HANDLEMAN CO /MI/
Form 10-K
July 30, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended May 2, 2009

or

¨ **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 1-7923

HANDLEMAN COMPANY

(Exact name of registrant as specified in its charter)

MICHIGAN	**38-1242806**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
500 Kirts Boulevard, Troy, Michigan	**48084-5225**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: 248-362-4400

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
NONE	NONE

Securities registered pursuant to Section 12(g) of the Act: COMMON STOCK $.01 PAR VALUE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO x

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 at least the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T(§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer ¨ Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.). YES ¨ NO x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter. The aggregate market value as of November 1, 2008 was $26,246,000.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date. The number of shares of common stock outstanding as of June 20, 2009 was 20,500,181.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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HANDLEMAN COMPANY

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PART I

Item 1. BUSINESS

Handleman Company, a Michigan corporation (herein referred to as the Company or Handleman or Registrant), which has its executive offices in Troy, Michigan, is the successor to a proprietorship formed in 1934, and to a partnership formed in 1937. Handleman Company operated as a category manager and distributor of prerecorded music and console video game hardware, software and accessories to leading retailers in the United States (U.S.), United Kingdom and Canada. The Company was dissolved on May 5, 2009.

Copies of the Forms 10-K, Forms 10-Q, Forms 8-K, all amendments to those reports and certain other materials are available, as soon as reasonably practicable after said material is electronically filed with or furnished to the Securities and Exchange Commission, free of charge on the Registrant s website, www.handleman.com.

RECENT DEVELOPMENTS

Wind Down of Business Operations

In recent years, music industry sales have declined at double-digit rates as the industry was impacted by digital distribution, downloading and piracy. In addition, the Company s gross margins were compressed because lower-margin promotional products became a greater proportion of annual sales. This level of continued erosion of CD music sales is expected to continue into the foreseeable future. In response to this dramatic decline, during fiscal years 2007 and 2008 the Company implemented significant cost reduction plans to reduce expenses and streamline operations. These plans included work force reductions; the consolidation of the operations of two U.S. automated distribution facilities into one facility; the reduction of benefits programs and realignment of medical plans; initiatives to reduce customer product returns; and various other cost cutting initiatives. However, the reduction in music sales volume and the loss of gross margin outpaced the Company s ability to reduce overhead costs; as a result, the Company experienced steep operating losses in those two fiscal years.

The Company s customers responded to the decline in music industry sales by contracting the amount of retail space devoted to music sales.

Additionally, the Company violated certain debt covenants within its credit agreements in the fourth quarter of fiscal 2008. Those violations were cured soon thereafter by amendments to the credit facilities. At that time, trade creditors expressed concern about whether the Company might be contemplating or be required to file a bankruptcy proceeding. As a result, the Company became concerned about whether it would have access to sufficient financing and vendor credit to meet its business needs.

As a result of concerns about the prospects for the music business and the availability of financing, in April 2008 the Board of Directors of the Company approved that management proceed with the sale of the U.S. and Canadian operations, which were actively being marketed as of May 3, 2008. On June 2, 2008, Handleman announced that it was exiting the music business in North America and that it had sold a portion of its U.S. inventory and its U.S. music business related to Wal-Mart Stores, Inc. (Wal-Mart) to Anderson Merchandisers L.P. (Anderson). Handleman worked with its other non-Wal-Mart U.S. customers to transition them to other music suppliers; these transitions were completed by the end of August 2008. Further, during the second quarter of fiscal 2009, Handleman sold all of the inventory, fixed assets and all operations of its Canadian subsidiary, Handleman Canada, to Anderson. Following the completion of these sales transactions and the transition to other suppliers, the Company has no ongoing music operations in North America.

Additionally, the Company sold to Tesco Stores Limited (Tesco) certain assets and operations of Handleman United Kingdom (Handleman UK or UK) related to the Tesco category management business and certain of the Company s corporate intellectual properties. The transaction was completed in the second quarter of fiscal 2009. Following the completion of this sales transaction, Handleman UK has no on-going business operations in the UK.

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On February 10, 2009, the Company sold certain assets of Crave Entertainment Group, Inc. (Crave) to Fillpoint LLC (Fillpoint). Following the completion of this sales transaction the Company does not have any continuing involvement in the operations of this business.

On April 6, 2009, the Company sold certain assets of REPS LLC (REPS) to Mosaic Sales Solutions US Operating Co., LLC (Mosaic). The Company will wind down the remaining business activities as quickly as possible and will have no continuing involvement in the operations of this business.

The remaining asset of the Company to be disposed of is the Company s corporate office building in Troy, Michigan, which is being actively marketed for sale. In addition, the Company must complete the termination of the U.S. and Canadian pension plans. Pursuant to the Board of Directors approval on March 11, 2009 for the termination of the U.S. pension plan, the Company will terminate this pension plan and will purchase a non-participating group annuity contract for all of its participants. The Canadian pension plan, which received Board of Directors approval for termination early in fiscal 2009, will be paid to participants, either by lump sum payout or through the purchase of an annuity contract, dependent upon the participant s selection of payment. These pension initiatives are expected to be completed, subject to regulatory approval and at the same payout percentage as other unsecured creditor claims, within a period of six to twelve months.

Basis of Accounting

At the Company s annual shareholders meeting on October 1, 2008, the Company s shareholders approved a Plan of Final Liquidation of the Company. As a result of this approval, the Company adopted the liquidation basis of accounting as of October 5, 2008. This basis of accounting is appropriate when the liquidation of a company appears imminent and the net realizable value of its assets is reasonably determinable. Under this basis of accounting, assets and liabilities are stated at their net realizable value, and estimated costs through the liquidation date are accrued for, to the extent reasonably determinable.

Dissolution Filed with State of Michigan

On May 5, 2009, Handleman Company filed a Certificate of Dissolution with the Michigan Department of Energy, Labor and Economic Growth, Bureau of Commercial Services, Corporate Division. As a dissolved company, Handleman will continue its corporate existence, but will not conduct business, except for the purpose of winding down its affairs. Under State of Michigan law, before making any distribution to shareholders, a dissolved corporation must pay or make provision for its non-barred, valid debts, including those obligations that arise after the effective date of dissolution, but before the bar date and before the distribution. Accordingly, Handleman s activities are now limited to: selling, collecting or otherwise realizing the value of its remaining assets; making tax and other regulatory filings; winding down the Company s remaining business activities; paying (or adequately providing for the payment) of all non-barred, valid creditor claims and obligations; and making a distribution to Handleman Company shareholders.

Payments during the liquidation period will be prioritized in the following hierarchy: (i) wind down related costs, including supplier costs necessary to the wind down of the business, employee obligations such as on-going salaries, fringe benefits and retention costs; (ii) income tax payments and other regulatory filing fees; (iii) payment of unsecured valid creditor claims and obligations, including the purchase of non-participating group annuity contracts to supplement the terminated U.S. and Canadian pension plans; and (iv) distribution to shareholders. Based on the Company s net asset balance as of May 2, 2009, proceeds from the liquidation of assets will be insufficient to provide payment in full to its unsecured creditors. These creditors will be paid according to their priority and pro rata within the priority category. It is likely that payment will not be made for at least six to twelve months in order to provide funds for payment to unknown creditors. If the Company is able to generate cash proceeds in excess of what is needed to satisfy all of the Company s obligations, the Company will distribute any such proceeds to shareholders in proportion to their interests as of the close of business on June 20, 2009, the date of record, although shareholder distribution appears unlikely based on the net asset balance of the Company as of May 2, 2009.

On May 6, 2009, Handleman Company petitioned the Circuit Court for Oakland County, State of Michigan, for an Order of Limited Supervision over the Liquidation of Handleman post-dissolution. On May 20, 2009, the court order was granted and declared that shares of Handleman common stock will become non-transferable 30 days after notification to shareholders. Accordingly, Handleman Company s shares of common stock became non-transferable on June 20, 2009. This allows the Company to reduce costs during liquidation and maximize the liquidated value of the Company for the benefit of its creditors and potential benefit to its shareholders.

In furtherance of the Plan of Final Liquidation and prior to the filing of the Certificate of Dissolution, the Company merged all remaining U.S. subsidiary companies into one entity, Handleman Company.

Credit Agreements

Handleman Company has no outstanding debt to its lenders and has repaid all its obligations to, and terminated its secured credit agreements with, Silver Point Finance and General Electric Capital Corporation. The credit agreement with Silver Point Finance was terminated on October 31, 2008 and the credit agreement with General Electric Capital Corporation was terminated on August 1, 2008. The Company entered into these agreements on April 30, 2007.

Board of Directors

Effective as of April 2, 2009, Lloyd E. Reuss, Ralph J. Szygenda, Elizabeth Chappell and Adam D. Sexton each resigned as a Director of the Company. The Company has two remaining members of the Board of Directors.

DESCRIPTION OF FORMER BUSINESS OPERATIONS

Prior to the wind down of business operations, the reportable segments of the Company were category management and distribution operations, video game operations and all other. Within the category management and distribution operations business segment, the Company s revenues were categorized as follows: (i) Category Management Revenues sales to customers who received the full suite of category management services included with their purchase of Handleman-owned tangible products (primarily music); this suite of services included assortment management utilizing the Company s category management systems and processes, product warehousing, ticketing, direct to store shipments, in-store field service and customer returns management; (ii) Greeting Cards Revenues sales to customers who received only certain category management services with the purchase of Handleman-owned greeting cards, including assortment management on replenishment orders, product warehousing, direct to store shipments, in-store field service and customer returns management; (iii) Fee-for-Services Revenues revenues generated from the sale of services performed by the Company such as in-store field service and/or warehousing and distribution of customer-owned product; in these arrangements, the customer did not purchase tangible product from Handleman Company. As a result of the Company s decision in the fourth quarter of fiscal 2008 to exit the music business in North America and the decision in the first quarter of fiscal 2009 to sell the Handleman UK operations, the U.S., Canadian and UK operations have been classified as discontinued operations in the Company s Consolidated Statements of Operations for all periods presented.

The U.S. and Canadian assets and liabilities were classified as held for sale in the Company s Consolidated Balance Sheet as of May 3, 2008.

Within the video game operations business segment, the Company generated revenues from the sale and distribution of Handleman-owned video game hardware, software and accessories. Product was shipped directly to individual stores. As a result of the Company s decision in the first quarter of fiscal 2009 to begin marketing Crave for sale, the Crave operations have been classified as discontinued operations for all periods presented.

The all other segment primarily represented the Company s REPS operating segment. REPS provided in-store merchandising for home entertainment and consumer product brand owners at mass merchant, warehouse club and specialty retailers. As a result of the Company s decision in the second quarter of fiscal 2009 to begin marketing REPS for sale, the REPS operations have been classified as discontinued operations for all periods presented.

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See Management s Discussion and Analysis of Financial Condition and Results of Operations for additional information regarding the Company s wind down activities.

As of May 2, 2009, Handleman Company had 26 employees remaining, with none belonging to a labor union.

Item 1A. RISK FACTORS

Cautionary Statement for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995 The discussion of the Company s future plans contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. There are risks associated with forward looking statements. Forward-looking statements are based on current expectations or beliefs concerning future events. Such statements can be identified by the use of terminology such as anticipate, believe, estimate, expect, intend, may, could, possible, plan, project, will, forecast an expressions. Do not place undue reliance on forward-looking statements since actual results may vary significantly from forward-looking statements.

Handleman cannot assure that it will have adequate cash to complete an orderly liquidation of the Company.

The Company believes that cash provided from operations and asset sales will be sufficient to execute its plan of liquidation provided that the Company is able to sell its corporate office building in Troy, Michigan at a favorable selling price and within a reasonable period of time and the amount at which the Company ultimately settles its unsecured U.S. pension liability. The Company does not believe, based upon its value of net assets as of May 2, 2009, that it will have sufficient funds to settle its liabilities and obligations with unsecured creditors in full. If assets are insufficient to settle its liabilities in full, creditors will be paid according to a defined priority and pro rata within each priority category. These assumptions are subject to change based upon the timing of and proceeds from asset sales, and the ultimate settlement of liabilities, particularly its pension plan obligations.

Handleman cannot assure the successful sale of its remaining asset or that the sale of this asset will be at anticipated terms.

While Handleman is hopeful that it will be able to successfully sell its remaining asset, its corporate office building, it cannot make any assurances that there will be a reasonable demand for this asset at what Handleman believes is a fair market value. Further, Handleman faces risk related to the significant pressures on the financial market. If these current conditions continue, a potential investor s ability to secure funding to purchase assets may be constrained. This may limit the number of investors expressing an interest in purchasing Handleman s corporate building and/or the price they are willing to pay.

Handleman is hopeful that sales of its remaining asset will be made on terms that are approved by the Board of Directors and may be conducted by competitive bidding, public sales or privately negotiated sales. The price at which the Company may be able to sell this asset will depend largely on factors beyond the Company s control, including, without limitation, the condition of financial markets, the availability of financing to prospective purchasers of the assets, public market perceptions and limitations on transferability of certain assets.

Handleman cannot assure that there will not be any unanticipated complications in the transitions of its businesses.

Handleman cannot assure that there will not be unanticipated complications related to the transition of its divested businesses. Handleman may be subject to claims filed by customers, Anderson, Tesco, Fillpoint and/or Mosaic related to the sale of those businesses, settling of accounts receivable disputes regarding customer product returns, accounts payable disputes regarding vendor claims or other related party claims. These risks include potential accounts receivable disputes with Handleman s former customers, accounts payable disputes with vendors and disputes with the music providers to which Handleman s former customers were transitioned.

The Company s decision to wind down all business operations has resulted in the termination of employee relationships. Handleman is, therefore, subject to risk of employee lawsuits. While Handleman has made every effort to comply with laws related to these situations, there is a risk that an employee might assert that Handleman terminated his/her relationship in violation of certain laws, and that Handleman is required to pay the employee damages related to the employment termination. Even if Handleman were to prevail in such matters, Handleman would have to defend itself in matters related to employee rights and benefits.

Handleman must resolve matters related to its U.S. and Canadian pension plans.

Handleman Company has certain risks related to its pension plans, which are defined benefit pension plans. Handleman s pension plans are at risk related to the current economic downturn. To the extent that Handleman s pension plans have investments in volatile instruments, Handleman is at risk that its pension plans will be under funded at any given time. Handleman took steps to immunize its U.S. pension plan, which is significantly larger than the Canadian pension plan, thereby removing a significant portion of the economic risk. The U.S. plan changed to an 80% long-bond portfolio and 20% equity exposure from a 60% equity exposure and a 40% long-bond portfolio. This significantly reduces asset/liability mismatch risk related to the fluctuating market. Handleman has elected to terminate its pension plans and will purchase a non-participating group annuity contract for all participants in the U.S. pension plan upon regulatory approval, and purchase either non-participating annuity contracts or make lump sum payments to participants in the Canadian pension plan following regulatory approval. These purchases will require a large amount of cash. The risk exists that the amounts accrued may be insufficient for these purchases if market conditions continue to fluctuate and if net assets of the Company are insufficient to pay unsecured creditors in full.

Handleman Company cannot provide assurance that shareholder distributions will occur.

The Company s Board of Directors will consider the appropriate application of the remaining cash balances, if any, including a distribution to shareholders after Handleman has settled all, or substantially all, of its obligations. However, based on the Company s net asset balance as of May 2, 2009, shareholder distribution is unlikely.

Handleman s inability to retain the services of its current personnel may impact its ability to successfully sell the assets of the Company.

Handleman s ability to successfully sell the assets of the Company is partially dependent upon its ability to retain its remaining personnel. The retention of qualified personnel is difficult under the current circumstances. While Handleman has offered its critical employees retention and severance plans, there is no legal obligation that would require the employee to remain employed at Handleman. In the event that critical employees decide to terminate their employee relationships with Handleman, Handleman would have to retain outside consultants to perform their duties or offer a premium salary in order to hire employees to work for the Company.

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Handleman may eventually rely on outside consultants and advisors to perform critical functions.

As Handleman progresses in the sale of its remaining assets, it may become more dependent on outside consultants and advisors to perform critical functions. While Handleman anticipates that it will maintain Handleman employees in certain critical accounting, finance and tax positions, Handleman may have to rely on consultants, outside legal counsel and other contractors to perform day-to-day tasks. There is a risk that these non-Handleman employees will have interests and arrangements that may be different from the Company s shareholders interests, including, but not limited to, other client priorities and relationships with entities that the Company may do business with in the future. Further, if the Company was unable to continue to employ qualified outside advisors and consultants to perform critical functions, the Company may be unable to meet its regulatory reporting obligations in a timely manner and the system of internal accounting controls may not function as intended.

Item 1B. UNRESOLVED STAFF COMMENTS

Handleman Company does not have any unresolved staff comments to report.

Item 2. PROPERTIES

As of May 2, 2009, Handleman Company occupied a leased warehouse located in Indianapolis, Indiana, whose lease expires in November 2010. The Company expects to vacate this space during the first quarter of fiscal 2010 and has been attempting to sublease the space.

The Company also has unoccupied sales offices in Tennessee and Arkansas, whose leases expire during the first quarter of fiscal 2010, and an occupied sales office in California that is being sublet to Fillpoint under the terms of the sales agreement for Crave. This lease expires in March 2013 and the sublease with Fillpoint expires in August 2009.

The Company owns its 130,000 square foot corporate office building located in Troy, Michigan. During the first quarter of fiscal 2009, the Company began actively marketing the building for sale.

Item 3. LEGAL PROCEEDINGS

See Note 11 of Notes to Consolidated Financial Statements for a discussion of the Company s contingencies.

Handleman Company is not currently involved in any legal proceedings that are material or for which it does not believe it has adequate reserves. Any other legal proceedings in which the Company is involved are routine legal matters that are incidental to the wind down of operations. The Company establishes reserves for all claims and legal proceedings based on its best estimate of the amounts it expects to pay.

Item 4. SUBMISSION OF MATTERS

TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of fiscal 2009, Handleman Company did not submit any matters to a vote of its security holders.

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PART II

Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER

PURCHASES OF EQUITY SECURITIES

Effective March 26, 2008, Handleman Company s stock began trading on the Pink Sheet Electronic Quotation Service, trading symbol HDLM.PK. Prior to March 19, 2008, Handleman s stock traded on the New York Stock Exchange Euronext (NYSE), under the symbol HDL. Handleman s stock was delisted by the NYSE prior to the NYSE market opening on March 25, 2008. The NYSE s action resulted from the Company s average market capitalization over a consecutive thirty trading-day period being below the NYSE minimum quantitative continued listing criteria of $25 million.

On May 6, 2009, Handleman Company petitioned the Circuit Court for Oakland County, State of Michigan, for an Order of Limited Supervision over the Liquidation of Handleman post-dissolution. On May 20, 2009, the court order was granted and declared that shares of Handleman common stock will become non-transferable 30 days after notification to shareholders. Accordingly, Handleman Company s shares of common stock became non-transferable on June 20, 2009. As of June 20, 2009, the Company had 2,551 shareholders of record.

There can be no assurance that the Company s common stock will continue to be quoted on the Pink Sheet Electronic Quotation Service or any other service.

Below is a summary of the market price of the Company s common stock:

	Fiscal Years Ended					
	May 2, 2009			May 3, 2008		
Quarter	**Low**	**High**	**Close**	**Low**	**High**	**Close**
First	$ 0.68	$ 2.07	$ 1.38	$ 4.81	$ 7.60	$ 4.84
Second	1.15	2.80	1.29	2.45	5.00	2.51
Third	0.13	1.37	0.14	1.21	2.56	1.40
Fourth	0.01	0.18	0.03	0.18	1.64	0.77

During the fourth quarter of fiscal 2007, the Company suspended indefinitely its quarterly cash dividends of $0.08 per share of common stock. Accordingly, no dividends were declared during the past two fiscal years.

On February 23, 2005, the Company s Board of Directors authorized a share repurchase program. Under this authorization, which has no expiration date, the Company can repurchase up to 15% of its then outstanding balance of 21,787,611 shares. The Company has not repurchased any shares of its common stock since fiscal 2006. The Company has repurchased 2,044,000 shares or 63% of the shares authorized under the current share repurchase program, as of May 2, 2009.

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Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company s fiscal year 2009, which consisted of 52 weeks, ended on May 2, 2009 and its fiscal year 2008, which consisted of 53 weeks, ended on May 3, 2008.

At the Company s annual shareholders meeting on October 1, 2008, the Company s shareholders approved a Plan of Final Liquidation of the Company. As a result of this approval, the Company adopted the liquidation basis of accounting as of October 5, 2008. This basis of accounting is appropriate when the liquidation of a company appears imminent and the net realizable value of its assets is reasonably determinable. Under this basis of accounting, assets and liabilities are stated at their net realizable value, and estimated costs through the liquidation date are accrued for, to the extent reasonably determinable.

On May 5, 2009, Handleman Company filed a Certificate of Dissolution with the Michigan Department of Energy, Labor and Economic Growth, Bureau of Commercial Services, Corporate Division. As a dissolved company, Handleman will continue its corporate existence, but will not conduct business, except for the purpose of winding down its affairs. Under State of Michigan law, before making any distribution to shareholders, a dissolved corporation must pay or make provision for its non-barred, valid debts, including those obligations that arise after the effective date of dissolution, but before the bar date and before the distribution. Accordingly, Handleman s activities are now limited to: selling, collecting or otherwise realizing the value of its remaining assets; making tax and other regulatory filings; winding down the Company s remaining business activities; paying (or adequately providing for the payment) of all non-barred, valid creditor claims and obligations; and making a distribution to Handleman s shareholders.

Payments during the liquidation period will be prioritized in the following hierarchy: (i) wind down related costs, including supplier costs necessary to the wind down of the business, employee obligations such as on-going salaries, fringe benefits and retention costs; (ii) income tax payments and other regulatory filing fees; (iii) payment of unsecured valid creditor claims and obligations, including the purchase of non-participating group annuity contracts to supplement the terminated U.S. and Canadian pension plans; and (iv) distribution to shareholders. Based on the Company s net asset balance as of May 2, 2009, proceeds from the liquidation of assets will be insufficient to provide payment in full to its unsecured creditors. These creditors will be paid according to their priority and pro rata within the priority category. It is likely that payment will not be made for at least six to twelve months in order to provide funds for payment to unknown creditors. If the Company is able to generate cash proceeds in excess of what is needed to satisfy all of the Company s obligations, the Company will distribute any such proceeds to shareholders in proportion to their interests as of the close of business on June 20, 2009, the date of record, although shareholder distribution appears unlikely based on the net asset balance of the Company as of May 2, 2009.

On May 6, 2009, Handleman Company petitioned the Circuit Court for Oakland County, State of Michigan, for an Order of Limited Supervision over the Liquidation of Handleman post-dissolution. On May 20, 2009, the court order was granted and declared that shares of Handleman common stock became non-transferable 30 days after notification to shareholders. Accordingly, Handleman Company s common shares became non-transferable on June 20, 2009. This allows the Company to reduce costs during liquidation and maximize the liquidated value of the Company for the benefit of its creditors and potential benefit to its shareholders.

Prior to the wind down of business operations, Handleman Company operated as a category manager and distributor of prerecorded music and console video game hardware, software and accessories to leading retailers in the U.S., United Kingdom (UK) and Canada.

In recent years, music industry sales have declined at double-digit rates as the industry was impacted by digital distribution, downloading and piracy. In addition, the Company s gross margins were compressed because lower-margin promotional products became a greater proportion of annual sales. This level of continued erosion of CD music sales is expected to continue into the foreseeable future. In response to this dramatic decline, during fiscal years 2007 and 2008 the Company implemented significant cost reduction plans to reduce expenses and streamline operations. These plans included work force reductions; the consolidation of the operations of two U.S. automated distribution facilities into one facility; the reduction of benefit programs and the realignment of medical plans; initiatives to reduce customer product returns; and various other cost cutting initiatives. However, the reduction in music sales volume and loss of gross margin outpaced the Company s ability to reduce overhead costs, and as a result, the Company experienced steep operating losses in those two fiscal years.

The Company s customers responded to the decline in music industry sales by contracting the amount of retail space devoted to music sales.

Additionally, the Company violated certain debt covenants within its credit agreements in the fourth quarter of fiscal 2008. Those violations were cured soon thereafter by an amendment to the credit facilities. At that time, trade creditors expressed concern about whether the Company might be contemplating or be required to file a bankruptcy proceeding. As a result, the Company became concerned about whether it would have access to sufficient financing and vendor credit to meet its business needs.

As a result of concerns about the prospects for the music business and the availability of financing, in April 2008 the Board of Directors of the Company approved that management proceed with the sale of the U.S. and Canadian operations, which were actively being marketed as of May 3, 2008. On June 2, 2008, Handleman announced that it was exiting the music business in North America and that it had sold a portion of its U.S. inventory and its U.S. music business related to Wal-Mart Stores, Inc. (Wal-Mart) to Anderson Merchandisers L.P. (Anderson). Handleman worked with its other non-Wal-Mart U.S. customers to transition them to other music suppliers; these transitions were completed by the end of August 2008. Further, during the second quarter of fiscal 2009, Handleman sold all of the inventory, fixed assets and all operations of its Canadian subsidiary, Handleman Canada, to Anderson. Following the completion of these sales transactions and the transition to other suppliers, the Company has no ongoing music operations in North America.

The Company also sold to Tesco Stores Limited (Tesco) certain assets and operations of Handleman United Kingdom (Handleman UK or UK) related to the Tesco category management business and certain of the Company s corporate intellectual properties. The transaction was completed in the second quarter of fiscal 2009. Following the completion of this sales transaction, Handleman UK has no on-going business operations in the UK. The wind down of Handleman UK is substantially completed.

On February 10, 2009, the Company sold certain assets of Crave Entertainment Group, Inc. (Crave) to Fillpoint LLC (Fillpoint). Following the completion of this sales transaction the Company does not have any continuing involvement in the operations of this business.

On April 6, 2009, the Company sold certain assets of REPS LLC (REPS) to Mosaic Sales Solutions US Operating Co., LLC (Mosaic). The Company will wind down the remaining business activities as quickly as possible and will have no continuing involvement in the operations of this business.

In accordance with accounting guidance, the U.S., Canada and Handleman UK music category management and distribution businesses, as well as Crave and REPS, have been classified as discontinued operations in the Company s Consolidated Statements of Operations for all periods presented. In addition, the U.S. and Canadian assets and liabilities have been classified as held for sale in the Company s Consolidated Balance Sheet as of May 3, 2008.

The remaining asset of the Company to be disposed of is the Company s corporate office building in Troy, Michigan, which is being actively marketed for sale. In addition, the Company must complete the termination of the U.S. and Canadian pension plans. Pursuant to Board of Directors approval on March 11, 2009 for the termination of the U.S. pension plan, the Company will terminate this pension plan and will purchase a non-participating group annuity contract for all of its participants. The Canadian pension plan, which received Board of Directors approval for termination early in fiscal 2009, will be paid to participants, either by lump sum payout or through the purchase of an annuity contract, dependent upon the participant s selection of payment. These pension initiatives are expected to be completed, subject to regulatory approval and at the same payout percentage as other unsecured creditor claims, within a period of six to twelve months.

The Company believes that cash provided from operations and asset sales will provide sufficient liquidity to fund the Company s wind down related costs. However, based on the Company s net asset balance as of May 2, 2009, proceeds from the liquidation of assets will be insufficient to provide payment in full to its unsecured creditors. If the Company is able to generate cash proceeds in excess of its total liabilities and obligations, the Company will distribute any such proceeds to shareholders; however, it appears that any such distribution to shareholders is unlikely.

Critical Accounting Estimates

The Company s discussion and analysis of its financial condition and results of operations are based upon the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. The Company continually evaluates its estimates and assumptions, which are based on historical experience, future expectations and other various factors that are believed to be reasonable under the circumstances. The results of these estimates and assumptions form the basis for making judgments about the carrying values of certain assets and liabilities.

The following are the Company s critical accounting estimates under the liquidation basis of accounting:

Accrued Liquidation Costs

At the Company s annual shareholders meeting on October 1, 2008, the Company s shareholders approved a Plan of Final Liquidation of the Company. As a result of this approval, the Company adopted the liquidation basis of accounting as of October 5, 2008. This basis of accounting is appropriate when the liquidation of a company appears imminent and the net realizable value of its assets is reasonably determinable. Under this basis of accounting, assets and liabilities are stated at their net realizable value, and estimated costs through the liquidation date are accrued for, to the extent reasonably determinable.

The transition from the going concern basis of accounting to the liquidation basis of accounting required management to make significant estimates and judgments in many areas. The Company will terminate its pension plans, in both the U.S. and Canada, and purchase non-participating group annuity contracts for all plan participants. Accordingly, actuarial valuation analyses have been prepared quarterly to determine the fair value of the U.S. plan. Each valuation resulted in significant adjustments being made to the accrued liquidation costs related to the U.S. pension plan as a result of fluctuation in the average discount rates. The termination value of the Canadian pension plan was recorded as of October 4, 2008, prior to the Company s transition to the liquidation basis of accounting. The Company estimated the fair value for its corporate headquarters building in Troy, Michigan based upon recent sales and current market conditions. These estimates are subject to change based upon the timing of potential sales and further deterioration in market conditions. The Company reviews, on a quarterly basis, all other remaining operating expenses and contractual commitments such as payroll and related expenses, lease termination costs, professional fees and other outside services to determine the estimated costs to be incurred during the liquidation period.

Pension Expense

Handleman Company will terminate its U.S. pension plan and purchase a non-participating group annuity contract for all plan participants at the same payout percentage as all other unsecured creditor claims. Under the liquidation basis of accounting, actuarial valuation analyses are prepared quarterly to determine the fair value, or termination value, of the plan. In the U.S., the Pension Benefit Guaranty Corporation issues select and ultimate interest rates for the specific purpose of determining the present value of annuities in involuntary and distress terminations of single-employer plans. The Company relies on these rates for their valuations. The valuations also utilize participant data and asset information provided by the Company.

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The Company performed an actuarial valuation analysis as of October 5, 2008, the date of adoption of the liquidation basis of accounting assuming the U.S. pension plan would be terminated through the purchase of annuity contracts. This resulted in an estimated cost of $11,508,000, which was included in accrued liquidation costs as of October 5, 2008. The estimated cost to settle the U.S. pension plan as of November 1, 2008 ranged from $8.2 million to $15.0 million based on discount rates of 7.1% and 6.1%, respectively. The Company received an estimate to settle the U.S. pension plan as of November 1, 2008 and accordingly, increased the liability to $11,998,000 as of November 1, 2008.

The Company increased the estimated U.S. pension cost by $1,366,000 in the third quarter of fiscal 2009. The increase was mainly attributable to a decrease in the average discount rate to 6.0% at January 31, 2009. The accrued liquidation cost related to the termination of the U.S. pension plan totaled $13,364,000 as of January 31, 2009.

The Company increased the estimated U.S. pension cost by $4,056,000 in the fourth quarter of fiscal 2009. The increase was mainly attributable to a decrease in the average discount rate to 5.5% at May 2, 2009. The U.S. pension plan assets at May 2, 2009 were $42,266,000 and the U.S. pension plan termination liability was $59,686,000 at May 2, 2009. The accrued liquidation cost related to the termination of the U.S. pension plan totaled $17,420,000 as of May 2, 2009.

The May 2, 2009 termination value of the Company s pension plans is affected by May 2, 2009 assumptions. Note that the following sensitivities may be asymmetric and are specific to fiscal 2009. They also may not be additive, so the impact of changing multiple factors simultaneously cannot be calculated by combining the individual sensitivities shown. The effect of the indicated increase/(decrease) in selected factors for the Company s U.S. pension plan is shown below (in thousands of dollars):

	May 2, 2009	
	Percentage Point Change	**Impact on Fiscal 2009 Cost of Liquidation**
Discount rate	+/-1 pt.	$7,633 /$(9,794)
Actual return on assets	+/-1 pt.	$404 / $(404)

The foregoing indicates that changes in the discount rate can have a significant effect on the termination value of the Company s U.S. pension plan, and accordingly, the amount of net assets available for distribution to unsecured creditors and shareholders.

Handleman Company terminated its Canadian pension plan and will purchase either non-participating annuity contracts or make lump-sum payments to participants in the Canadian pension plan following regulatory approval by the Financial Services Commission of Ontario. The termination value of the Canadian pension plan was $1,121,000 as of May 2, 2009.

Long-Lived Assets

The Company tests for impairment annually in the fourth quarter or as business conditions warrant a review. During fiscal years 2008 and 2009, the Company recorded significant impairment and disposal charges related to its long-lived assets. To determine fair value of assets, management relies on valuations, purchase agreements and/or letters of intent from interested third parties, when available. If third-party interest or valuations are unavailable, management relies on a probability weighted cash flow estimation approach.

Income Taxes

The provision for income taxes is based on reported income before income taxes. The Company is required to adjust its effective tax rate for each quarter to be consistent with the estimated annual effective tax rate and record the tax impact of certain discrete items, including changes in judgment about valuation allowances and effects of changes in tax laws or rates, in the interim periods in which they occur. Income taxes are allocated between continuing operations, discontinued operations and other comprehensive income by tax jurisdiction and, in periods in which there is a pre-tax loss from continuing operations and pre-tax income in another category, such as discontinued operations or other comprehensive income, tax expense is first allocated to the other sources of income, with a related benefit recorded in continuing operations. Deferred income taxes are provided for the effect of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and amounts recognized for income tax purposes. Valuation allowances are recognized to reduce deferred tax assets when it is more likely than not that the assets will not be realized. In assessing the likelihood of realization, consideration is given to all available evidence including estimates of future taxable income and the character of income needed to realize future benefits. Based on information available to date, the Company recorded any income tax receivable or payable for the ultimate tax amount owed to wind down the Company. The calculation of current and deferred tax assets (including valuation allowances) and liabilities requires management to apply significant judgment related to the application of complex tax laws, changes in tax laws or related interpretations, uncertainties related to the outcomes of tax audits and changes in the Company s operations or other facts and circumstances. Further, management must continually monitor changes in these factors. Changes in such factors may result in changes to management estimates and could require the Company to adjust its tax assets and liabilities and record additional income tax expense or benefits. With the adoption of FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, in fiscal 2008, Handleman Company makes assumptions about individual tax positions before any part of the related benefit can be recognized in its financial statements. A company must consider whether it is more likely than not that a tax position will be sustained upon examination by a taxing authority. In accordance with FIN No. 48, significant judgment is required in assessing the timing and amounts of deductible and taxable items. The Company establishes reserves when, despite its belief that its tax return positions are supportable, it is determined that certain positions may be successfully challenged by the taxing authorities. When facts and circumstances change, the Company adjusts these reserves through its provision for income taxes.

Comparison of the Five Months Ended October 4, 2008 (Fiscal 2009) with Fiscal Year 2008

Unless otherwise noted, the following discussion relates only to results from continuing operations, which primarily includes the Company s corporate function.

Revenues for all periods presented in the Company s Consolidated Statements of Operations are classified in discontinued operations because all operations of the Company have ceased.

Direct product costs for all periods presented in the Company s Consolidated Statements of Operations are classified in discontinued operations because all operations of the Company have ceased.

Selling, general and administrative (SG&A) expenses for the first five months of this fiscal year were $26.8 million, compared to $67.2 million for fiscal year 2008. Due to the shortened time period during fiscal 2009, as a result of the adoption of the liquidation basis of accounting effective October 5, 2008, these amounts are not comparable.

Impairment of subsidiary assets from continuing operations was $14.5 million in fiscal 2008. The Company performed its impairment testing of long-lived assets as of the fourth quarter of fiscal 2008. Based on the Company s decision in the fourth quarter of fiscal 2008 to exit the music business in North America, and projected forecasts of cash flows, the Company determined that certain corporate fixed assets were impaired.

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Loss before interest expense, investment income (expense) and income taxes (operating loss) for the first five months of this fiscal year was $26.8 million, compared to a loss of $81.6 million for fiscal 2008. Due to the shortened time period during fiscal 2009, as a result of the adoption of the liquidation basis of accounting effective October 5, 2008, these amounts are not comparable.

Interest expense was $3.7 million for the first five months of fiscal 2009, compared to $2.9 million for last fiscal year. Interest expense for the first five months of this fiscal year included $3.2 million related to prepayment penalties from the early payment of outstanding debt to lenders on its revolving credit facility. No comparable fees existed in the prior fiscal year.

Investment income for the first five months of fiscal 2009 was $0.1 million, compared to investment expense of $2.4 million for fiscal 2008. The fiscal 2008 investment expense was comprised of an impairment charge related to the Company s minority interest in an equity investment totaling $3.8 million, partially offset by investment income of $1.0 million related to the gain on the sale of an investment in PRN, a company that provides in-store media networks.

Income tax benefit of $0.7 million was recorded for the five months ended October 4, 2008, compared to income tax benefit of $4.1 million for the last fiscal year. Due to the shortened time period during fiscal 2009, as a result of the adoption of the liquidation basis of accounting effective October 5, 2008, these amounts are not comparable.

The Company had a net loss from continuing operations for the first five months of fiscal 2009 of $29.6 million, or $1.45 per diluted share, compared to a net loss of $82.7 million, or $4.07 per diluted share, for fiscal 2008. Due to the shortened time period during fiscal 2009, as a result of the adoption of the liquidation basis of accounting effective October 5, 2008, these amounts are not comparable.

Other

The Company did not repurchase any shares of its common stock during fiscal 2009 or fiscal 2008 and has not repurchased shares since fiscal 2006. The Company has repurchased 2,044,000 shares, or 63% of the shares authorized under the current 15% share repurchase program authorized by the Board of Directors.

The Company is not currently involved in any legal proceedings that are material or for which it does not believe it has adequate reserves. Any other legal proceedings in which the Company is involved are routine legal matters that are incidental to the wind down of business operations. The Company establishes reserves for all claims and legal proceedings based on its best estimate of the amounts it expects to pay.

Liquidity and Capital Resources

Handleman Company had no outstanding debt to its lenders as of May 2, 2009. The Company repaid all of its obligations to, and terminated its secured credit agreements with, Silver Point Finance and General Electric Capital Corporation during fiscal 2009. The credit agreement with Silver Point Finance was terminated on October 31, 2008 and the credit agreement with General Electric Capital Corporation was terminated on August 1, 2008. The Company entered into these agreements on April 30, 2007. Borrowings as of May 3, 2008 were $63.7 million.

Based on Handleman Company s filing of a Certificate of Dissolution, its activities are now limited to: selling, collecting or otherwise realizing the value of its remaining assets; making tax and other regulatory filings; winding down the Company s remaining business activities; paying (or adequately providing for the payment) of all non-barred, valid creditor claims and obligations; and making a distribution to Handleman s shareholders, if available.

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Based on the Company s net asset balance as of May 2, 2009, proceeds from the liquidation of assets will be insufficient to provide payment in full to its creditors. As a result, creditors will be paid according to their priority in the following hierarchy and pro rata within the priority category. Payments are estimated as follows (in thousands of dollars):

Category	Total Liabilities	Proration Percentage	Total Assets Available for Distribution
Wind down related costs	$ 11,046	100%	$ 11,046
Taxes (income and other)	3,100	100%	3,100
Unsecured creditor claims, including termination costs for the pension plans of $18,541	34,215	83%	28,340
Shareholder distribution			
	$ 48,361		$ 42,486
Shortfall			$ 5,875

It is likely that payment of unsecured creditor claims will not be made for at least six to twelve months in order to provide funds for payment to creditors yet unknown. These projected payments are based on significant estimates and judgments. The actual amount and timing of cash distributions will depend on a variety of factors, including, but not limited to, the sale of the Company s remaining assets, collection of the remaining future proceeds from the sale of Crave and REPS, actual costs incurred in connection with the wind down of operations and market fluctuations as it relates to the Company s U.S. and Canadian pension plans.

The Company intends to liquidate its remaining asset, its corporate office building in Troy, Michigan. The Company is hopeful that sale of this remaining asset will occur with favorable terms and in a reasonable period of time. The price at which the Company may be able to sell its corporate building will depend largely on factors beyond the Company s control, including, without limitation, the condition of financial markets, the availability of financing to prospective purchasers of the assets, public market perceptions and limitations on transferability of certain assets.

On February 10, 2009, during the Company s fourth quarter of fiscal 2009, the Company entered into an asset purchase agreement related to the sale of certain assets of the Crave Entertainment subsidiary companies. The cash received at closing related to this sale totaled $8,103,000, which consisted of payments for accounts receivable of $4,625,000; inventory of $3,518,000; and property, plant and equipment of $100,000, less accrued employee vacation liabilities assumed by buyer of $140,000. For a more detailed discussion on this transaction see Note 1 of Notes to Consolidated Financial Statements.

On April 6, 2009, during the Company s fourth fiscal quarter of fiscal 2009, the Company entered into an asset purchase and assignment agreement related to certain assets of REPS. The cash received at closing related to this sale totaled $250,000 and represented an advance against future revenue sharing. The asset purchase and assignment agreement provided for additional payments to Handleman of up to $1,000,000, based on defined revenue sharing terms. See Note 1 of Notes to Consolidated Financial Statements for additional information related to this sale transaction.

Included in the net assets shortfall of $5.9 million as of May 2, 2009, was $24.5 million of cash and cash equivalents, and $0.8 million in cash held in escrow related to the sales of certain assets of the Company s Canadian and UK subsidiaries. The Company does not believe, based upon its value of net assets as of May 2, 2009, that it will have sufficient funds to settle its liabilities and obligations in full with unsecured creditors.

The Company also believes it is unlikely that there will be excess cash for distribution to the Company s shareholders. These assumptions are subject to changes based upon the timing of and proceeds from asset sales, and the ultimate settlement of liabilities, particularly related to the Company s U.S. pension plan. Working capital as of May 3, 2008 was $62.5 million, of which $1.0 million was cash and cash equivalents.

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At May 2, 2009, accounts receivable relates to the Crave and REPS operations.

The Company had no significant off-balance sheet arrangements as of May 2, 2009.

Net cash provided from operating activities for the five months ended October 4, 2008 was $42.6 million. The net cash changes in operating assets and liabilities was primarily related to the reduction in accounts receivable and merchandise inventories of $120.7 million and $23.4 million, respectively. These changes were offset, in part, by a decrease in accounts payable of $62.2 million, an increase in other operating assets of $6.8 million and a decrease in other operating liabilities of $1.4 million.

Net cash provided from investing activities for the five months ended October 4, 2008 was $48.7 million, consisting primarily of cash proceeds of $19.5 million related to the sale of certain U.S. music inventory and Wal-Mart fixtures to Anderson, $15.9 million in proceeds related to the sale of Canadian music inventory and Wal-Mart Canada fixtures to Anderson and $16.4 million in proceeds related to the sale of fixed assets as part of the sale of the Tesco business. The Company also received $1.3 million in proceeds which was previously held in escrow at the time Handleman had purchased Crave in November 2005. These cash proceeds were offset, in part, by cash payments related to software and development costs and acquired rights of $4.0 million.

Net cash used by financing activities for the five months ended October 4, 2008 was $66.3 million. This use of cash was predominately due to net debt repayments of $63.7 million as a result of the Company paying all outstanding debt under its credit facility and incurring $2.5 million in financing related fees.

New Accounting Pronouncements

Although many new accounting pronouncements were issued during fiscal 2009, the following pronouncements were applicable to the Company as a result of the Company s transition to the liquidation basis of accounting:

SFAS No. 157

In September 2006, SFAS No. 157, Fair Value Measurements, was issued by the FASB. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements; however, this pronouncement does not require any new fair value measurements. The Company adopted this portion of the Statement for the fiscal year beginning May 3, 2009. The effective date for SFAS No. 157 has been delayed by the FASB for non financial assets and non financial liabilities. SFAS No. 157 was effective for financial assets and liabilities of the Company for the fiscal year beginning May 4, 2008 for items that are recognized or disclosed at fair value in an entity s financial statements on a recurring basis. The Statement did not have a material impact on the Company s consolidated financial statements.

SFAS No. 159

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115. SFAS No. 159 allows companies to irrevocably elect to recognize most financial assets and financial liabilities at fair value on an instrument-by-instrument basis. Unrealized gains and losses will be reported in earnings at each reporting date. The cumulative effect of re-measuring such instruments to fair value at adoption is accounted for as an adjustment to the beginning balance of retained earnings. SFAS No. 159 was effective for the Company s fiscal year beginning May 4, 2008, and did not have a significant impact on the Company s consolidated financial statements.

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SFAS No. 165

In May 2009, the FASB issued SFAS No. 165, Subsequent Events. This Statement establishes general standards of accounting for and disclosures of events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009 and as such, the Company will adopt this Statement in the first quarter of fiscal 2010. SFAS No. 165 is not expected to materially impact the Company s consolidated financial statements.

Other Information

The Company has no significant investments that are accounted for under the equity method in accordance with accounting principles generally accepted in the United States of America. Accordingly, there are no liabilities associated with investments accounted for under the equity method that would be considered material to the Company.

The Company s financial statements have reported amounts based on historical costs, which represent dollars of varying purchasing power and do not measure the effects of inflation. If the financial statements had been restated for inflation, net income would have been lower because depreciation expense would have to be increased to reflect the most current costs. Management does not believe that inflation within the economies in which the Company conducted business would have a material effect on the Company s results of operations.

On November 27, 2007, the Board of Directors appointed Mr. Albert A. Koch as Handleman s President and Chief Executive Officer through Handleman s engagement of AP Services, LLC (APS). AP Services is affiliated with AlixPartners, a financial advisory and consulting firm, where Mr. Koch is a Vice Chairman, Managing Director and Partner. In addition to an hourly rate and time commitment for services, Handleman s agreement, as amended, provides that in lieu of the success fee previously agreed to by Handleman and APS, Handleman will pay APS a success fee based on 5% (five percent) of the fair value of cash and/or other assets that is distributed to shareholders if such a distribution is approved by the Company s Board of Directors. The success fee shall be paid in cash, concurrent with the date or dates that distributions are made to Handleman Company s shareholders. It is unlikely that the Company will pay this fee based on the shortfall of net assets as of May 2, 2009. In addition to Mr. Koch, the Managing Director of Handleman UK and one of Handleman s Vice Presidents of Finance are also employees of Alix Partners that were retained by Handleman Company after Mr. Koch s appointment. This additional staffing was approved, in advance of their joining Handleman by the CEO Governing Committee, which is a Committee of the Board that was formed to oversee the AlixPartners engagement. Mr. Koch and the Managing Director of Handleman UK are now engaged on a part-time basis by the Company and the Vice President of Finance completed his assignment with Handleman Company in April 2009. All invoices from AlixPartners to the Company are reviewed and approved by a member of the CEO Governing Committee prior to their payment. In accordance with accounting guidance, this relationship is viewed as a related party transaction since the APS consultants may control or significantly influence the management and operating policies of the Company.

The Company has not engaged in any other related party transactions, which would have had a material effect on the Company s financial position, results of operations or cash flows.

* * * * * * * * * *

This document contains forward-looking statements, which are not historical facts. These statements involve risks and uncertainties, and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Actual results, events and performance could differ materially from those contemplated by these forward-looking statements including, without limitation, collection of the remaining estimated proceeds related to the sale of Crave and REPS, successfully selling the Company s corporate headquarters for an amount reasonably consistent with the Company s valuation of that asset, maintaining sufficient liquidity to fund wind down operations, retaining key personnel, satisfactory resolution of any outstanding claims or claims which may arise, selling certain other Company s assets in a timely manner, and other factors discussed in this document and those detailed from time to time in the Company s filings with the Securities and Exchange Commission. Handleman Company notes that the preceding conditions are not a complete list of risks and uncertainties. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date of this document.

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Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements and supplementary data are filed as a part of this report:

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Report Of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

Handleman Company

We have audited the accompanying consolidated statement of net assets of Handleman Company and subsidiaries (the Company) as of May 2, 2009, and the related consolidated statement of changes in net assets for the period October 5, 2008 to May 2, 2009. We have audited the accompanying consolidated statements of operations, shareholders equity and cash flows for the period May 4, 2008 to October 4, 2008. We have also audited the accompanying consolidated balance sheet of the Company as of May 3, 2008, and the related consolidated statements of operations, shareholders equity, and cash flows for the year then ended. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15 (a)(2). These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the shareholders of the Company approved a plan of liquidation on October 1, 2008. As a result, the Company changed its basis of accounting from the going concern basis to a liquidation basis effective October 5, 2008.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated net assets of the Handleman Company and subsidiaries as of May 2, 2009, the consolidated changes in net assets for the period October 5, 2008 to May 2, 2009, the results of their operations and their cash flows for the period May 4, 2008 to October 4, 2008, the financial position as of May 3, 2008, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ GRANT THORNTON LLP
Southfield, Michigan
Date July 30, 2009

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HANDLEMAN COMPANY

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS (LIQUIDATION BASIS)

FOR THE PERIOD OCTOBER 5, 2008 TO MAY 2, 2009

(in thousands of dollars)

Shareholders equity at October 4, 2008	$ 67,226
Liquidation basis adjustments:	
Adjust assets and liabilities to fair value	(6,143)
Accrued liquidation costs	(30,669)
Net assets (liquidation basis) as of October 5, 2008	30,414
Net revenues incurred from October 5, 2008 to May 2, 2009	81,789
Net costs incurred from October 5, 2008 to May 2, 2009	(82,531)
Adjust assets and liabilities to fair value	(22,492)
Adjustment to accrued liquidation costs	(13,055)
Net assets (liabilities) liquidation basis as of May 2, 2009	$ (5,875)

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

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HANDLEMAN COMPANY

CONSOLIDATED STATEMENT OF NET ASSETS AS OF MAY 2, 2009 (LIQUIDATION BASIS)

CONSOLIDATED BALANCE SHEET AS OF MAY 3, 2008 (GOING CONCERN BASIS)

(in thousands of dollars except share data)

	May 2, 2009	May 3, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 24,526	$ 1,043
Accounts receivable, less allowances of $2,602 in 2008	7,083	62,479
Merchandise inventories		29,404
Other current assets	10,877	10,221
Assets held for sale		139,943
Total current assets	42,486	243,090
Property and equipment, net		28,870
Goodwill, net		6,903
Intangible assets, net		35,062
Other assets, net		14,779
Total assets	$ 42,486	$ 328,704
LIABILITIES		
Current liabilities:		
Debt	$	$ 63,706
Accounts payable	3,205	31,023
Accrued and other liabilities	13,055	23,548
Accrued liquidation costs	32,101	
Liabilities held for sale		62,298
Total current liabilities	48,361	180,575
Other liabilities		6,456
Commitments and contingencies (Note 11)		
Total liabilities	48,361	187,031
SHAREHOLDERS EQUITY		
Preferred stock, $1.00 par value; 1,000,000 shares authorized; none issued		
Common stock, $.01 par value; 60,000,000 shares authorized; 20,500,000 and 20,464,000 shares issued and outstanding at May 2, 2009 and May 3, 2008, respectively		205
Additional paid-in capital		788
Accumulated other comprehensive income		17,099
Retained earnings		123,581
Total shareholders equity		141,673

Total liabilities and shareholders equity	$ 48,361	$ 328,704
Net assets (liabilities) liquidation basis	$ (5,875)	

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

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HANDLEMAN COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE FIVE-MONTH PERIOD ENDED OCTOBER 4, 2008 AND

THE FISCAL YEAR ENDED MAY 3, 2008 (GOING CONCERN BASIS)

(in thousands of dollars except per share data)

	For the Five Months Ended October 4, 2008	For the Fiscal Year Ended May 3, 2008
Revenues	$ 20	$ 98
Costs and expenses:		
Direct product costs		
Selling, general and administrative expenses	(26,808)	(67,175)
Impairment of subsidiary assets		(14,490)
Operating loss	(26,788)	(81,567)
Interest expense	(3,678)	(2,922)
Investment income (expense)	127	(2,365)
Loss before income taxes	(30,339)	(86,854)
Income tax benefit	699	4,145
Net loss from continuing operations	$ (29,640)	$ (82,709)
Discontinued operations (Note 3):		
Loss from operations of discontinued subsidiaries (including net loss on disposal of subsidiary assets of $24,478 for the five-month period ended October 4, 2008)	(15,350)	(9,269)
Income tax expense	(5,788)	(4,807)
Net loss from discontinued operations	$ (21,138)	$ (14,076)
Net loss	$ (50,778)	$ (96,785)
Loss per share:		
Continuing operations - basic	$ (1.45)	$ (4.07)
Continuing operations - diluted	$ (1.45)	$ (4.07)
Discontinued operations - basic	$ (1.03)	$ (0.69)
Discontinued operations - diluted	$ (1.03)	$ (0.69)
Net loss - basic	$ (2.48)	$ (4.76)

Net loss - diluted	$ (2.48)	$ (4.76)
Weighted average number of shares outstanding during the period		
Basic	20,472	20,341
Diluted	20,472	20,341

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

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HANDLEMAN COMPANY

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

FOR THE FIVE-MONTH PERIOD ENDED OCTOBER 4, 2008

AND THE FISCAL YEAR ENDED MAY 3, 2008

(GOING CONCERN BASIS)

(in thousands of dollars)

	Common Stock		Accumulated Other Comprehensive Income (Loss)				
	Shares Issued	**Amount**	**Foreign Currency Translation Adjustment**	**Employee Benefit Related**	**Additional Paid-in Capital**	**Retained Earnings**	**Total Shareholders Equity**
April 28, 2007	20,291	$ 203	$ 22,654	$ (5,240)	$	$ 220,366	$ 237,983
Net loss						(96,785)	(96,785)
Adjustment for foreign currency translation, net of tax of $2,301			(1,213)				(1,213)
Employee benefit plan related adjustment, net of tax of $(484)				898			898
Comprehensive loss, net of tax							(97,100)
Stock-based compensation:							
Performance shares/units	130	2			567		569
Stock options					(127)		(127)
Restricted stock and other	43				348		348
May 3, 2008	20,464	205	21,441	(4,342)	788	123,581	141,673
Net loss						(50,778)	(50,778)
Adjustment for foreign currency translation, net of tax of $(2,301)			(21,441)				(21,441)
Employee benefit plan related adjustment, net of tax of $1,208				(2,261)			(2,261)
Comprehensive loss, net of tax							(74,480)
Stock-based compensation:							
Performance shares/units	67				(73)		(73)
Restricted stock and other	(21)				106		106
October 4, 2008	20,510	$ 205	$	$ (6,603)	$ 821	$ 72,803	$ 67,226

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

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HANDLEMAN COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE FIVE-MONTH PERIOD ENDED OCTOBER 4, 2008 AND

THE FISCAL YEAR ENDED MAY 3, 2008 (GOING CONCERN BASIS)

(in thousands of dollars)

	For the Five Months Ended October 4, 2008	For the Fiscal Year Ended May 3, 2008
Cash flows from operating activities:		
Net loss	$ (50,778)	$ (96,785)
Adjustments to reconcile net loss to net cash provided from operating activities:		
Depreciation	2,126	15,844
Amortization of definite-lived intangible assets	2,630	7,961
Recoupment of development costs/licensed rights	1,533	11,120
Amortization of financing related fees	5,581	3,070
Loss on extinguishment of debt		3,068
Net loss on disposal of subsidiary assets	24,478	
Impairment of equity investments		3,805
Impairment of subsidiary assets and inventory markdowns		22,802
Impairment of goodwill	(1,294)	30,035
Gain on sale of investment		(957)
Unrealized investment income		(215)
Loss on disposal of property and equipment	88	770
Foreign currency translation adjustment	(15,598)	
Stock-based compensation	96	670
Retirement plans curtailment/settlement charges		148
Changes in operating assets and liabilities:		
Decrease in accounts receivable	120,714	78,906
Decrease in merchandise inventories	23,395	44,661
(Increase) decrease in other operating assets	(6,801)	6,579
Decrease in accounts payable	(62,208)	(74,491)
Decrease in other operating liabilities	(1,396)	(708)
Total adjustments	93,344	153,068
Net cash provided from operating activities	42,566	56,283
Cash flows from investing activities:		
Additions to property and equipment	(553)	(6,702)
License advances and acquired rights	(4,026)	(16,734)
Proceeds from sale of subsidiary assets	51,778	
Proceeds from escrow settlement for Crave Entertainment Group	1,294	
Proceeds from disposition of properties and equipment	239	150
Proceeds from sale of investment		1,217

Net cash provided from (used by) investing activities	48,732	(22,069)
Cash flows from financing activities:		
Issuances of debt	176,472	4,139,371
Repayments of debt	(240,178)	(4,182,574)
Financing related fees	(2,540)	(7,755)
Cash (payments) proceeds from stock-based compensation plans	(62)	120
Net cash used by financing activities	(66,308)	(50,838)
Effect of exchange rate changes on cash	(2,423)	(790)
Net increase (decrease) cash and cash equivalents	22,567	(17,414)
Cash and cash equivalents at beginning of year	1,043	18,457
Cash and cash equivalents at end of period	$ 23,610	$ 1,043

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless otherwise noted, the following Notes to Consolidated Financial Statements relate only to results from continuing operations.

1. Basis of Presentation

At the annual shareholders meeting on October 1, 2008, the Company s shareholders approved a Plan of Final Liquidation of the Company and on May 5, 2009, the Company filed a Certificate of Dissolution with the State of Michigan. Through the liquidation period, if the Company is able to generate cash proceeds in excess of what is needed to satisfy all the Company s obligations, the Company will distribute any such proceeds to shareholders. The actual amount and timing of future liquidating distributions, if any, to shareholders, will depend upon a variety of factors, including, but not limited to, the sale of the Company s corporate headquarters facility, collection of the remaining proceeds from the sale of Crave Entertainment Group, Inc. (Crave) and REPS LLC (REPS), ultimate settlement amounts of the Company s liabilities and obligations, and actual costs incurred in connection with carrying out the Company s Plan of Final Liquidation, including administrative costs during the liquidation period. However, based on the net asset position of the Company as of May 2, 2009, shareholder distribution is unlikely.

As a result of the Company s shareholders approval of the Plan of Final Liquidation, the Company adopted the liquidation basis of accounting as of October 5, 2008, which was the beginning of the fiscal month closest to the shareholders approval date.

The consolidated financial statements for the period ending October 4, 2008 were prepared on the going concern basis of accounting, which contemplated realization of assets and satisfaction of liabilities in the normal course of business. In the opinion of management, the accompanying Consolidated Statements of Operations, Shareholders Equity and Cash Flows contain all adjustments, including normal recurring adjustments, necessary to present fairly the results of operations and changes in cash flows for the five months then ended on a going concern basis. The Consolidated Balance Sheet as of May 3, 2008 included in this Form 10-K was derived from the audited consolidated financial statements of the Company included in the Company s fiscal year 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Liquidation Basis of Accounting

The liquidation basis of accounting is appropriate when the liquidation of a company appears imminent and the net realizable value of its assets is reasonably determinable. Under this basis of accounting, assets are stated at their net realizable value, liabilities are stated at their estimated settlement amounts, and estimated costs through the liquidation date are provided to the extent reasonably determinable.

The transition from the going concern basis of accounting to the liquidation basis of accounting required management to make significant estimates and judgments. The recording of assets at estimated net realizable value and liabilities at estimated settlement amounts under the liquidation basis of accounting required the Company to record the following adjustments as of October 5, 2008, the date of adoption of the liquidation basis of accounting (in thousands of dollars):

Adjustments of assets and liabilities:	Amount
Prepaid U.S. pension plan adjustment	$ 3,248
Write down of real estate	1,435
Write down of other fixed assets	689
Prepaid assets adjustment	771
Total	$ 6,143

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The adjustment of prepaid pension costs of $3,248,000 resulted from the write off of prepaid pension related balances in the United States (U.S.) and Canada, recorded under the going concern basis of accounting in accordance with Statement of Financial Accounting Standards (SFAS) No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans.

The Company reduced the carrying value of its corporate headquarters by $1,435,000 to its liquidation value based on recent sales of similar properties and current market conditions.

The adjustments of other fixed assets (computer software) and prepaid assets in the amounts of $689,000 and $771,000, respectively, were the result of these assets not having a net realizable value upon the Company s adoption of liquidation accounting.

The Company is required to make significant estimates and exercise judgment in determining accrued liquidation costs. The Company accrued costs expected to be incurred in liquidation and recorded payments made related to the accrued liquidation costs as follows (in thousands of dollars):

Accrued Liquidation Costs	**As Booked October 5, 2008**	**Adjustments to Reserves**	**Payments**	**Balance at May 2, 2009**
U.S. pension plan costs	$ 11,508	$ 5,912	$	$ 17,420
Outside services	6,701	849	(3,571)	3,979
Contractual commitments	4,699	2,062	(2,255)	4,506
Payroll related costs	4,216	3,278	(3,833)	3,661
Other	3,545	954	(1,964)	2,535
Total	$ 30,669	$ 13,055	$ (11,623)	$ 32,101

The Company has a qualified defined benefit pension plan that covers substantially all full-time U.S. employees. The Company performed an actuarial valuation analysis assuming the pension plan would be terminated through the purchase of non-participating group annuity contracts. This resulted in an estimated cost of $11,508,000 at October 5, 2008, which was included in accrued liquidation costs as of that date. The estimated cost to settle the U.S. pension plan as of October 5, 2008 was based upon an average discount rate of approximately 6.5%. This discount rate was derived from interest rates published by the Pension Benefit Guaranty Corporation for the specific purpose of determining the present value of annuities in involuntary and distress terminations of single-employer plans. As of October 5, 2008, the U.S. pension plan assets totaled $45,976,000 and the U.S. pension plan liability totaled $57,484,000.

The Company performed an actuarial valuation analysis as of May 2, 2009. As a result of this analysis, the estimated termination cost for the U.S. pension plan increased by $5,912,000 to $17,420,000 as of May 2, 2009. The U.S. pension plan assets at May 2, 2009 were $42,266,000 and the U.S. pension plan termination liability totaled $59,686,000 at May 2, 2009.

The termination cost of the Canadian pension plan was accrued for under the going concern basis of accounting and is not included in the accrued liquidation costs. As of May 2, 2009, the termination cost for the Canadian pension plan totaled $1,121,000. See Note 9 of Notes to Consolidated Financial Statements for additional information related to the Canadian pension.

The Company reviewed all other remaining operating expenses and contractual commitments such as payroll and related expenses, lease termination costs, professional fees and other outside services to determine the estimated costs to be incurred during the liquidation period. The payroll and related expenses as well as all other expenses are principally expected to occur through January 2010. The initial estimate of payroll related costs in the accrued costs of liquidation was increased by $3,278,000 for the period October 5, 2008 through May 2, 2009. This increase was

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

principally due to estimated payroll, severance and fringe benefit costs totaling $1,278,000 resulting from the sale of REPS taking significantly longer than anticipated, as well as higher than expected medical claims. Estimated payroll and severance costs for Crave also increased by $851,000 based upon the terms of the agreement for the sale of certain Crave assets. In addition, estimated payroll and fringe benefit costs increased by $597,000 due to corporate employees being retained beyond their originally scheduled departure dates, along with higher than anticipated medical costs. Contractual commitments cost increased by $2,062,000, primarily driven by an exclusive distribution arrangement at Crave, whereby $1,336,000 is payable to a licensor for guaranteed minimum product purchases.

Adjustments to Fair Value

The following table summarizes adjustments to fair value under the liquidation basis of accounting (in thousands of dollars):

Adjustments to fair value:	**October 5, 2008 through May 2, 2009**
Adjust Crave subsidiary to fair value	$ 16,309
Adjust REPS subsidiary to fair value	4,167
Adjust real estate to fair value	1,339
Adjust other fixed assets to fair value	677
Total loss	$ 22,492

Crave

The carrying value of Crave at October 5, 2008 was calculated based on estimated proceeds to be received upon sale based on an average of Letters of Intent received by the Company from prospective buyers as of that date. The Company recorded a loss of $16,309,000, net of legal expenses of $124,000, for the period October 5, 2008 through May 2, 2009, based on proceeds received at closing and estimated future proceeds to be received in accordance with the terms of the agreement. This deterioration in the carrying value of Crave was due to market conditions. During the fourth quarter of fiscal 2009, the Company entered into an asset purchase agreement with Fillpoint LLC (Fillpoint) related to the sale of certain assets of the Crave Entertainment subsidiary companies. The sale was completed on February 10, 2009 and the buyer purchased or obtained by license certain assets including: (i) all accounts receivable; (ii) all prepayments and prepaid expenses transferable and related to exclusive distribution or publishing contracts; (iii) all inventory, including goods returned by Crave s customers following the closing; (iv) all furniture, equipment, office supplies and data processing equipment; (v) all transferable Government Licenses; (vi) certain contracts, including Crave s exclusive distribution and publishing agreements; (vii) all proprietary rights; and (viii) all choses in action, rights and benefits under any warranties, rights and benefits under any indemnity provision other than those arising under the asset purchase agreement. Liabilities assumed as part of the transaction were: (i) obligations related to assumed contracts arising after the closing date; and (ii) certain trade and other payables.

The cash received at closing totaled $8,103,000, which consisted of $4,625,000 for accounts receivable; $3,518,000 for inventory; and $100,000 for property, plant and equipment; less accrued employee vacation liabilities assumed by Fillpoint of $140,000. Of the total purchase price for accounts receivable, 75% of current accounts receivable, net of reserves and allowances, and excluding the current accounts receivable owed by a certain customer, was paid with the remaining balance of the purchase price to be paid by Fillpoint only as such accounts receivable are collected. Of the total inventory purchase price, half of the purchase price for the inventory on hand at close

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

was paid and the remaining balance is to be paid subsequent to the closing date. Following the closing, the Company will receive: (i) periodic cash payments related to the collection of a certain customer s current accounts receivable, the collection of other current accounts receivable in excess of the amount received by the Company at closing and the collection of non-current accounts receivable in excess of the amount received by the Company at closing, less collection fees; and (ii) 12.50% of the inventory purchase price (in addition to payment for inventory returned to Fillpoint from customers after closing, less a 5% restocking fee) on each of April 10, 2009, June 10, 2009, August 10, 2009 and October 10, 2009. The carrying value of Crave considered estimated future proceeds related to accounts receivable and inventory in the amounts of $1,646,000 and $3,518,000, respectively, based on the terms of the asset purchase agreement. Payments received in fiscal 2009 related to these estimated future proceeds totaled $1,567,000 for accounts receivable collections and $880,000 for inventory (25% of the remaining balance due). The Company believes the remaining balance due will be collected in full. Fillpoint also agreed to pay the Company 50% of the net profit in excess of $300,000 realized during the 24-month period following the closing with respect to the sale of video games published by Fillpoint and acquired as part of exclusive distribution or publishing agreements assumed by Fillpoint as part of the transaction. The Company has not recorded an asset related to this arrangement because the amount due is not estimable at this time. No payments have been received by the Company related to this exclusive distribution arrangement as of the filing of this Form 10-K.

REPS

The carrying value of REPS at October 5, 2008 was calculated based on estimated proceeds to be received upon sale based on an average of Expression of Interest Letters received by the Company from prospective buyers as of that date. The Company recorded a loss of $4,167,000, net of legal expenses of $17,000, for the period October 5, 2008 through May 2, 2009 based on proceeds received at closing and estimated future proceeds to be received in accordance with the terms of the agreement. This deterioration in the carrying value of REPS was due to market conditions. During the fourth quarter of fiscal 2009, the Company entered into an asset purchase and assignment agreement with Mosaic Sales Solutions US Operating Co. LLC (Mosaic) related to the sale of certain assets of REPS. This sale was completed on April 6, 2009 and Mosaic purchased or assumed certain assets including (i) all contracts, agreements and other arrangements with certain REPS customers; (ii) all promotion lists, marketing data and advertising materials used in the REPS business; (iii) all lists of REPS customers, suppliers, vendors, prospects and others having a business relationship with REPS; and (iv) all laptop or personal computer equipment or hardware owned by REPS and used by employees of REPS who became employees of Mosaic, with the exception of mobile hardware.

Assets excluded from the agreement included: (i) all cash and cash equivalents; (ii) all current assets of the REPS; (iii) all other contracts and agreements not identified in the agreement, including all office leases related to REPS office space and other contract agreements or other arrangements with third party vendors; (iv) all mobile hardware and related software; and (v) all securities and other investments held by REPS. Mosaic will only assume liability for all obligations that arise, accrue and first become due after April 6, 2009, the closing date, related to the purchased customer contracts. All other REPS liabilities are retained by the Company.

As consideration for this purchase, Mosaic advanced a cash payment of $250,000 against future revenue sharing, as defined in the agreement. Mosaic will also pay the Company, on a calendar quarterly basis, an amount equal to the revenue sharing amount, which equals 10% of actual revenues earned during the calendar quarter from purchased customer contracts and is not to exceed $1,250,000 in the aggregate. The revenue sharing amount is defined as a percentage of gross annual revenue directly related to purchased customer contracts booked by Mosaic during the twelve-month period subsequent to the closing date as follows: (i) 10% if gross annual revenue is less than $2,000,000; (ii) 12% if gross annual revenue is greater than $1,999,999.99 and less than

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

$5,000,000; or (iii) 15% if gross annual revenue is greater than $4,999,999.99. At each six-month and twelve-month anniversary after the closing date, a reconciliation and settlement of payments will occur. The Company has not recorded an asset related to any future estimated proceeds of REPS because the amount was not estimable beyond the $250,000 advance. Handleman has provided customary representations and warranties as of the closing date.

Real Estate and Other Fixed Assets

The Company recorded a loss on the carrying value of its corporate headquarters in the amount of $1,339,000 for the period October 5, 2008, through May 2, 2009, under the liquidation basis of accounting. This write down was mainly driven by further deterioration in financial market conditions. The Company also recorded a loss on the carrying value of other fixed assets of $677,000 for the period October 5, 2008 through May 2, 2009 (mainly computer hardware) due to lack of interest from third-party buyers, as well as a further decline in overall economic conditions.

Dissolution

On May 5, 2009, Handleman Company filed a Certificate of Dissolution with the State of Michigan. As a dissolved company, Handleman will continue its corporate existence, but will not conduct business, except for the purpose of winding down the business. Accordingly, Handleman s activities are now limited to: selling, collecting or otherwise realizing the value of its remaining assets; making tax and other regulatory filings; winding down the Company s remaining business activities; paying (or adequately providing for the payment) of all non-barred, valid claims and obligations; and making distributions to Handleman s shareholders. Based on the Company s net asset balance as of May 2, 2009, proceeds from the liquidation of assets will be insufficient to provide payment in full to its unsecured creditors or any distribution to shareholders. Payments during the liquidation period will be prioritized in the following hierarchy: (i) wind down related costs, including supplier costs necessary to the wind down of the business and employee obligations such as on-going salaries, fringe benefits and retention costs; (ii) income tax and other regulatory filing fees; (iii) payments of other unsecured valid creditor claims and obligations, including the purchase of non-participating group annuity contracts or lump sum payments (Canada) to supplement the terminated U.S. and Canadian pension plans; and (iv) shareholder distribution. Creditors will be paid according to their priority in the hierarchy and pro rata within the priority category. It is likely that payment of creditor claims will not be made for at least six to twelve months in order to provide funds for payment to creditors yet unknown. The actual amount and timing of cash distributions will depend on a variety of factors, including, but not limited to, the sale of the Company s remaining assets, collection of the proceeds from the sale of Crave and REPS, ultimate settlement of liabilities, actual costs incurred in connection with the wind down of operations, and market fluctuations in the discount rate as it relates to the settlement of the pension plans.

2. Accounting Policies

Liquidation Basis of Accounting

Accrued Liquidation Costs

Under the liquidation basis of accounting, assets are stated at their net realizable value, liabilities are stated at their estimated settlement amounts and estimated costs through the liquidation date are accrued for, to the extent reasonably determinable.

The transition from the going concern basis of accounting to the liquidation basis of accounting required management to make significant estimates and judgments in many areas. These estimates are subject to change based upon the timing of potential sales and further deterioration in market

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

conditions. The Company reviews, on a quarterly basis, the estimated fair value of its assets and all other remaining operating expenses and contractual commitments such as payroll and related expenses, lease termination costs, professional fees and other outside services to determine the estimated costs to be incurred during the liquidation period.

Pension Expense

Handleman Company will terminate its U.S. pension plan and purchase a non-participating group annuity contract for all plan participants subject to regulatory approval. Under the liquidation basis of accounting, actuarial valuation analyses are prepared quarterly to determine the fair value, or termination value, of the plan. These valuations and the ultimate liability to settle the plan may result in adjustments driven by changes in assumptions due to market conditions.

Handleman Company terminated its Canadian pension plan in the first quarter of fiscal 2009 and will purchase either non participating annuity contracts or make lump-sum payments to participants in the Canadian pension plan following regulatory approval by the Finance Service Commission of Ontario. The Company accrued the termination value of the Canadian pension plan under the going concern basis of accounting.

The liabilities related to these pension plans will be settled at the same payout percentage as all other unsecured creditor claims.

Long-Lived Assets

Long-lived assets are recorded at net realizable value based on valuations, purchase agreements and/or letters of intent from interested third parties, when available. If third-party interest or valuations are unavailable, management relies on a probability weighted cash flow estimation approach.

Income Taxes

The provision for income taxes is based on reported income before income taxes. The Company is required to adjust its effective tax rate for each quarter to be consistent with the estimated annual effective tax rate and record the tax impact of certain discrete items, including changes in judgment about valuation allowances and effects of changes in tax laws or rates, in the interim periods in which they occur. Income taxes are allocated between continuing operations, discontinued operations and other comprehensive income by tax jurisdiction and, in periods in which there is a pre-tax loss from continuing operations and pre-tax income in another category, such as discontinued operations or other comprehensive income, tax expense is allocated to the other sources of income, with a related benefit recorded in continuing operations.

Deferred income taxes are provided for the effect of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and amounts recognized for income tax purposes. Valuation allowances are recognized to reduce deferred tax assets when it is more likely than not that the assets will not be realized. In assessing the likelihood of realization, consideration is given to all available evidence including estimates of future taxable income and the character of income needed to realize future benefits. Based on information available to date, the Company recorded any income tax receivable or payable for the ultimate tax amount owed to wind down the Company. The calculation of current and deferred tax assets (including valuation allowances) and liabilities requires management to apply significant judgment related to the application of complex tax laws, changes in tax laws or related interpretations, uncertainties related to the outcomes of tax audits and changes in the Company s operations or other facts and circumstances. Further, management must continually monitor changes in these factors. Changes in such factors may result in changes to management estimates and could require the Company to

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

adjust its tax assets and liabilities and record additional income tax expense or benefits. With the adoption of FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, in fiscal 2008, Handleman Company makes assumptions about individual tax positions before any part of the related benefit can be recognized in its financial statements. A company must consider whether it is more likely than not that a tax position will be sustained upon examination by a taxing authority. In accordance with FIN No. 48, significant judgment is required in assessing the timing and amounts of deductible and taxable items. The Company establishes reserves when, despite its belief that its tax return positions are supportable, it is determined that certain positions may be successfully challenged by the taxing authorities. When facts and circumstances change, the Company adjusts these reserves through its provision for income taxes.

The Company s estimates of tax implications related to the liquidation of the Company are subject to change. Accordingly, the amount of liability, if any, will be included in the Company s financial statements as changes in estimates occur.

Going Concern Basis of Accounting

Business

Handleman Company previously had the following reporting segments: category management and distribution operations, video game operations and all other. As a category manager and distributor of product, the Company created value for its customers by leveraging its core competencies of logistics services, field services and intellectual services. Prior to fiscal 2009, the Company predominately provided full category management services for prerecorded music product to leading retail chains in the U.S., United Kingdom (UK) and Canada. The video game operations were related to Crave and the all other segment primarily represented REPS.

Fiscal Year

The Company s fiscal year ends on the Saturday closest to April 30. The fiscal year ended May 2, 2009 (fiscal 2009) consisted of 52 weeks and the fiscal year ended May 3, 2008 (fiscal 2008) consisted of 53 weeks.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all subsidiaries where the Company has voting control. All intercompany accounts and transactions have been eliminated. All subsidiary companies are wholly owned. The Company does not have any significant equity investments other than in companies in which it has voting control.

The Company had intercompany transactions between its U.S. category management and distribution operations and REPS related to revenues and expenses resulting from REPS providing field service for the U.S. music business. As these revenues and expenses are not on-going, costs and associated eliminations have been classified as discontinued operations in the Company s Consolidated Statements of Operations for all periods presented.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Foreign Currency Translation

The Company s foreign subsidiaries utilized the local currency as their functional currency. Therefore, the Company followed the guidance outlined in SFAS No. 52, Foreign Currency Translation, to convert the balance sheets and statements of operations of its foreign subsidiaries to United States dollars. The Company used an average exchange rate for the period, based on published daily rates, to convert foreign operational transactions to United States dollars. Assets and liabilities of foreign subsidiaries were converted to United States dollars using the prevailing published exchange rate on the last business day of the fiscal period. Common stock and additional paid in capital were converted at historical exchange rates. Resulting translation adjustments are included as a component of Accumulated other comprehensive income in the Company s Consolidated Balance Sheets as of May 3, 2008. Net transaction gains included in Selling, general and administrative expenses from continuing operations in the Company s Consolidated Statements of Operations were $50,000 and $1,029,000 for the five-month period ended October 4, 2008 and the fiscal year ended May 3, 2008, respectively.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. The Company has deposits in a bank account in excess of FDIC limits.

Accounts Receivable

The table below presents information about the components of the accounts receivable balance included in the Company s Consolidated Balance Sheet as of May 3, 2008 (in thousands of dollars):

	May 3, 2008
Trade accounts receivable	$ 65,081
Less allowances for:	
Gross profit impact of estimated future returns	(440)
Doubtful accounts	(2,162)
Accounts receivable, net	$ 62,479

Inventory Valuation

Merchandise inventories were recorded at the lower of cost (average cost method) or market. The Company accounted for inventories using the full cost method which included costs associated with acquiring and preparing inventory for distribution. Costs associated with acquiring and preparing inventory for distribution of $3,307,000 and $14,801,000 were incurred during the five months ended October 4, 2008 and the fiscal year ended May 3, 2008, respectively, and were classified as discontinued operations in the Company s Consolidated Statements of Operations. Merchandise inventories as of October 4, 2008 and May 3, 2008 included $269,000 in each period of such costs.

Prior to the liquidation of assets, the Company s inventory consisted substantially of compact discs and video game hardware and software, which are not substandard from a functional standpoint. Typically, the Company s music suppliers offered return privileges for excess inventory quantities. Therefore, inventory reserves were provided for the risk that exists related to the carrying value of non-returnable slow moving inventory that may have exceeded market value, although the effect of markdowns was minimized since the Company s music vendors generally offered some level of return allowances and price protection.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Long-Lived Assets

The Company accounted for long-lived assets in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This Statement applies to long-lived assets other than goodwill, and prescribes a probability-weighted cash flow estimation approach to evaluate the recoverability of the carrying amount of long-lived assets such as property, plant and equipment. See Note 4 of Notes to Consolidated Financial Statements for information related to long-lived asset impairment charges recorded in fiscal 2008.

Common Stock Repurchases

The Company is authorized to repurchase shares of its common stock pursuant to authorizations approved by its Board of Directors. Upon repurchase, the Company immediately retires the shares and, as a result, records a reduction in the number of common shares outstanding along with a reduction to additional paid-in-capital (representing the excess of the purchase price over the par value of the shares repurchased) in the period of repurchase/retirement. These transactions generally result in a negative balance in additional paid-in-capital. In the event of an active repurchase program, the negative balance in additional paid-in-capital is subsequently reclassified to retained earnings. The effect of these share repurchase transactions on common shares and shareholders equity is included in the Company s Consolidated Statements of Shareholders Equity for all periods presented. The Company has not repurchased shares since fiscal 2006.

Selling, General and Administrative Expenses

The major components of the Company s selling, general and administrative expenses from continuing operations included in its Consolidated Statements of Operations were as follows:

labor expense, which includes corporate office labor and stock-based compensation expense, along with associated payroll taxes and fringe benefits;

outside information technology related service expenses;

depreciation expense;

travel expense;

banking fees;

- outside consulting expense; and

- repairs and maintenance expense.

Income Taxes

The provision for income taxes is based on reported income before income taxes. The Company is required to adjust its effective tax rate for each quarter to be consistent with the estimated annual effective tax rate and record the tax impact of certain discrete items, including changes in judgment about valuation allowances and effects of changes in tax laws or rates, in the interim periods in which they occur. Income taxes are allocated between continuing operations, discontinued operations and other comprehensive income by tax jurisdiction and, in periods in which there is a pre-tax loss from continuing operations and pre-tax income in another category, such as discontinued operations or other comprehensive income, tax expense is first allocated to the other sources of income, with a related benefit recorded in continuing operations. Deferred income taxes are provided for the effect of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and amounts recognized for income tax purposes. Valuation allowances are recognized to reduce deferred tax assets when there is a higher probability the assets will not be realized. In assessing the likelihood of realization, consideration is given to estimates of future taxable income, the character of income needed to realize future benefits and all available evidence. With the adoption of FIN No. 48 in fiscal 2008, Handleman Company makes assumptions about individual tax positions before any part of the related benefit can be recognized in its financial statements. A company must consider whether it is more likely than not that a tax position will be sustained upon examination by a taxing authority. In accordance with FIN No. 48, significant judgment is required in assessing the timing and amounts of deductible and taxable items. The Company establishes reserves when, despite its belief that its tax return positions are supportable, it is determined that certain positions may be successfully challenged by the taxing authorities. When facts and circumstances change, the Company adjusts these reserves through its provision for income taxes.

Value-added taxes are presented in the Company s Consolidated Statements of Operations on a net-basis, that is, they are excluded from revenues.

Earnings Per Share

The Company computed diluted earnings per share from net loss in accordance with SFAS No. 128, Earnings Per Share.

No additional shares related to stock options issued by the Company were included in the computation of diluted weighted average shares because the options exercise prices were greater than the average market price of the common shares or as a result of the net losses for the periods presented.

New Accounting Pronouncements

Although many new accounting pronouncements were issued during fiscal 2009, the following pronouncements were applicable to the Company as a result of the Company s transition to the liquidation basis of accounting.

SFAS No. 157

In September 2006, SFAS No. 157, Fair Value Measurements, was issued by the FASB. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements; however, this pronouncement does not require any new fair value measurements. The Company adopted this portion of the Statement for the fiscal year beginning May 3, 2009. The effective date for SFAS No. 157 has been delayed by the FASB for non financial assets and non financial liabilities. SFAS No. 157 was effective for financial assets and liabilities of the Company for the fiscal year beginning May 4, 2008 for items that are recognized or disclosed at fair value in an entity s financial statements on a recurring basis. The Statement did not have a material impact on the Company s consolidated financial statements.

SFAS No. 159

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115. SFAS No. 159 allows companies to irrevocably elect to recognize most financial assets and financial liabilities at fair value on an instrument-by-instrument basis. Unrealized gains and losses will be reported in earnings at each reporting date. The cumulative effect of re-measuring such instruments to fair value at adoption is accounted for as an adjustment to the beginning balance of retained earnings. SFAS No. 159 was effective for the Company s fiscal year beginning May 4, 2008, and did not have a significant impact on the Company s consolidated financial statements.

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SFAS No. 165

In May 2009, the FASB issued SFAS No. 165, Subsequent Events. This Statement establishes general standards of accounting for and disclosures of events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009 and as such, the Company will adopt this Statement in the first quarter of fiscal 2010. SFAS No. 165 is not expected to materially impact the Company s consolidated financial statements.

3. Disposal of Long-Lived Assets Going Concern Accounting

Assets Held for Sale

During the fourth quarter of fiscal 2008, management committed to a plan that was approved by the Company s Board of Directors in April 2008, to exit the North American music business and entered into negotiations with Anderson Merchandisers L.P. (Anderson) for the sale of certain U.S. and Canadian assets and operations. Therefore, the Company classified the assets and liabilities of its U.S. and Canadian music operations as held for sale in its Consolidated Balance Sheet as of May 3, 2008, in accordance with the guidance provided in SFAS No. 144.

The table below summarizes the major categories of assets and liabilities held for sale at May 3, 2008 (in thousands of dollars):

Assets Held for Sale	**May 3, 2008**
Accounts receivable	$ 94,420
Merchandise inventories	37,803
Property and equipment, net	7,635
Other assets	85
Total assets held for sale	$ 139,943
Liabilities Held for Sale	
Accounts payable	$ 56,839
Accrued and other liabilities	5,459
Total liabilities held for sale	$ 62,298

Music Business in North America

Pursuant to the decision to exit the music business in North America, Handleman Company entered into separate arrangements with Anderson related to its U.S. and Canadian operations during the first quarter of fiscal 2009. The Company announced on June 2, 2008 that it entered into a definitive Asset Purchase Agreement (APA) with Anderson to purchase a portion of the U.S. music inventory and all of the store display fixtures related to its Wal-Mart Stores, Inc. (Wal-Mart) business in the U.S. The APA was effective on June 2, 2008, at which time the Company ceased providing music category management and distribution services to Wal-Mart in the U.S. The Company s remaining non-Wal-Mart category management and distribution customers were substantially transitioned to other suppliers by the end of August 2008. Pursuant to this agreement, an initial purchase of U.S. music inventory was delivered to Anderson, FOB shipping point, from the Company s Indianapolis, Indiana automated distribution center.

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The price paid by Anderson for the initial purchase of U.S. music inventory was $10,783,000, which equaled Handleman s supplier invoice cost. The price paid by Anderson for the purchase of the Wal-Mart retail display fixtures was $3,629,000, which equaled the net book value of the fixtures as of June 2, 2008. Anderson also paid Handleman $175,000 for transition related services and $5,000,000 as compensation for costs related to handling, packaging, shipping, warehousing, billing and management costs incurred by Handleman in connection with the closing. The Anderson APA related to the U.S. sale of assets resulted in a gain on the sale of $5,124,000, net of legal expenses of $51,000, and generated net cash proceeds of $19,536,000 during the first quarter of fiscal 2009. The gain on the sale was recognized in the first quarter of fiscal 2009 and was included in discontinued operations in the Company s Consolidated Statements of Operations; all of the proceeds from the U.S. sale were used to pay Handleman s lenders and reduce outstanding loan balances.

Also, in accordance with the APA, an additional inventory purchase by Anderson occurred in early September 2008. The additional U.S. inventory purchase by Anderson totaled $1,255,000. This was the final purchase of U.S. music inventory by Anderson. The proceeds were received during the second quarter of fiscal 2009 and were used to pay Handleman s lenders and reduce outstanding loan balances.

In July 2008, the Company signed a definitive agreement with Anderson to sell all of the music inventory, fixed assets and operations of its Canadian subsidiary, inclusive of customer relationships. This sale was completed on September 2, 2008. Anderson paid Handleman Canada $10,800,000 for the music inventory, $2,738,000 for the net book value of fixed assets, $10,000 for prepaid expenses, plus $1,000,000, less $1,753,000 in assumed liabilities. The total net proceeds of $12,602,000 were received in the second quarter of fiscal 2009, less $750,000, which was being held in escrow for certain representations and warranties (the Company has collected $500,000 of the amount held in escrow as of May 2, 2009). The sale of this Canadian subsidiary resulted in a gain of $419,000, net of legal expenses of $193,000, in the second quarter of fiscal 2009, which was included in discontinued operations in the Company s Consolidated Statements of Operations. The net cash proceeds received at closing were used to pay Canadian trade accounts payable and reduce outstanding loan balances.

Anderson also agreed to pay the Company a $4,000,000 incentive fee if Handleman identified, sold or transitioned to Anderson any other Handleman business that added value to the U.S. music transaction. The sale of the Canadian subsidiary on September 2, 2008 fulfilled this incentive requirement. The $4,000,000 incentive fee was received during the second quarter of fiscal 2009 upon completion of the Canadian sale and was included in discontinued operations in the Company s Consolidated Statements of Operations.

Handleman United Kingdom

Handleman UK began providing distribution, replenishment and store merchandising services to Tesco Stores Limited (Tesco) in support of its entertainment businesses specifically music, video and video games at the beginning of fiscal 2008. Under this arrangement, Tesco retained title to the inventory, which was housed in and distributed from a Handleman UK distribution facility. During the first quarter of fiscal 2009, the Company began actively marketing the Tesco-related assets of Handleman UK by initiating conversations with Tesco and reached an agreement in principle with Tesco to sell certain assets and assume all of the operations related to the Tesco category management and distribution operations, as well as to transfer certain of the Company s intellectual properties to Tesco. The Handleman UK operations have been reclassified as discontinued operations in the Company s Statements of Operations for all periods presented in accordance with the guidance provided in SFAS No. 144.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The sale to Tesco was completed on September 16, 2008. The purchase price paid by Tesco totaled $16,687,000 and related to all of the fixed assets located in the Tesco-dedicated distribution center; certain licensed assets; proprietary computer software held by the Company s corporate subsidiary; certain business contracts; and certain leased assets and motor vehicles. The sale of assets to Tesco resulted in a gain of $188,000, net of legal expenses of $357,000, in the second quarter of fiscal 2009, which was recorded in discontinued operations in the Company s Consolidated Statements of Operations. The proceeds from this sale, net of $2,663,000 which was held in escrow for certain indemnifications at the time of sale, were also received in the second quarter of fiscal 2009 and were used to pay UK trade accounts payable, reduce outstanding loan balances and provide cash for operations. The Company has $596,000 remaining in escrow as of May 2, 2009. At the time of this sale all related assets and services of Handleman UK were transitioned to Tesco. Following its discontinuance of business with Tesco, Handleman UK had no on-going operations other than winding down its former business relationship with ASDA, which was completed during fiscal 2009. Handleman UK is undergoing a members voluntary liquidation, which is a formal process by which solvent companies wind down their operations in the UK. This liquidation is expected to be completed in the second quarter of fiscal 2010.

Crave Entertainment

During the fourth quarter of fiscal 2008, the Company announced that it retained an investment banking firm for the purpose of exploring possible strategic options for Crave. An Offering Memorandum for Crave was completed in June 2008 and the Company decided, upon Board approval, to begin actively marketing Crave for sale at that time. The Crave operations have been reclassified to discontinued operations in the Company s Statements of Operations for all periods presented in accordance with the guidance provided in SFAS No. 144.

In accordance with SFAS No. 144, the Company considered Crave held for sale and adjusted its carrying value at August 2, 2008 and October 4, 2008 under the going concern basis of accounting. A $26,634,000 loss was recorded for the period May 4, 2008 through October 4, 2008 under the going concern basis of accounting. This loss was calculated using projected cash flows prepared by the Company. This loss was recorded in discontinued operations in the Company s Consolidated Statements of Operations. See Note 1 of Notes to Consolidated Financial Statements for a more detailed discussion on the losses recorded related to the carrying value of Crave.

REPS LLC

In July 2008, the Company retained an investment banking firm to explore strategic options for REPS. An Offering Memorandum for REPS was completed late in the first quarter of fiscal 2009, and the Company began actively marketing REPS for sale early in the second quarter of fiscal 2009. The REPS operation has been reclassified to discontinued operations in the Company s Statements of Operations for all periods presented, in accordance with SFAS No. 144.

In accordance with SFAS No. 144, the Company considered REPS held for sale during the second quarter of fiscal 2009 and adjusted its carrying value at October 4, 2008 under the going concern basis of accounting. The $7,577,000 loss was calculated based on estimated proceeds to be received upon sale based on an average of Expression of Interest Letters received by the Company from prospective buyers. This loss was recorded in discontinued operations in the Company s Consolidated Statements of Operations. See Note 1 of Notes to Consolidated Financial Statements for a more detailed discussion on the losses recorded related to the carrying value of REPS.

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Discontinued Operations

The results of operations for the U.S., Canadian and Handleman UK music category management and distribution businesses, as well as Crave and REPS, are reported in discontinued operations in the Company s Consolidated Statements of Operations for all periods presented in accordance with the guidance in SFAS No. 144. After completion of these sales transactions and the wind down of the remaining business activities, the operations and cash flows of these business units were eliminated from the ongoing operations of the Company, and the Company does not have any continuing involvement in the operations of these businesses.

Upon completion of the Canadian and Handleman UK asset purchase agreements, all of their music category management and distribution operations were transitioned to the buyers in the second quarter of fiscal 2009. As a result, in accordance with SFAS No. 52, the Company recorded foreign currency translation gains of $4,321,000 and $11,320,000 related to the Canadian and UK operations, respectively, offset in part by a foreign currency translation loss of $43,000 related to other foreign operations, resulting from the substantial liquidation of the investments in these businesses. These amounts were recorded in discontinued operations in the Company s Consolidated Statements of Operations in the second quarter of fiscal 2009 under the going concern basis of accounting.

The U.S., Canadian and Handleman UK music operations were previously included in the category management and distribution operations reporting segment, whereas Crave and REPS were previously included in the video game operations and all other reporting segments, respectively. All of the assets and liabilities classified as held for sale in the Company s Consolidated Balance Sheet as of May 3, 2008 were in the category management and distribution operations reporting segment.

The table below summarizes the discontinued operations included in the Company s Consolidated Statements of Operations, by segment, for the five months ended October 4, 2008 and the fiscal year ended May 3, 2008 (in thousands of dollars):

	Category Management and Distribution Operations	Video Game Operations	All Other
	Five Months Ended October 4, 2008		
Revenues	$ 117,895	$ 89,561	$ 5,207
Pre-tax income (loss) from operations excluding net loss on disposal of subsidiary assets for the five months ended October 4, 2008	8,475	3,866	(3,213)
	Fiscal Year Ended May 3, 2008		
Revenues	$ 884,094	$ 259,568	$ 15,462
Pre-tax income (loss) from operations	23,049	(21,335)	(10,983)

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4. Impairment and Other Charges

Impairment Charges Fiscal 2008

The following table summarizes the impairment charges recorded during fiscal 2008 by reporting segment and included in the Company s Consolidated Statements of Operations (in thousands of dollars):

	Category Management and Distribution Operations	Corporate
Computer software corporate	$	$ 14,490
Total impairment charges included in continuing operations	$	$ 14,490
UK machinery and equipment Tesco business	$ 1,275	$
UK machinery and equipment greeting cards business	1,432	
U.S. machinery and equipment U.S. music business	1,483	
Total impairment charges included in discontinued operations	$ 4,190	$

In light of the change in the Company s future outlook, the Company reviewed its long-lived assets for potential impairment as of the end of fiscal 2008. In April 2008, the Company s Board of Directors approved that the Company exit the music distribution business in North America and enter into an agreement in principle with Anderson for select U.S. music inventory and all of the store fixtures related to the Wal-Mart business. During the first quarter of fiscal 2009, the Company also began discussions with Tesco, and reached an agreement in principle to sell certain assets and assume all of the operations related to its UK category management and distribution business related to Tesco. Based on the revised Company outlook and the projected cash flows for these business units, impairment analyses were performed in accordance with the guidance in SFAS No. 144, and as a result, certain assets were deemed impaired; accordingly, impairment charges of $15,765,000 were recorded in the fourth quarter of fiscal 2008. These charges primarily related to certain Handleman corporate proprietary and licensed computer software to be transferred to Tesco at the close of the asset purchase agreement with Tesco and Handleman UK s machinery and equipment and related assets that were used exclusively for the storage and distribution of Tesco inventory to Tesco stores under their current business arrangement.

In addition, an impairment charge related to U.S. machinery and equipment in the Indianapolis, Indiana distribution center, and leasehold improvements on that facility, was recorded in the fourth quarter of fiscal 2008 in the amount of $1,483,000.

During the third quarter of fiscal 2008, Handleman UK and its customer ASDA determined that their business relationship related to the greeting cards business, which began in October 2006, would terminate in May 2008. This decision was mainly due to the customer s desire to work directly with the greeting cards vendor to service its retail stores. Upon cessation of this greeting cards business relationship, ASDA was no longer a customer of Handleman UK. Management determined that events leading up to and resulting in this separation represented a triggering event during the third quarter of fiscal 2008. In accordance with SFAS No. 144, the Company recorded a fixed asset impairment charge of $1,432,000 in the third quarter of fiscal 2008 primarily related to Handleman UK s machinery and equipment and related assets that were used exclusively for this product line.

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No significant impairment charges were recorded for the five months ended October 4, 2008.

Wind Down of the Music Business in North America

Under the going concern basis of accounting, the Company incurred one-time costs related to its decision to exit the music business in North America. These costs were recorded in accordance with the guidance provided in SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, and related to the category management and distribution operations reporting segment. Costs to be incurred after October 4, 2008 have been estimated and included in accrued liquidation costs under the liquidation basis of accounting.

The following table summarizes one-time costs incurred in the first five months of fiscal 2009 related to the exiting of the music business in North America, which have been recorded in discontinued operations in the Company s Consolidated Statements of Operations (in thousands of dollars):

	Five Months Ended October 4, 2008		
	Severance/ Retention Costs	Contract Termination Costs	Other Costs
Balance as of May 3, 2008	$	$	$
Expensed during the period	8,099	1,370	268
Cash paid during the period	(3,737)	(1,370)	(268)
Balance as of October 4, 2008	$ 4,362	$	$

In addition to the one-time costs identified above, the Company recorded inventory markdowns in the amounts of $2,200,000 and $2,760,000 during the fourth quarter of fiscal 2008 and the first quarter of fiscal 2009, respectively, representing the Company s best estimate of the adjustment necessary to write down inventory to net realizable value. These inventory markdowns were recorded in discontinued operations in the Company s Consolidated Statements of Operations.

Handleman United Kingdom

Under the going concern basis of accounting, the Company incurred one-time costs related to the sale of the Tesco-related business (which was completed in the second quarter of fiscal 2009) and the wind down of the remaining UK operations. These costs were recorded in accordance with SFAS No. 146.

In the UK, there is a statutory obligation for companies to pay severance, upon termination, to employees who will neither be transferred to a new organization (if applicable) under the Transfer of Undertakings (Protection of Employment) regulations, nor be retained by the existing company in some other capacity. This statutory requirement is the equivalent of a benefit plan and is subject to the guidance in SFAS No. 112, Employers Accounting for Postemployment Benefits, an amendment of FASB Statements No. 5 and 43, because there is a mutual understanding between the employee and the company. A substantial majority of the employees in Handleman UK transitioned with the operations to Tesco upon closing of the asset purchase agreement in the second quarter of fiscal 2009. The Company recorded severance costs of $364,000 in the first five months of fiscal 2009 for the employees discharged related to the wind down of the remaining UK operations. In the first five months of fiscal 2009, the Company incurred legal fees of $445,000 related to the wind down of the UK business. These costs all related to the category management

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and distribution operations reporting segment and were charged to discontinued operations in the Company s Consolidated Statements of Operations. Costs to be incurred after October 4, 2008 to complete the wind down of the Handleman UK business have been estimated and included in accrued liquidation costs under the liquidation basis of accounting.

Handleman UK/ASDA Greeting Cards Supply Arrangement

During the third quarter of fiscal 2008, Handleman UK determined, in conjunction with its customer (ASDA), that their business relationship related to the greeting cards business, which began in October 2006, would terminate in May 2008. This decision was mainly due to the customer s desire to work directly with the greeting cards vendor to service its retail stores. Upon cessation of this greeting cards business relationship, ASDA was no longer a customer of Handleman UK.

The following table summarizes one-time costs incurred under the going concern basis of accounting in the first five months of fiscal 2009 and since the third quarter of fiscal 2008 when the decision was made to exit the ASDA greeting cards business in the UK. These costs related to the category management and distribution operations reporting segment and have been recorded in discontinued operations in the Company s Consolidated Statements of Operations (in thousands of dollars):

	Five Months Ended October 4, 2008	Incurred Prior to Fiscal 2009	Total Costs Incurred
Merchandise penalties and inventory shrinkage	$	$ 247	$ 247
Vehicle termination fees		176	176
Severance costs	61		61
	$ 61	$ 423	$ 484

In the greeting cards business model, Handleman UK did not own the greeting cards product until the product was shipped from its facility. Accordingly, no inventory markdown to liquidation value was required. The payment of one-time costs related to the termination of the greeting cards business was completed in fiscal 2009.

Handleman UK/ASDA Music Supply Arrangement

On May 24, 2007, the Company announced that Handleman UK and ASDA decided not to continue their music supply arrangement. Under this arrangement, Handleman UK provided category management and distribution of music CDs and, to a limited extent, DVDs to ASDA stores. The decision not to continue the music supply arrangement was due to the inability of Handleman UK and ASDA to reach terms that were mutually beneficial. Handleman UK provided music category management and distribution services to ASDA through August 2007.

Management determined that events leading up to and resulting in this separation represented an impairment triggering event during the fourth quarter of fiscal 2007 and recorded an inventory markdown at that time, representing the Company s best estimate of the adjustment necessary to mark inventory down to liquidation value. The Company recorded an additional inventory markdown of $1,922,000 in the fourth quarter of fiscal 2008. The Company completed the liquidation of the remaining inventory in the first quarter of fiscal 2009. Exit costs associated with this termination have been recorded in accordance with SFAS No. 146. During fiscal 2008, the Company incurred $2,674,000 in one-time costs related to the discontinuance of the ASDA music business under the going concern basis of accounting. These costs included $1,079,000 related to warehouse and storage costs incurred to liquidate inventory; $850,000 related to inventory liquidation retail outlets;

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$655,000 related to third-party consulting costs; and $90,000 related to vehicle contract termination costs. In accordance with UK Transfer of Undertakings (Protection of Employment) regulations, the Company accrued severance costs of $253,000 during fiscal 2008. These amounts were included in discontinued operations in the Company s Consolidated Statements of Operations. No charges related to the termination of the music arrangement with ASDA were incurred in fiscal 2009.

5. Other Current Assets

The other current assets line item in the Company s Consolidated Statement of Net Assets as of May 2, 2009 consisted of property and equipment, net of $3,640,000, taxes receivable of $3,081,000, a letter of credit of $2,619,000, deposits of $705,000 and other various current assets of $832,000.

6. Goodwill and Intangible Assets

Goodwill

The Company began actively marketing REPS for sale in the second quarter of fiscal 2009. Accordingly, the Company considered REPS held for sale and adjusted the carrying value of its assets, including goodwill in the amount of $6,903,000, as of October 4, 2008 under the going concern basis of accounting. The valuation was based on estimated proceeds to be received upon sale based on an average of Expressions of Interest Letters received by the Company from prospective buyers. This adjustment was included in discontinued operations in the Company s Consolidated Statements of Operations. See Notes 1 and 3 of Notes to Consolidated Financial Statements for additional information related to the write down of REPS.

The Company accounted for goodwill in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. Accordingly, the Company performed an annual impairment test for goodwill in the fourth quarter of each fiscal year or as business conditions warranted a review. The goodwill test for impairment was conducted on a reporting unit level, whereby the carrying value of each reporting unit, including goodwill, was compared to its fair value. Fair value was estimated using a discounted cash flow methodology.

The Company performed its annual goodwill impairment tests during the fourth quarter of fiscal 2008. A third-party valuation was obtained to determine the fair value of the Crave and REPS entities using projected cash flows prepared by the Company; management determined that the fair value of Crave did not exceed its carrying value and, as a result, all of the Crave goodwill was deemed impaired. This impairment for Crave was mainly due to future cash flows being negatively impacted by Crave s strategy to increase expenditures related to its software development business, specifically to increase its investments in exclusive distribution arrangements. In accordance with SFAS No. 142, the Company recorded a goodwill impairment charge of $26,629,000, under the going concern basis of accounting, related to Crave in the fourth quarter of fiscal 2008. The charge was included in discontinued operations in the Company s Consolidated Statements of Operations. The valuation for REPS resulted in no goodwill impairment.

During the third quarter of fiscal 2008, Handleman UK determined in conjunction with its customer ASDA, that their business relationship related to the greeting cards business, would terminate effective May 2008. Due to the discontinuance of this business in the UK, an impairment test of goodwill related to the Handleman UK reporting unit was performed in the third quarter of fiscal 2008. As a result of this test, no goodwill impairment charge was recorded.

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The Company also performed its annual goodwill impairment test related to Handleman UK as of the fourth quarter of fiscal 2008. Based on the Company s decision in the first quarter of fiscal 2009 to begin discussions with Tesco for the possible sale of the Tesco-related UK operations, the projected cash flows of that entity changed significantly from the assumptions used in the third quarter. Using the new assumptions for cash flow and fair value for Handleman UK, management determined that all of the Handleman UK goodwill was impaired, based on the guidance provided in SFAS No. 142. The Company recorded a goodwill impairment charge of $3,406,000 under the going concern basis of accounting in the fourth quarter of fiscal 2008. This charge was included in discontinued operations in the Company s Consolidated Statements of Operations.

The following table summarizes the changes in the Company s goodwill, under the going concern basis of accounting, by reporting segment, for the fiscal year ended May 3, 2008 and the first five months of fiscal 2009 (in thousands of dollars):

	Category Management and Distribution Operations	Video Games	All Other
Balance as of April 28, 2007	$ 3,406	$ 26,629	$ 6,903
Impairment charges	(3,406)	(26,629)	
Balance as of May 3, 2008	$	$	$ 6,903
Carrying value adjustment			(6,903)
Balance as of October 4, 2008	$	$	$

Intangible Assets

The Company s intangible assets predominately related to the acquisitions of Crave and REPS. The Company performed annual impairment analyses, or as business conditions warranted a review, comparing the carrying value of its intangible assets with the future economic benefit of these assets. Based on such analyses, the Company adjusted, as necessary, the value of its intangible assets. The Company performed its annual impairment tests in the fourth quarter of fiscal 2008. A third-party valuation was prepared in accordance with SFAS No. 144 for the Crave and REPS intangible assets and management determined that these assets were not impaired. Accordingly, no impairment charge was recorded during fiscal 2008. As a result of the Crave and REPS business units being marketed for sale, the Company adjusted the carrying values of these entities, including intangibles during the second quarter of fiscal 2009 under the going concern basis of accounting. See Notes 1 and 3 of Notes to Consolidated Financial Statements for additional information related to the losses recorded on the carrying values of Crave and REPS.

Internally Developed Video Game Software

Crave, through one of its subsidiary companies, published video game titles under the Crave brand name. These titles supported Sony, Nintendo and/or Microsoft video game platforms and were distributed by Crave. As a result, Crave incurred obligations to contracted video game software developers and, in some cases, obligations to intellectual property right holders.

Under its software development agreements, payments were typically based on the achievement of defined milestones, which varied by agreement. Such milestones included payments due at the signing of the agreements, design and/or technical achievements and delivery of completed product; these advances were typically not refundable. These developed games were the property of Crave. Software development costs were recorded in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed, which required that these costs be capitalized once technological feasibility of a product is established and such costs are

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

determined to be recoverable. Under this guidance, technological feasibility should be evaluated on a product-by-product basis. Payments prior to technological feasibility, or amounts otherwise related to software development that are not capitalized, should be charged immediately to research and development expense. Crave generally engaged independent software developers experienced with the current video game platforms developed by the manufacturers. Due to the experience of the software developers and the established game platform technology, technological feasibility was already proven prior to the beginning of, or occurred very early in, the development cycle. Therefore, Crave typically did not incur any research and development costs. The Company did not incur any research and development costs for the five-month period ended October 4, 2008 or the fiscal year ended May 3, 2008, because technological feasibility related to the development of video game titles was established prior to the start of game development.

Software development payments were classified as Intangible assets, net in the Company s Consolidated Balance Sheet. Commencing upon product release, these payments were amortized as royalty expense based upon the ratio of current revenues to total projected revenues, generally over a period of approximately 18 months, and included in discontinued operations in the Company s Consolidated Statements of Operations. The Company performed quarterly analyses, comparing the carrying value of its software development costs with the expected sales performance of the specific products for which the costs relate. Management s judgments and estimates were utilized in the ongoing assessment of the recoverability of these advances. Based on such analyses, the Company adjusted, when necessary, the value of its software development costs.

Certain software development agreements may have required Crave to make additional payments based on pre-defined sales volumes. Subject to these terms, once all advance payments to developers were expensed, additional payments to developers may have been required. These additional payments were accrued as royalties and included in Accrued and other liabilities in the Company s Consolidated Balance Sheet.

Under Crave s intellectual property licensing agreements, payments were made to licensors in exchange for the rights to utilize intellectual properties owned by the licensors (e.g. popular animated characters, including all designs, themes and story lines) that may be used in the development of video game software. Payments to licensors allowed Crave the limited right to use these intellectual properties, and at no time did Crave take ownership of these intellectual properties. Advances under these licensing agreements typically occurred at the signing of the agreements and were not refundable. License advance payments were classified as Intangible assets, net in the Company s Consolidated Balance Sheet. Commencing upon product release, these payments were amortized as royalty expense based upon the ratio of current revenues to total projected revenues, generally over a period of approximately 18 months, and included in discontinued operations in the Company s Consolidated Statements of Operations. The Company performed quarterly analyses comparing the carrying value of its license advances with the expected sales performance of the specific products to which the costs relate. Management s judgments and estimates were utilized in the ongoing assessment of the recoverability of these advances. Based on such analyses, the Company adjusted, when necessary, the value of its license advances. Certain intellectual property licensing agreements may have required Crave to make additional payments based on sales volumes. Subject to these terms, once all advance payments to licensors were expensed, additional payments to licensors may have been required. These additional payments were accrued as royalties and are included in Accrued and other liabilities in the Company s Consolidated Balance Sheet.

Purchased Video Game Software

Crave also purchased video game software from other software developers that supported Sony, Nintendo and Microsoft video game platforms. As a distributor, Crave occasionally entered into exclusive distribution agreements with these video game suppliers. Under these exclusive distribution agreements, Crave had the right to sole distribution of the agreed upon video software

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games. The agreements varied by supplier, and may have obligated Crave to pay minimum distribution fees or purchase a specified number of units over a designated period of time. Payments under these exclusive distribution agreements were usually made at the time the agreements were signed, at the time of manufacturing, or in some instances, at the time of product receipt by Crave. These exclusive distribution advances were classified as Intangible assets, net in the Company s Consolidated Balance Sheet and were amortized as royalty expense based upon sales of product purchased from these suppliers, and included in Direct product costs in the Company s Consolidated Statements of Operations. Under certain of these exclusive distribution agreements, additional payments to these suppliers may have been required if pre-defined minimum purchase volumes were exceeded. These additional payments were also classified as Intangible assets, net in the Company s Consolidated Balance Sheet. Management s judgments and estimates were utilized in the ongoing assessment of the recoverability of these advances.

Accrued royalties as of May 3, 2008 totaled $673,000.

The following information relates to intangible assets subject to amortization being held and used as of May 3, 2008 (in thousands of dollars):

Amortized Intangible Assets	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Amount**	**Weighted Average Amortization Period**
As of May 3, 2008:				
Trademark	$ 7,900	$ 3,550	$ 4,350	180 mos.
Customer relationships	28,100	12,350	15,750	227 mos.
Non-compete agreements	4,770	3,466	1,304	37 mos.
Software development costs and distribution/license advances	35,522	21,864	13,658	18 mos.
Total	$ 76,292	$ 41,230	$ 35,062	113 mos.

Royalty expense related specifically to software development costs and licensed rights included in Recoupment of development costs/licensed rights in the Company s Consolidated Statements of Cash Flows is as follows (in thousands of dollars):

Royalty Expense	**Five Months Ended October 4, 2008**	**Fiscal Year Ended May 3, 2008**
Software development costs, including write down to net realizable value of $286 and $568 for fiscal years 2009 and 2008, respectively	$ 1,048	$ 5,560
Exclusive distribution rights, including write down	370	4,775

to net realizable value of $75 and $15 for fiscal years 2009 and 2008, respectively		
Licensed intellectual property rights, including write down to net realizable value of $62 for fiscal year 2008	115	785
Total	$ 1,533	$ 11,120

The Company s aggregate amortization expense for the five months ended October 4, 2008 was $4,163,000 and was $18,908,000 for the fiscal year ended May 3, 2008.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

7. Property and Equipment

As a result of the Company s Plan of Final Liquidation and the adoption of the liquidation basis of accounting, property and equipment are now classified as Other current assets in the Company s Consolidated Statement of Net Assets. The remaining assets of the Company are recorded at fair value and depreciation ceased when the assets were deemed held for sale in accordance with accounting guidance.

Property and equipment being held and used as of May 3, 2008 under the going concern basis of accounting, consisted of the following (in thousands of dollars):

	May 3, 2008
Land	$ 640
Buildings and improvements	13,245
Display fixtures	1
Computer hardware and software	21,641
Equipment, furniture and other	24,711
	60,238
Less accumulated depreciation	31,368
Total property and equipment, net	$ 28,870

Property and equipment was recorded at cost. Upon retirement or disposal, the asset cost and related accumulated depreciation were eliminated from the respective accounts and the resulting gain or loss was included in results of operations for the period. Repair costs were charged to expense as incurred.

As a result of the fixed asset impairment charges recorded in the fourth quarter of fiscal 2008, the Company used the adjusted carrying amount of the applicable fixed assets as its new cost basis in accordance with SFAS No. 144. Furthermore, the new cost basis was depreciated over the remaining useful life of that asset.

In accordance with Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, the Company capitalized internal labor costs associated with developing computer software. Such costs were depreciated over the expected life of the software, generally three to seven years.

The Company included depreciation expense in Selling, general and administrative expenses in its Consolidated Statements of Operations. Depreciation was computed primarily using the straight-line method based on the following useful lives:

Buildings and improvements	Lesser of the lease term or the useful life
Leasehold improvements	Lesser of the lease term or the useful life
Display fixtures	2-5 years
Computer hardware and software	3-7 years
Equipment, furniture and other	3-10 years

8. Debt