repurchases made by the Company over the past twelve months, largely offset by cash provided by operating activities.

Other Expense

Other expense, which primarily consists of the discount and loss on the accounts receivable securitization, was $3.7 million in the first six months of fiscal 2008, compared to $3.6 million in the comparable period of 2007.

Provision for Income Taxes

Provision for income taxes increased $6.2 million due to increased pre-tax income. The effective income tax rate decreased 10 basis points from 39.1% for the six months ended October 28, 2006 to 39.0% for the six months ended October 27, 2007.

The effective income tax rate of 39.0% exceeds the federal statutory rate of 35% primarily due to the impact of state income taxes and foreign income that is taxed at higher rates than domestic income.

Liquidity and Capital Resources

At October 27, 2007, we had working capital of $108.0 million. Our capitalization at October 27, 2007 was $1,010.2 million and consisted of debt of $445.1 million and shareholders' equity of $565.1 million.

Our credit facility matures on February 1, 2011 and provides for $350.0 million of revolving loan availability and $100.0 million incremental term loan availability. The amount outstanding as of October 27, 2007 under the revolving and incremental term loans was $96.2 million and $0, respectively. The credit facility is secured by substantially all of our assets and contains certain financial and other covenants. During the first six months of fiscal 2008, we borrowed under our credit facility primarily to meet seasonal working capital requirements and to fund share repurchases. Our borrowings are usually significantly higher during the first two quarters of our fiscal year to meet the working capital requirements of our peak selling season. As of October 27, 2007, our effective interest rate on borrowings under our credit facility was approximately 6.94%, which excludes amortization of loan origination fee costs and the commitment fees on unborrowed funds. During the six months ended October 27, 2007, we paid commitment fees on unborrowed funds under the credit facility of $0.3 million and amortized loan origination fee costs of $0.2 million related to the credit facility. The credit facility contains certain financial covenants, including a consolidated total and senior leverage ratio, a consolidated fixed charge ratio and a limitation on consolidated capital expenditures. The Company was in compliance with these covenants at October 27, 2007.

Our $133.0 million, 3.75% convertible subordinated notes became convertible during the second quarter of fiscal 2006 as the closing price of the Company's common stock exceeded $48.00 for the specified amount of time. As a result, holders of the notes may surrender the notes for conversion at any time from October 1, 2005 until July 31, 2023. The notes are recorded as a current liability. Holders that exercise their right to convert the notes will receive up to the accreted principal amount in cash, with the balance of the conversion obligation, if any, to be satisfied in shares of Company common stock or cash, at the Company's discretion. No notes have been converted into cash or shares of common stock as of October 27, 2007.

Net cash provided by operating activities decreased $14.3 million from $50.4 million for the six months ended October 28, 2006 to $36.1 million for the six months ended October 27, 2007. The decrease in cash provided by operating activities was primarily related to the accounts receivable balances as of the end of the second quarter of 2008 as compared to the second quarter of 2007. The increase in accounts receivable is related to the increase in revenue between years along with a delayed ordering season as result of later school starts in many districts. In addition, the incremental science curriculum revenue recognized in the first half of fiscal 2008 is affecting the cash conversion cycle as these sales tend to have longer collection periods.

Net cash used in investing activities for the six months ended October 27, 2007 was $12.9 million as compared to $15.0 million for the six months ended October 28, 2006. Additions to property, plant and equipment decreased $3.6 million from $11.1 million in fiscal 2006 to $7.5 million in fiscal 2007, primarily as a result of increased spending in fiscal 2007 related to the initial implementation of our new ERP system, along with a general reduction in spending on distribution assets in the current year as compared to the prior year.

Net cash used in financing activities for the six months ended October 27, 2007 was $21.0 million as compared to $28.7 million for the six months ended October 28, 2006. The net cash used in financing activities during the first six months of fiscal 2008 and fiscal 2007 reflected the repurchase of 1.3 million shares of our common stock at a net cost of $44.9 million, and 1.1 million shares of our common stock at a net cost of $36.5 million, respectively. Since the beginning of fiscal 2007, we have repurchased 3.4 million shares at a net cost of $121.4 million. The decrease in the number of our weighted average common shares outstanding effected by share repurchases has had and will continue to have a positive impact on our earnings per share computations as compared to prior periods. See Part II, Item 2, Issuer Purchases of Equity Securities for additional information regarding share repurchases.

We anticipate that our cash flow from operations, borrowings available from our existing credit facility and other sources of capital will be sufficient to meet our liquidity requirements for operations, including anticipated capital expenditures and our contractual obligations for the foreseeable future.

Off Balance Sheet Arrangements

We have an accounts receivable securitization facility. The facility was amended on February 1, 2007 to extend its expiration to January 31, 2008 and it may be extended further with the financial institution' s consent. In addition, the facility was amended to permit advances up to $175.0 million from July 1 through November 30 of each year, and advances up to $75.0 million from December 1 through June 30 of each year. We entered into the facility for the purpose of reducing our variable rate interest expense. At October 27, 2007, $50.0 million was advanced for accounts receivables sold under the accounts receivable securitization and accordingly, that amount of accounts receivable has been removed from our condensed consolidated balance sheet. Costs associated with the sale of receivables, primarily related to the discount and loss on sale, for the first six months of fiscal 2008 and fiscal 2007 were $3.7 and $3.6, respectively. These costs are included in other expenses in our condensed consolidated statements of operations.

Fluctuations in Quarterly Results of Operations

Our business is subject to seasonal fluctuations. Our historical revenues and profitability have been dramatically higher in the first two quarters of our fiscal year, primarily due to increased shipments to customers coinciding with the start of each school year. Quarterly results also may be materially affected by the timing of acquisitions, the timing and magnitude of costs related to such acquisitions, variations in our costs for the products sold, the mix of products sold and general economic conditions. Moreover, the operating margins of companies we acquire may differ substantially from our own, which could contribute to further fluctuation in quarterly operating results. Therefore, results for any fiscal quarter are not indicative of the results that we may achieve for any subsequent fiscal quarter or for a full fiscal year.

Inflation

Inflation has had and is expected to have only a minor effect on our results of operations and our internal and external sources of liquidity.

Forward-Looking Statements

Statements in this Quarterly Report which are not historical are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements include: (1) statements made under Item 2, Management' s Discussion and Analysis of Financial Condition and Results of Operation, including, without limitation, statements with respect to internal growth plans, projected revenues, margin improvement, future acquisitions, capital expenditures and adequacy of capital resources; (2) statements included or incorporated by reference in our future filings with the Securities and Exchange Commission; (3) information contained in written material, releases and oral statements issued by, or on behalf of School Specialty including, without limitation, statements with respect to projected revenues, costs, earnings and earnings per share. Forward-looking statements also include statements regarding the intent, belief or current expectation of School Specialty or its officers. Forward-looking statements include statements preceded by, followed by or that include forward-looking terminology such as "may," "should," "believes," "expects," "anticipates," "estimates," "continues" or similar expressions.

All forward-looking statements included in this Quarterly Report are based on information available to us as of the date hereof. We do not undertake to update any forward-looking statements that may be made by or on behalf of us, in this Quarterly Report or otherwise. Our actual results may differ materially from those contained in the forward-looking statements identified above. Factors which may cause such a difference to occur include, but are not limited to, the risk factors set forth in Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended April 28, 2007.

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ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in qualitative and quantitative disclosures about market risk from what was reported in our Annual Report on Form 10-K for the fiscal year ended April 28, 2007.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation as of the end of the period covered by this quarterly report, the Company' s principal executive officer and principal financial officer have concluded that the Company' s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective for the purposes set forth in the definition of the Exchange Act rules.

Changes in Internal Control

No change in our internal control over financial reporting occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially effect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1A. Risk Factors

The business and financial results of the Company are subject to numerous risks and uncertainties. The risks and uncertainties have not changed materially from those reported in the fiscal 2007 Annual Report on Form 10-K.

ITEM 2. Issuer Purchases of Equity Securities

Share Repurchase Program

For the three months ended October 27, 2007	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Fiscal August	290,400	$ 35.86	290,400	$ 18,597,000
Fiscal September	518,796	35.68	518,796	89,000
Fiscal October	–	–	–	89,000
Total	809,196	$ 35.74	809,196	89,000

On June 5, 2007 School Specialty, Inc. announced that its Board of Directors approved a new share repurchase program which gives School Specialty the ability to purchase up to $45.0 million of its issued and outstanding common stock. Purchases under this program may be made from time to time in open market or privately negotiated transactions. The Company repurchased a total of 1,254,681 shares during the first six months of fiscal 2008 at a purchase price of $44.9 million.

On June 15, 2006 the Company' s Board of Directors approved a share repurchase program, which allowed the Company to purchase up to $50.0 million of the Company' s outstanding common stock. In November 2006, the Company' s Board of Directors authorized an additional $26.5 million repurchase, bringing the total authorization to $76.5 million. During fiscal 2007, the Company repurchased a total of 2,126,121 shares, substantially completing the available purchases under authorizations at April 28, 2007.

Common stock acquired through the share repurchase programs is available for general corporate purposes and is reflected as Treasury Stock in the accompanying consolidated balance sheets. As of October 27, 2007 the Company has repurchased 3,380,802 shares at a purchase price of $121.4 million since June 15, 2006.

ITEM 6. Exhibits

See the Exhibit Index, which is incorporated herein by reference.

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SIGNATURES

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

	SCHOOL SPECIALTY, INC. (Registrant)
12/3/07 Date	/s/ David J. Vander Zanden David J. Vander Zanden Chief Executive Officer (Principal Executive Officer)
12/3/07 Date	/s/ Kevin L. Baehler Kevin L. Baehler Vice President and Interim Chief Financial Officer (Interim Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit No.	Description
12.1	Statement Regarding Computation of Ratio of Earnings to Fixed Charges.
31.1	Certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002, by Chief Executive Officer.
31.2	Certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002, by Interim Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002, by Chief Executive Officer.
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002, by Interim Chief Financial Officer.

EXHIBIT 12.1

School Specialty, Inc.
Ratio of Earnings to Fixed Charges
(Dollars in Thousands)

	Six Months Ended October 27, 2007	Fiscal Year (1) 2007	2006	2005	2004	2003
Earnings						
Income before income taxes -						
Continuing operations	$127,064	$65,693	$30,829	$70,529	$65,397	$62,821
Discontinued operations	(1,074)	(34,438)	(29,572)	(205)	1,315	3,216
Subtotal	125,990	31,255	1,257	70,324	66,712	66,037
Plus:						
Fixed charges	12,039	25,631	22,776	16,301	21,100	20,840
Amortization of capitalized interest	26	36	49	48	48	48
Less interest capitalized during period	(220)	(336)	–	–	–	–
	$137,835	$56,586	$24,082	$86,673	$87,860	$86,925
Fixed Charges						
Interest (expensed or capitalized)	$9,523	$21,149	$17,951	$11,623	$16,564	$16,042
Estimated portion of rent expense representative of interest	1,536	3,117	3,511	3,291	2,797	2,675
Amortization of deferred financing fees	980	1,365	1,314	1,387	1,739	2,123
	$12,039	$25,631	$22,776	$16,301	$21,100	$20,840
Ratio of earnings to fixed charges	11.4	2.2	1.1	5.3	4.2	4.2

(1) All fiscal years presented were 52 weeks, except for fiscal 2005, which had 53 weeks.

EXHIBIT 31.1

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES OXLEY ACT OF 2002

I, David J. Vander Zanden, certify that:

1. I have reviewed this quarterly report on Form 10-Q of School Specialty, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any changes in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

5. The registrant' s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: December 3, 2007

/s/ David J. Vander Zanden

David J. Vander Zanden
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES OXLEY ACT OF 2002

I, Kevin L. Baehler, certify that:

1. I have reviewed this quarterly report on Form 10-Q of School Specialty, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant' s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d) Disclosed in this report any changes in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and
5. The registrant' s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of the registrant' s board of directors (or persons performing the equivalent functions):
    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and
    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: December 3, 2007

/s/ Kevin L. Baehler

Kevin L. Baehler
Vice President and Interim Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, David J. Vander Zanden, President and Chief Executive Officer of School Specialty, Inc., certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the knowledge of the undersigned:

1. The Quarterly Report on Form 10-Q for the three months ended October 27, 2007 (the "Report") which this statement accompanies fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of School Specialty, Inc.

Date: December 3, 2007

/s/ David J. Vander Zanden

David J. Vander Zanden
Chief Executive Officer

This certification accompanies this Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed as filed by School Specialty, Inc. for purposes of Securities Exchange Act of 1934.

EXHIBIT 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Kevin L. Baehler, Vice President and Interim Chief Financial Officer of School Specialty, Inc., certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the knowledge of the undersigned:

1. The Quarterly Report on Form 10-Q for the three months ended October 27, 2007 (the "Report") which this statement accompanies fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of School Specialty, Inc.

Date: December 3, 2007

/s/ Kevin L. Baehler

Kevin L. Baehler
Vice President and Interim Chief Financial Officer

This certification accompanies this Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed as filed by School Specialty, Inc. for purposes of Securities Exchange Act of 1934.