

BLOCKBUSTER INC  
Form 10-K  
April 06, 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 January 4, 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 001-15153

**BLOCKBUSTER INC.**

(Exact name of registrant as specified in its charter)

**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

**52-1655102**  
(I.R.S. Employer  
Identification Number)

**1201 Elm Street**  
**Dallas, Texas 75270**  
**(214) 854-3000**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
<b>Class A Common Stock, \$.01 par value per share</b>	<b>New York Stock Exchange</b>
<b>Class B Common Stock, \$.01 par value per share</b>	<b>New York Stock Exchange</b>

**Securities registered pursuant to Section 12(g) of the Act: None**

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the 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.

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

As of July 3, 2008, which was the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's common stock held by non-affiliates was \$404,251,870, based on the closing price of \$2.67 per share of Class A common stock and \$2.12 per share of Class B common stock as reported on the New York Stock Exchange composite tape on that date.

As of March 30, 2009, 121,242,152 shares of Class A common stock, \$0.01 par value per share, and 72,000,000 shares of Class B common stock, \$0.01 par value per share, were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

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Portions of our definitive proxy statement to be filed for our 2009 annual meeting of stockholders are incorporated by reference into Part III of this Form 10-K.

THIS ANNUAL REPORT ON FORM 10-K IS BEING DISTRIBUTED TO STOCKHOLDERS IN LIEU OF A SEPARATE ANNUAL REPORT PURSUANT TO RULE 14a-3(b) OF THE ACT AND SECTION 203.01 OF THE NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL.

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**DISCLOSURE REGARDING FORWARD-LOOKING INFORMATION**

This annual report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may also be included from time to time in our other public filings, press releases, our website and oral and written presentations by management. Specific forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and include, without limitation, words such as may, will, expects, believes, anticipates, plans, estimates, projects, predicts, targets, seeks, could, intends, foresees or the negative of such terms or other terms or comparable terminology. Similarly, statements that describe our strategies, initiatives, objectives, plans or goals are forward-looking.

These forward-looking statements are based on management's current intent, belief, expectations, estimates and projections regarding our Company and our industry. These statements are not guarantees of future performance and involve risks, uncertainties, assumptions and other factors that are difficult to predict. Therefore, actual results may vary materially from what is expressed in or indicated by the forward-looking statements. The risk factors set forth below under Item 1A. Risk Factors, and other matters discussed from time to time in subsequent filings with the Securities and Exchange Commission, including the Disclosure Regarding Forward-Looking Information and Risk Factors sections of our Quarterly Reports on Form 10-Q, among others, could affect future results, causing these results to differ materially from those expressed in our forward-looking statements. In that event, our business, financial condition, results of operations or liquidity could be materially adversely affected and investors in our securities could lose part or all of their investments. Accordingly, our investors are cautioned not to place undue reliance on these forward-looking statements because, while we believe the assumptions on which the forward-looking statements are based are reasonable, there can be no assurance that these forward-looking statements will prove to be accurate.

Further, the forward-looking statements included in this Form 10-K and those included from time to time in our other public filings, press releases, our website and oral and written presentations by management are only made as of the respective dates thereof. We undertake no obligation to update publicly any forward-looking statement in this Form 10-K or in other documents, our website or oral statements for any reason, even if new information becomes available or other events occur in the future.

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**PART I**

**Item 1. Business**

**BLOCKBUSTER OVERVIEW**

Blockbuster Inc. is a leading global provider of rental and retail movie and game entertainment, with over 7,400 stores in the United States, its territories and 20 other countries as of January 4, 2009. Our mission is to provide our customers with the most convenient access to media entertainment, including movie and game entertainment delivered through multiple distribution channels such as our stores, by-mail, vending and kiosks, online and at home. We believe Blockbuster offers customers a value-priced entertainment experience, combining the broad product depth of a specialty retailer with local neighborhood convenience.

**Domestic Operations**

***Physical Delivery***

**In-store** As of January 4, 2009, we had 4,585 stores operating under the BLOCKBUSTER® brand in the United States and its territories. Of these stores, 707 stores were operated through our franchisees. Our stores offer movie and game rental and new and traded movie and game product to our customers, including the addition of Blu-ray DVDs to our product offerings in 2007. Additionally, 404 of these locations include a game store-in-store concept operating under the GAME RUSH® brand.

**By-mail** We offer an Internet-based subscription service through blockbuster.com that allows customers to rent DVDs by mail and offers substantially more titles than our individual stores, including a wide array of both new release and catalog DVDs. This allows us to reach customers located in geographic areas where we do not presently have store locations. Subscribers of our BLOCKBUSTER Total Access program have the benefit of:

over 90,000 movie titles;

two ways to get movies with no due dates online and in-store;

a variety of plans to meet our customers lifestyle and budget needs;

the convenience of thousands of participating store locations; and

the option of video game rentals beginning in the first quarter of 2009.

**Vending** We have been exploring the growing vending channel as an opportunity to expand physical distribution of media entertainment. Vending machines are automated fixed capacity machines that enable the browsing and dispensing of a limited catalog of media entertainment. We recognize vending as an area of opportunity and we continue to test and evaluate solutions that would allow us to offer vending as an added form of convenience to customers.

***Digital Delivery***

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**Download to PC** During 2008, we integrated our Movielink, LLC ( Movielink ) offering with the blockbuster.com website. Movielink is an online movie downloading business with one of the largest libraries of digital content for both rental and sale, which we purchased all the outstanding membership interests of in 2007. This has allowed us to capitalize on the rapidly growing filmed entertainment downloading market and provide additional entertainment delivery choices to meet our customers' needs including 24/7 access to their blockbuster.com account for downloading and watching movies as well as movie recommendations and reviews.

**Other alternatives** We are committed to providing convenient access to media entertainment and are continually seeking out alternative methods to deliver on this mission. With the convergence of media

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content and electronic devices, we are exploring further opportunities to digitally deliver content to our customers, including the development of digital delivery kiosks in our stores, and leveraging strategic partners to digitally deliver entertainment content to our customers' homes and electronic and portable devices. Along those lines, we launched BLOCKBUSTER OnDemand in November 2008 with the 2Wire MediaPoint digital media player, an easy-to-use, on-demand video solution that offers movie fans instant access through their television sets to BLOCKBUSTER OnDemand content, including thousands of titles from the latest movie releases to classic favorites.

**International Operations**

As of January 4, 2009, we had 2,820 stores in 20 markets outside of the United States operating under the BLOCKBUSTER brand and other brand names we own. Of these stores, 892 stores were operated through our franchisees. In the Republic of Ireland and Northern Ireland, we operate under the XTRA-VISION® brand name due to its strong local brand awareness. In Canada, Italy, Mexico and Denmark, we operate store-in-store game locations in addition to freestanding game locations in Mexico, all under the GAME RUSH brand. During 2008 and 2007, 32% and 35% of our worldwide revenues were generated outside of the United States, respectively. Our international operations have historically been more dependent on retail sales and, in particular, the retail game industry.

During the third quarter of 2008, we sold our Chilean subsidiary, coupled with a license agreement.

We plan to continue selectively licensing some of our international markets as this will allow us to retain our brand's presence while redeploying capital. Longer term, a strong licensed presence in each country can significantly establish the BLOCKBUSTER brand, facilitate growth, and set the stage for a future digital offering.

We maintain offices for each major region and most of the countries in which we operate in order to manage, among other things, (i) store development and operations, (ii) marketing, and (iii) the purchase, supply and distribution of product. Additional information regarding our revenues and long-lived assets by geographic area and financial data by segment is included in Note 11 to the consolidated financial statements.



**Table of Contents****INDUSTRY OVERVIEW****Domestic Media Entertainment Industry**

We define our market as the media entertainment market. The estimated relative market sizes for various segments of the U.S. entertainment industry in which we compete are reflected in the following table (in millions):

	2008	2007
In-store rental	\$ 5,797	\$ 6,215
Vending	377	198
By-mail rental	2,128	1,789
Physical film rental market	8,302	8,202
Cable video-on-demand ( VOD )	1,164	1,038
Digital VOD	258	166
Subscription VOD	468	277
Digital film rental market	1,890	1,481
Total film rental market	10,192	9,683
Physical retail	16,083	15,946
Digital retail	437	269
Film retail market	16,520	16,215
Game software (rental and retail)	8,886	6,667
Game hardware and accessories	7,975	7,000
Game portable hardware, software and accessories	4,469	4,309
Total game market	21,330	17,976
Total U.S. media entertainment market	\$ 48,042	\$ 43,874

The foregoing estimates and projections have been compiled from reports and information published by Adams Media Research, with respect to filmed entertainment, and NPD Group, with respect to game entertainment.

The overall domestic media entertainment industry grew 9.5% in 2008. The movie rental market is forecasted to continue that growth in 2009, while the overall industry is forecasted to decline slightly due to a low cyclical period for new game platform releases. There are continuing channel and product shifts, primarily driven by introduction of next-generation game console release cycles as well as the emergence of new channels of distribution for movie entertainment, such as by-mail delivery, vending, and digital. We believe we have capitalized on the next-generation game console launches and the associated broadening of the consumer demographic in 2008.

**Movies**

A competitive advantage that the U.S. retail home video industry has traditionally enjoyed over most other movie distribution channels, except theatrical release, is the early timing of its distribution window. Currently, studios distribute their movie entertainment content three to six months after theatrical release to the home video market; seven to eight months after theatrical release to pay-per-view and video-on-demand ( VOD ); one year after theatrical release to pay TV networks; and two to three years after theatrical release to basic cable and syndicated networks. Recently, there has been increasing experimentation by studios and various movie content



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aggregators and retailers with the traditional distribution window, including simultaneous VOD and DVD releases. For example, although movie selections tend to be limited at present, customers can now download to their computers or TVs certain available movies on the same day that the movie's DVD is released by the studios nationwide in retail stores for rental or sale. In some cases consumers can also burn the downloaded movie to a blank DVD for playback in a DVD player, allowing them to watch the movies on their TVs or portable devices. We expect that the movie studios will continue to assess the traditional release windows and it is possible that the studios may decide to alter the traditional home video retailer distribution window for an increasing number of movies, particularly in connection with simultaneous VOD distribution of movies and DVD release dates. However, we also believe that the studios have a vested interest in maintaining the home video distribution window in a manner that allows them to maximize revenues generated by the retail home video industry.

### ***Games***

According to estimates by NPD Group, game revenues in the United States grew 18.7% in 2008 after a 43.5% increase in 2007. These trends were largely due to recent introduction of new, more advanced hardware platforms in 2007, including the Xbox 360, the Sony PlayStation 3 and the Nintendo Wii, and the growth of portable gaming systems, particularly the Nintendo DS Lite.

Many next-generation hardware platforms, including Sony PlayStation 2 and 3 and Microsoft Xbox and Xbox 360, utilize a DVD and/or Blu-Ray software format and have the potential to serve as multi-purpose entertainment centers by doubling as players for DVD movies and compact discs. For example, the Sony PlayStation 3 consoles are equipped to play high-definition Blu-ray discs. In addition, Sony PlayStation 3 and PSP, Nintendo DS and Wii and Microsoft Xbox 360 all provide Internet connectivity.

Sales of video game software generally increase as next-generation platforms mature and gain wider acceptance. Historically, when a new platform is released, a limited number of compatible game titles are immediately available, but the selection grows rapidly as manufacturers and third-party publishers develop and release game titles for that new platform. With respect to game rentals, we believe that the difference between the retail price and the rental price of a popular new video game title is typically high enough to make rentals an attractive alternative for customers. We also believe rental pricing provides both a testing ground for consumers considering a game purchase and an attractive alternative for customers who do not want to buy a game on an older format as they evaluate the purchase of a next generation hardware platform.

While the typical electronic game enthusiast is male and between the ages of 14 and 35, the electronic game industry is broadening its appeal across all demographics, especially with the introduction of Nintendo Wii. In addition, the availability of used video game products for sale has enabled a lower-economic demographic that may not have been able to afford the considerably more expensive new video game products, to participate in the video game industry.

### **International Home Video Industry In-Home Movies**

Some of the attributes of the home video industry outside of the United States are similar to those of the home video industry within the United States. For example, the major studios generally release movies outside of the United States according to sequential distribution windows. However, other attributes of the home video industry outside of the United States do not necessarily mirror the home video industry within the United States. For example, most countries have different systems of supply and distribution of movies, and competition in many of our international markets tends to be more fragmented. In addition, under the laws of some countries and trading blocs (*e.g.*, the European Union), home video retailers must obtain the right to rent videos to consumers through a licensing arrangement or a purchase-with-the-right-to-rent arrangement. Studios may charge these home video retailers more for product purchased for rental than product purchased solely for sale to consumers. This is commonly referred to as two-tiered pricing, and affects our European operations. Two-tiered pricing not only results in increased competition from mass merchant retailers in those countries and

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trading blocs, it also creates increased competition with video rental outlets that operate in violation of the two-tiered pricing contractual limitations by renting product purchased at the lower retail price. The potential impact of studio pricing decisions is discussed under Item 1A. Risk Factors. The international home video industry also faces high levels of piracy. Although piracy is also a concern in the United States, it is having a more significant adverse affect on the rental and retail video industry in international markets. Piracy is discussed further below under Competition and Item 1A. Risk Factors.

### **Competition**

We operate in a highly competitive environment. We believe our most significant competition comes from (i) retailers that rent, sell or trade movies and games; (ii) providers of direct delivery home viewing entertainment or other alternative delivery methods of entertainment content; (iii) piracy; and (iv) other forms of leisure entertainment. In addition, many consumers maintain relationships with several different in-home entertainment providers and can shift in-home entertainment spending from one provider to another.

*Competition with Retailers that Rent, Sell or Trade Movies and Games.* These retailers include, among others:

mass merchant retailers, such as Wal-Mart, Best Buy and Target;

local, regional and national video and game stores, such as GameStop and Movie Gallery;

Internet sites and companies that rent or sell movies and other entertainment content, such as Netflix;

toy and entertainment retailers; and

supermarkets, pharmacies, convenience stores and fast food restaurants, including the kiosks operated by Redbox.

We believe that the principal factors we face in competing with retailers that rent, sell or trade movies and games are:

consumer preference between purchasing and renting movies and games;

alternative product distribution channels and the perceived convenience and ease of use of such alternative channels to the customer;

pricing;

convenience and visibility of store locations;

quality, quantity and variety of titles in the desired format;

customer service; and

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value-added services, such as movie search capabilities, ratings and recommendations and community features.

In particular, while the studios' promotion of movies for simultaneous sale and rental has served to lower the wholesale cost of movies to us, it has also resulted in increased competition from mass merchant retailers, as discussed under Item 1A. Risk Factors.

### ***Competition with Providers of Direct Delivery Home Viewing Entertainment or Other Alternative Delivery Methods of Entertainment***

***Content.*** We believe that competitive risks to our business include direct broadcast satellite, digital cable television, high-speed Internet access, TIVO/DVR and other alternatives for delivering videos and entertainment content to consumers. These providers offer an expanded number of conventional channels and expanded programming, including sporting events, through these services. Direct broadcast satellite, digital cable and traditional cable providers not only offer numerous channels of

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conventional television, they also offer pay-per-view movies, which permit a subscriber to pay a fee to see a selected movie, and other specialized movie services. Many digital cable providers, Internet content providers and other companies also provide video-on-demand, which transmits movies and other entertainment content on demand with interactive capabilities such as start, stop and rewind. In addition, some cable providers allow a subscriber to purchase a DVD movie and watch it over the cable system while the DVD is shipped to the subscriber.

The availability and ease of downloading movies over the Internet continues to grow. Apple's video iTunes service, Amazon's Unbox and announcements from other companies ranging from Netflix to Intel regarding their efforts in digital delivery of content signal future growth of video entertainment delivery. Other examples of alternative delivery methods of entertainment content include personal video recorders, download-to-burn DVDs, video vending machines, download-to-burn kiosks, movie downloads to portable devices and disposable DVDs.

Any consolidation or vertical integration of media companies to include both content providers and digital distributors could pose additional competitive risk to our business. Risks associated with this competition are discussed further under Item 1A. Risk Factors.

**Piracy.** We compete against the illegal copying and sale of movies and video games. Because piracy is an illegal activity, it is difficult to quantify its exact impact on the home video industry. The primary methods of piracy affecting the home video industry are:

the illegal copying of theatrical films at the time they are first run;

the illegal copying of DVDs that are authorized by the studios solely for retail sale and/or rental by authorized retailers; and

the illegal online downloading of movies.

These methods of piracy enable the low-cost sale of DVDs and free viewing and sharing of DVDs, both of which compete with rentals and sales by authorized retailers like us. Competition from piracy has increased in recent years, in particular in our international markets, due in part to developments in technology that allow for faster copying and downloading of DVDs. Piracy has had a lesser effect on the video game industry in the United States, but has been a significant hindrance to the development of the home video game industry in many international markets, particularly in Latin America and Asia.

**Other Competition.** We also compete generally for the consumer's entertainment dollar and leisure time with, among others:

movie theaters;

Internet browsing, online gaming and other Internet-related activities;

consumers' existing personal movie libraries;

live theater;

sporting events; and

music entertainment.

These and other competitive pressures may have a material adverse effect on our business.



**Table of Contents****OUR OPERATIONS****Stores and Store Operations**

**Store Operations.** Our U.S. company-operated stores generally operate under relatively similar hours of operation. Domestic stores are generally open 365 days a year, with daily hours from approximately 10:00 a.m. to 10:00 p.m. and closing later on weekends. We continually assess our store hours on a store by store basis in order to maximize profitability. The hours of operation for franchised stores will vary depending on the franchisee, but generally, franchisees follow the store hours of our company-operated stores. Our U.S. company-operated stores each employ an average of 10 people, including one store manager. Staffing for franchised stores will vary and is the sole responsibility of our franchisees. International store operations vary by country.

**Portfolio Management.** Within each targeted market, we identify potential sites for new and replacement stores by evaluating market dynamics, some of which include population demographics, customer concentration levels and possible competitive factors. We seek to place stores in locations that are convenient and visible to the public. We also seek to locate our stores in geographic areas with population and customer concentrations that enable us to better allocate available resources and manage operating efficiencies in inventory management, advertising, marketing, distribution, training and store supervision. We use our extensive membership transaction and real estate databases to monitor market conditions, select strategic store locations and attempt to maximize revenues without significantly decreasing the revenues of our nearby stores. We also periodically examine whether the sizes and formats of our existing stores are optimal for their locations and may adjust the sizes of, relocate or close existing stores as conditions require.

As a result of the declining revenues and anticipated consolidation in the in-store rental industry, during 2007 and to a lesser extent in 2008, we reviewed many of our store leases and selected a number of sites to close or downsize based on various factors, including proximity to other Blockbuster and competitor locations and profitability. We have also selected a number of locations based upon certain operational and financial criteria and are engaging landlords for those locations in negotiations regarding reduced monthly lease payments, in some instances in exchange for longer lease term commitments. We cannot now determine to what extent our efforts will be successful. Additionally, we anticipate closing or divesting of a comparable number of domestic store locations during 2009 as in 2008. During 2008, we also sold our Chilean subsidiary, coupled with a license agreement. We will continue to explore the divestiture of our non-core assets, including selling and/or franchising some of our remaining international operations.

The following table sets forth our store count information for both company-operated and franchised stores, domestic and international, during 2008:

	Company-Operated			Franchised			Total		
	U.S.	Int l.	Total	U.S.	Int l.	Total	U.S.	Int l.	Total
January 6, 2008	4,005	2,068	6,073	850	907	1,757	4,855	2,975	7,830
Opened	5	21	26	2	6	8	7	27	34
Closed	(167)	(90)	(257)	(110)	(92)	(202)	(277)	(182)	(459)
Purchased/(sold)(1)	35	(71)	(36)	(35)	71	36	0	0	0
Net additions/(closures)	(127)	(140)	(267)	(143)	(15)	(158)	(270)	(155)	(425)
January 4, 2009	3,878	1,928	5,806	707	892	1,599	4,585	2,820	7,405

(1) In 2008, we acquired 35 stores from franchisees in our domestic markets, and refranchised or licensed 71 stores in our international markets.



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**Store Locations.** At January 4, 2009, in the United States and its territories, we operated 3,878 stores and our franchisees operated 707 stores. The following table sets forth, by state or territory, the number of domestic stores operated by us and our franchisees as of January 4, 2009.

STATE OR TERRITORY	Company-Operated	Franchised	Total
Alaska		16	16
Alabama	35	22	57
Arkansas		17	17
Arizona	122	5	127
California	504	23	527
Colorado	98	4	102
Connecticut	39	20	59
District of Columbia	4		4
Delaware	7	8	15
Florida	325	53	378
Georgia	153		153
Guam	2		2
Hawaii	22		22
Iowa	22	1	23
Idaho	1	8	9
Illinois	190	3	193
Indiana	67	31	98
Kansas	18	35	53
Kentucky	37	29	66
Louisiana	66	12	78
Massachusetts	72	17	89
Maryland	77	22	99
Maine	6		6
Michigan	139	1	140
Minnesota	49	8	57
Missouri	79	13	92
Mississippi	12	23	35
Montana		4	4
North Carolina	129	1	130
North Dakota		6	6
Nebraska	24	2	26
New Hampshire	19		19
New Jersey	115	20	135
New Mexico		18	18
Nevada	41	2	43
New York	193	8	201
Ohio	151	1	152
Oklahoma	60	5	65
Oregon	67	14	81
Pennsylvania	155	6	161
Puerto Rico		24	24
Rhode Island	12	6	18
South Carolina	71	2	73
South Dakota		9	9
Tennessee	42	54	96
Texas	314	108	422
Utah	43	2	45
Virginia	100	22	122
Virgin Islands		2	2
Vermont	8		8
Washington	113	2	115

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Wisconsin	63	3	66
West Virginia	12	6	18
Wyoming		9	9
Domestic Store Totals	3,878	707	4,585

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At January 4, 2009, we operated 1,928 stores outside of the United States, including game store-in-store concepts operating under the name GAME RUSH in Canada and Denmark and 13 specialty game stand-alone stores operating under the name GAME RUSH in Italy and Mexico. In addition, our franchisees operated 892 stores outside of the United States. The following table sets forth, by country, the number of stores operated by us and by our franchisees as of January 4, 2009.

	Company- Operated	Franchised	Total
Argentina	70		70
Australia		333	333
Brazil		175	175
Canada	459		459
Chile		69	69
Colombia		22	22
Denmark	70		70
Great Britain	663		663
Guatemala		5	5
Ireland (Republic) and Northern Ireland	186		186
Israel		10	10
Italy	157	55	212
Mexico	320	4	324
New Zealand		30	30
Panama		15	15
Portugal		19	19
Taiwan		132	132
Thailand		3	3
Uruguay	3		3
Venezuela		20	20
International Store Totals	1,928	892	2,820
United States	3,878	707	4,585
Domestic and International Store Totals	5,806	1,599	7,405

**Franchised Operations**

At January 4, 2009, 166 domestic franchisee entities operated 707 stores in the United States and 278 international franchisee entities operated 892 stores outside of the United States. Our \$5.3 billion in revenues during fiscal 2008 does not include the actual revenues of our franchisees, as we only record royalty and fee revenues generated from our franchised operations. Under our current U.S. franchising program, we enter into a development agreement and subsequent franchise agreement(s) with the franchisee. Pursuant to the terms of a typical development agreement, we grant the franchisee the right to develop one or a specified number of stores at a permitted location or locations within a defined geographic area and within a specified time. We generally charge the franchisee a development fee at the time of execution of the development agreement for each store to be developed during the term of the development agreement. A development agreement is not, however, typically entered into when a franchisee acquires an existing store from us or another franchisee. The typical franchise agreement is a long-term agreement that governs, among other things, the operations of the store to protect our brand. We generally require the franchisee to pay us a one-time franchise fee and continuing royalty fees, service fees and monthly payments for, among other things, maintenance of our proprietary software. In addition, from time to time we provide optional programs and product and support services to our franchisees for which we occasionally receive fees. We also require our franchisees to contribute funds for national advertising and marketing programs and require that franchisees spend an additional amount for local advertising or other marketing efforts. The amounts our franchisees are required to contribute for national advertising and marketing

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efforts may change from time to time in order to allow our franchisees to invest in their business. Our international franchising program is similar in many ways to our domestic franchising program. For example, our international franchisees are generally required to pay us a one-time franchise fee and continuing royalty fees and service fees.

Our franchisees have control over all operating and pricing decisions at their respective locations. For example, our franchisees have control over whether to charge extended viewing fees and the specific rental terms underlying any elimination of extended viewing fees and over whether or not to participate in the BLOCKBUSTER Total Access program. This has resulted in variations of rental terms, selling terms and restocking fees between company-operated and franchised BLOCKBUSTER stores, as well as variations in these terms among franchised BLOCKBUSTER stores. As of January 4, 2009, 112 of our franchise stores in the United States were participating in the no late fees program. Many of our franchisees chose not to eliminate extended viewing fees or have returned to charging extended viewing fees due to the fact that they operate under a different business model than we do, whereby they are not able, or choose not, to purchase the additional product to support the no late fees program. As of January 4, 2009, substantially all of our franchisees in the United States were participating in the BLOCKBUSTER Total Access program. We also do not require our franchisees to purchase inventory from us. A franchisee has sole responsibility for all financial commitments relating to the development, opening and operation of its stores, including rent, utilities, payroll and other capital and incidental expenses. We cannot offer assurances that our franchisees will be able to achieve profitability levels in their businesses sufficient to pay our franchise fees, as discussed in more detail below under Item 1A. Risk Factors. Our results of operations could be materially adversely affected if our franchisees failed to pay our franchise fees. Furthermore, we cannot offer assurances that we will be successful in marketing and selling new franchises, that we will continue to actively pursue new franchisees or that any new franchisees will be able to obtain desirable locations and acceptable leases. Finally, we cannot predict the impact that our franchisees' decisions with respect to product depth and pricing may have on our overall business results.

### **Alternative Delivery Method Operations**

In addition to our traditional stores, we also offer consumers access to home video entertainment via mail and digital downloading.

**By-mail.** The BLOCKBUSTER by-mail program allows subscribers to select DVDs online which are then shipped to them free of charge by U.S. mail. Once a subscriber has finished viewing the DVD, the subscriber may return the DVD via mail using the postage prepaid envelope that accompanied the DVD or at a participating BLOCKBUSTER store. BLOCKBUSTER Total Access takes the concept of convenient DVDs by mail a step further and gives online subscribers the option of exchanging their DVDs through the mail or at a nearby participating BLOCKBUSTER store. There are no due dates for DVDs shipped via these online programs.

**Digital Downloading.** In 2007 we acquired all of the outstanding equity interests of Movielink, LLC, an online movie downloading business. Movielink lets customers download movies, television shows and other popular videos for rental or purchase. The customers can then watch the downloaded programs on their computer, television or portable electronic device. Downloaded videos that are rented may be stored for up to 30 days after the customer checks out and then watched as many times as desired during a 24-hour viewing period that commences when Play Movie is clicked. Movielink does not charge any subscription, membership or late fees. Downloaded videos that are purchased can be viewed on up to three personal computers and one portable device. As of December 16, 2008, the Movielink website was discontinued and its content was incorporated into blockbuster.com, where it became available to our customers, including former Movielink customers.

### **Marketing and Advertising**

We design our marketing and advertising campaigns in order to maximize opportunities in the marketplace and thereby increase the return on our marketing and advertising expenditures. We obtain information from our

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membership transaction database, our real estate database and outside research agencies to formulate and adjust our marketing and advertising campaigns based on:

membership behavior and transaction trends;

consumer needs and attitudes;

our market share in the relevant market;

our financial position;

our evaluation of industry trends;

local demographics; and

other competitive issues.

This enables us to focus our resources in areas that we believe will generate the best return on our investment.

During 2008, we focused on offering programs that are an alternative to the programs offered by mass merchant retailers and other online subscription service providers. We continued a tent-pole title strategy in the stores with both a rent and buy message and also continued to offer our in-store movie and game subscription services Total Access In-Store and the BLOCKBUSTER Game Pass<sup>®</sup> and our BLOCKBUSTER Rewards<sup>®</sup> program. Each of these is discussed below.

*BLOCKBUSTER Total Access.* Online subscribers have the option of exchanging their DVDs through the mail or returning them to a nearby BLOCKBUSTER store in exchange for free in-store movie rentals. We offer various priced plans with associated in-store exchange quantity offerings.

*Tent-Pole Title Program.* This in-store program is a major focus bringing customers more copies of big box office titles to rent or to buy and is supported with a significant marketing message in the store and in our customer relations management program.

*BLOCKBUSTER In-Store Total Access and BLOCKBUSTER Game Pass.* These in-store programs allow customers to watch or play an unlimited amount of movies or games (the number of movies or games allowed out at a time is dependent on the pass the customer selects) for one monthly price and keep them for whatever period of time that they desire during the term of the pass, subject to certain limitations.

*BLOCKBUSTER Rewards.* This premium in-store membership program is designed to offer benefits to our customers and enhance customer loyalty by encouraging our customers to rent movies and games only from our stores.

In 2008, we sponsored the Indiana Jones-themed car Marco Andretti drove in the Indianapolis 500 race. Andretti's show car was featured at local community events at selected BLOCKBUSTER stores across the U.S. before hitting the track at the Indy 500 on May 25, 2008. The sponsorship and show car tour were both part of a unique program that brought Indiana Jones into Blockbuster stores nationwide through an in-store

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merchandising program that includes exclusive Indiana Jones and merchandise available for sale to the public only at our stores.

Our advertising efforts in 2008 were partially limited by our focus on our cash conservation strategy. We focused advertising efforts on the in-store marketing of our tent-pole title strategy, growing the games software and hardware category, new product line introductions and traffic-driving promotions. The studios generally spend a significant amount on advertising to promote new DVD releases, from which we benefit. We anticipate that the studios will continue this spending in 2009. In addition, some of our business alliances, including some of those with the studios, allow us to direct a portion of their home video advertising expenditures. For example, we often receive cooperative advertising funds from the studios that might be used for direct mail or point-of-purchase advertising. We expect to continue our cash conservation strategy in 2009, which will maintain current advertising limitations, and may require additional limitations on advertising commitments.

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### **Suppliers and Purchasing Arrangements**

Our goal in purchasing domestic rental inventory is to design purchasing strategies with each individual studio or game publisher that will provide us with the most appropriate level of copy depth at the best available price in order to satisfy our customers' demands and, eventually, to increase our customer traffic. In some instances, those deals involve our purchasing rental inventory on a title-by-title basis. In other instances, we may negotiate a revenue-sharing arrangement. Revenue-sharing arrangements for rental inventory generally provide for a lower initial payment in order to acquire the product. In exchange for this lower initial payment, these contracts include minimum purchase requirements that are based upon box office results of the title. In addition, we pay an agreed upon percentage of our rental revenues earned from that product to the studio/game vendor for a limited period of time. These revenue-sharing payments become due as the rental revenues are earned. In addition to the revenue-sharing component, most arrangements also provide for the method of disposition of the product at the conclusion of the rental cycle and/or additional payments for the early sale of unreturned product which is automatically purchased by the customer. A majority of our revenue sharing agreements require product to be destroyed at the conclusion of the initial rental cycle instead of converting the product to previously rented product ( PRP ), as is our practice under traditional purchase arrangements. This shortening of the rental life cycle negatively impacts our PRP revenues. While the terms of revenue-sharing arrangements are generally similar for rental movie and game software inventory, revenue-sharing arrangements for domestic rental movies are generally negotiated for all titles released during the term of the contract, while revenue-sharing arrangements for rental game software are generally negotiated on a title-by-title basis.

Our unit purchases of domestic movie rental inventory increased 13% in 2008 as compared with 2007 in order to maximize our product availability with the goal of improving our domestic movie rental revenues through improving customer satisfaction. We continued to utilize revenue-sharing arrangements during 2008 to support the increase in inventory unit purchases. Purchases under revenue sharing arrangements made up 85% of our total domestic movie rental unit purchases in 2008, versus 82% in 2007. The number of domestic game software rental inventory units purchased under revenue-sharing arrangements increased from 58% in 2007 to 65% in 2008.

In our international markets, 54% of our movie and game rental inventory units are purchased on a title-by-title basis directly from the studios or through sub-wholesalers appointed by the studios to distribute the studios' product in particular countries. The remainder of our international rental product is purchased under revenue-sharing arrangements similar to those discussed above. Our purchasing arrangements vary by country and studio depending on factors such as the availability of the rental window and revenue-sharing terms.

New retail movie and game inventory is purchased from the studios or their designated sub-wholesalers on a title-by-title basis. We also acquire retail movie and game inventory through our trading programs. We purchase general merchandise that is complementary to our rental and retail movie and video game inventory, such as confection, game and other accessories and consumer electronics, from a variety of suppliers on a product-by-product basis.

We require each franchisee to comply with basic guidelines that set forth the minimum amount and selection of movies to be kept in its store inventory. Franchisees typically obtain movies from their own suppliers and are also responsible for obtaining some of the other complementary products from their own suppliers. However, if we have purchased the distribution rights to a movie or if a franchisee participates with us under our revenue-sharing arrangements, the franchisee may obtain the applicable product from us.

### **Distribution and Inventory Management**

In the United States, we currently receive substantially all of our movies and games for our U.S. company-operated stores at our 850,000 square foot distribution center in McKinney, Texas. The distribution center is a highly automated, centralized facility that we use to mechanically repackage newly-released movies to make

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them suitable for rental at our stores. We also use our distribution center to restock products and process returns, as well as to provide some office space. We use a network of third-party delivery agents for delivery of products to our U.S. stores. We ship our products to these delivery agents, located strategically throughout the United States, which in turn deliver them to our stores. The distribution center supports substantially all of our company-operated stores in the United States and operates 24 hours a day, six days a week. As of January 4, 2009, we employed 973 employees at our distribution center. We are currently evaluating various alternatives to optimize our distribution network, including the potential outsourcing of these distribution center operations.

In addition to our distribution center in McKinney, we also have 38 distribution centers spread strategically throughout the United States to support our by-mail subscription service. These distribution centers are spread across the country because we use the United States Postal Service to distribute our online product, and the closer the distribution center is to a customer, the faster our customers receive the product and the faster it is made available for rental again once our customers mail them back. Additionally, to expedite the delivery of product to our by-mail customers, we currently transport product from our 38 distribution centers to a total of 85 different mail entry points, which enables us to reach over 90% of our online subscriber base within one business day. Each distribution center operates 16 hours a day, 5 days a week and employs approximately 15 people, including one distribution center manager.

Franchisees generally obtain their products directly from third-party suppliers, except for their point-of-sale systems hardware and software, some accessories and supplies, movies for which we have exclusive distribution rights and movies for franchisees that participate in our franchisee revenue-sharing programs, which domestic franchisees receive from our distribution center. We have negotiated new agreements with the studios that allow us to consolidate our purchases for our online business with those of our stores.

In our international markets, our stores generally receive rental product directly from the studios or sub-wholesalers. Retail product is generally distributed through a central warehouse for the market or through a third-party distributor.

## **Management Information Systems**

We believe that the accurate and efficient management of purchasing, inventory and sales records is important to our future success. We maintain information, updated daily, regarding revenues, current and historical sales and rental activity, demographics of store customers and rental patterns. This information can be organized by store, market, region, state, country or for all operations.

All of our Blockbuster branded company-operated stores use our point-of-sale system. Our national point-of-sale system in the United States is linked with a data center located in our distribution center. The point-of-sale system tracks all of our products distributed from the distribution center to each U.S. store using scanned bar code information. All domestic rental and sales transactions are recorded by the point-of-sale system when scanned at the time of customer checkout. At the end of each day, the point-of-sale system transmits store data from operations to the data center and the membership transaction database.

Our online services use internally developed software that focus on optimizing our online supply chain to ensure timely delivery of products and providing a user-friendly website experience. These systems transmit data to a data center and other systems which support, among other things, content delivery, customer web analytics and offer management.

During 2008 we completed several information technology initiatives to stabilize our current infrastructure and enhance the customer experience. We outsourced our application development and maintenance as a means of stabilizing our existing application infrastructure while providing the flexibility to take on new initiatives. Additionally, we developed a new Store System Foundation that supports the legacy applications while enabling new functionality to be built on the new platform. We also created an enterprise payment platform and deployed



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it to blockbuster.com. It will be deployed to Blockbuster retail stores in 2009. Another major initiative improved the customer experience on blockbuster.com by implementing better site navigation and providing easy access to account activity for BLOCKBUSTER Total Access subscribers.

In addition to improving the customer experience on blockbuster.com, the site was modified to enable a wider selection of retail transactions. Customers are able to purchase DVDs, games, gift subscriptions, gift cards, and movie downloads on blockbuster.com.

## **Regulation**

### ***Domestic Regulation***

We are subject to various federal, state and local laws that govern the access to and use of our video stores by disabled customers and the disclosure, retention and security of customer records and information, including laws pertaining to the use of our membership transaction database. We also must comply with various regulations affecting our business, including federal, state or local securities, advertising, consumer protection, credit protection, franchising, licensing, zoning, land use, construction, second-hand dealer, environmental, health and safety, minimum wage, labor and employment, trading activities and other regulations.

We are also subject to the Federal Trade Commission's Trade Regulation Rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" and state laws and regulations that govern the offer and sale of franchises and franchise relationships. If we want to offer and sell a franchise, we are required to furnish to each prospective franchisee a current franchise disclosure document prior to the offer or sale of a franchise. In addition, a number of states require us to comply with registration or filing requirements prior to offering or selling a franchise in the state and to provide a prospective franchisee with a current franchise disclosure document complying with the state's laws, prior to the offer or sale of the franchise. We intend to maintain a franchise disclosure document that complies with all applicable federal and state franchise sales and other applicable laws. However, if we are unable to comply with federal franchise sales and disclosure laws and regulations, we will be unable to offer and sell franchises anywhere in the United States. In addition, if we are unable to comply with the franchise sales and disclosure laws and regulations of any state that regulates the offer and sale of franchises, we will be unable to offer and sell franchises in that state.

We are also subject to a number of state laws and regulations that regulate some substantive aspects of the franchisor-franchisee relationship, including:

those governing the termination or non-renewal of a franchise agreement, such as requirements that:

- (a) good cause exist as a basis for such termination; and
- (b) a franchisee be given advance notice of, and a right to cure, a default prior to termination;

requirements that the franchisor deal with its franchisees in good faith;

prohibitions against interference with the right of free association among franchisees; and

those regulating discrimination among franchisees in charges, royalties or fees.

### ***International Regulation***

We are subject to various international laws that govern the disclosure, retention and security of customer records and information. For example, the laws pertaining to the use of our membership transaction database in some markets outside of the United States are more restrictive than the relevant laws in the United States and may restrict data flow across international borders.

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We must also comply with various other international regulations affecting our business, including advertising, consumer protection, access to and use of our video stores by disabled customers, credit protection,

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film and game classification, franchising, licensing, zoning, land use, construction, second-hand dealer, environmental, health and safety, minimum wage and other labor and employment regulations. Some foreign countries have copyright and other intellectual property laws that differ from the laws of the United States. These laws may prevent or limit certain types of business activity in the affected markets.

Similar to the United States, some foreign countries have franchise registration and disclosure laws affecting the offer and sale of franchises within their borders and to their citizens. They are often not as extensive and onerous as U.S. laws and regulations. However, as in the United States, failure to comply with such laws could limit or preclude our ability to expand in those countries through franchising or could affect the enforceability of franchise agreements.

Compliance with any of the domestic or international regulations discussed above is costly and time-consuming, and we may encounter difficulties, delays or significant costs in connection with such compliance.

## **Historical Information**

Our business and operations were previously conducted by Blockbuster Entertainment Corporation, which was incorporated in Delaware in 1982 and entered the movie rental business in 1985. Blockbuster Inc., formerly an indirect subsidiary of Viacom Inc. (Viacom), was incorporated under a different name on October 16, 1989 in Delaware. On September 29, 1994, Blockbuster Entertainment Corporation was merged with and into Viacom. Subsequent to the merger, our business and operations were conducted by various indirect subsidiaries of Viacom. Over the year and a half prior to our initial public offering in August 1999, our business and operations were either (1) merged into Blockbuster Inc. or (2) purchased by Blockbuster Inc. and/or one of its subsidiaries. In October 2004, Blockbuster Inc. split off from Viacom and became a fully independent company.

## **Intellectual Property**

**Trademarks.** We own various existing trademark registrations and have trademark applications pending registration with respect to our services and products offered worldwide. These include BLOCKBUSTER®, BLOCKBUSTER VIDEO®, TORN TICKET Logos, blockbuster.com®, BLOCKBUSTER Total Access word mark and logo, BLOCKBUSTER GiftCard/s®, BLOCKBUSTER Game Pass® and BLOCKBUSTER Movie Pass® word marks and logos, BLOCKBUSTER Night®, BLOCKBUSTER Online®, BLOCKBUSTER Rewards® word mark and logo, MAKE IT A BLOCKBUSTER NIGHT®, and the related BLOCKBUSTER Family of Marks, GAME RUSH® word mark and logo, MyQ Logo®, MyQ At A Glance Logo®, MOVIE STORE AT YOUR DOOR®, ONLINE RENTING WITHOUT THE WAIT, RENTING IS BETTER THAN EVER®, THE GIFT OF ENTERTAINMENT®, QUIK DROP®, MOVIECLIQUE, MOVIELINK® word mark and logo, and XTRA-VISION®, among others, and trade dress elements including, but not limited to, the blue and yellow awning outside our stores. In addition, we own the domain name registration for blockbuster.com and the related BLOCKBUSTER Family of Domain Names for top level and country domain names, plus a wide variety of other domain name registrations worldwide. We consider our intellectual property rights to be among our most valuable assets.

**Copyrights.** In addition to our own intellectual property rights, the scope of the rights of those who own copyrights in the products we rent also are of importance to us. The copyright first sale doctrine provides that, in the United States, the owner of a legitimate copy of a copyrighted work may, without the consent of the copyright owner, sell, rent or otherwise transfer possession of that copy. The first sale doctrine does not apply to sound recordings or computer software (other than software made for a limited purpose computer, such as a video game platform) for which the U.S. Copyright Act vests the right to control the rental of the copy in the copyright holder. The first sale doctrine does not exist in most countries outside of the United States where the copyright owner retains the rental rights to a copyrighted work. In these countries, home video retailers must obtain the right to rent videos to consumers through a licensing arrangement or a purchase-with-the-right-to-rent arrangement. Studios may charge these home video retailers more for product purchased for rental than product purchased solely for

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sale to consumers. This is commonly referred to as two-tiered pricing and is discussed further above under Industry Overview International Home Video Industry In-Home Movies. The potential impact of studio pricing decisions in countries where two-tiered pricing is allowed is discussed under Item 1A. Risk Factors Risks Relating to Our Business Operations. The risk of changes in U.S. and international copyright laws is discussed under Item 1A. Risk Factors Other Business Risks.

### **Seasonality**

Historically, there has been a distinct seasonal pattern to the home movie and video games business, with slower business in April and May, due in part to improved weather and Daylight Saving Time, and in September and October, due in part to the start of school and the introduction of new television programs. The months of November and December have also historically been our highest revenue months. While we expect these months to continue to make the largest contributions to our rental revenues, we believe the strength of rental revenues in these months has been and will continue to be negatively affected, to some degree, by consumers purchasing DVDs during the holiday season. Additionally, while we have diversified our product offerings in an effort to partially mitigate the impact of seasonality and weather conditions on our business, they are expected to continue to impact our business and our period-to-period financial results in the future. While we believe the current worldwide economic downturn will impact our future operational trends, we cannot predict the timing or extent to which this will occur.

### **Employees**

As of January 4, 2009, we employed 58,561 persons, including 40,107 within the United States and 18,454 outside of the United States. Of the total number of U.S. employees, 11,700 were full-time, 26,732 were part-time and 1,675 were seasonal employees. We believe that our employee relations are good.

### **Directors and Executive Officers of the Registrant**

The following information regarding our directors and executive officers is as of February 27, 2009.

<b>Name</b>	<b>Age</b>	<b>Position</b>
James W. Keyes	53	Chairman of the Board of Directors and Chief Executive Officer
Edward Bleier	79	Director
Robert A. Bowman	53	Director
Jackie M. Clegg	46	Director
James W. Crystal	71	Director
Gary J. Fernandes	65	Director
Jules Haimovitz	58	Director
Carl C. Icahn	73	Director
Strauss Zelnick	51	Director
Thomas M. Casey	50	Executive Vice President and Chief Financial Officer
Eric H. Peterson	48	Executive Vice President, General Counsel and Secretary

Set forth below is a description of the background of each of our directors and executive officers.

*James W. Keyes* has served as our Chairman of the Board of Directors and Chief Executive Officer since July 2007. Mr. Keyes served as President and Chief Executive Officer of 7-Eleven, Inc. from 2000 to 2005. Prior to his service as President and Chief Executive Officer, he was Executive Vice President and Chief Operating Officer of 7-Eleven, Inc. from 1998 to 2000 and Chief Financial Officer of 7-Eleven, Inc. from 1996 to 1998. Since his departure from 7-Eleven, Inc., Mr. Keyes has been Chairman of Key Development, LLC, a private investment firm.

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*Edward Bleier* was elected as a director of Blockbuster in May 2005. Mr. Bleier was with Warner Bros. Entertainment Inc., New York, New York, from October 1969 to January 2005, where he served, partly, as President of Domestic Pay-TV, Cable and Networks Features, encompassing feature films, TV programming, animation, network sales, video-on-demand and consumer marketing. Mr. Bleier is a member of the board of directors of RealNetworks, Inc. and CKX, Inc. He is also Chairman Emeritus of the Center for Communication and the Academy of the Arts Guild Hall, serves as a trustee of the Charles A. Dana Foundation and The Bleier Center for Television and Popular Culture at Syracuse University and is a member of the Council on Foreign Relations.

*Robert A. Bowman* was appointed as a director of Blockbuster in December 2004. He has served as President and CEO of Major League Baseball Advanced Media LP, the interactive media and Internet company of Major League Baseball, since 2000. Mr. Bowman serves as President of the Michigan Education Trust and is a member of the board of directors of World Wrestling Entertainment Inc., The Warnaco Group Inc. and Take-Two Interactive Software, Inc.

*Jackie M. Clegg* was appointed as a director of Blockbuster in July 2003. She serves as Managing Partner of Clegg International Consultants, LLC, an international strategic consulting firm she founded in September 2001. In July 2001, Ms. Clegg stepped down as Vice Chairman and First Vice President of the Export-Import Bank of the United States, financier to foreign buyers of U.S. goods and services, after serving in that role since June 1997. She also served as its Chief Operating Officer from January 1999 through fiscal year 2000. Ms. Clegg also serves on the board of directors and audit committees of Brookdale Senior Living Inc., Cardiome Pharma Corp. and Javelin Pharmaceuticals Inc. (chair). In accordance with the listing standards of the NYSE, Blockbuster's Board of Directors has determined that Ms. Clegg's simultaneous service on Blockbuster's Audit Committee and on the audit committees of the foregoing public companies does not impair Ms. Clegg's ability to effectively serve on Blockbuster's Audit Committee. Ms. Clegg also serves on the board of directors of the Chicago Mercantile Exchange.

*James W. Crystal* was appointed as a director of Blockbuster in February 2007. Mr. Crystal currently serves as Chairman and Chief Executive Officer of Frank Crystal & Company, a privately owned insurance brokerage firm, and has served in such capacities since 1958. Mr. Crystal also serves as Vice Chairman, trustee and member of the executive committee and Co-Chairman of the audit committee of Mt. Sinai Medical Center as well as a trustee of Congregation Emanu-El. In addition, he serves on the board of directors of Stewart & Stevenson LLC, a publicly traded company where he also serves on the audit committee, Banco de Caribe, ENNIA Caribe Holding, N.V., Auto Resources, Inc. and Atlantic International Insurance Co., Ltd.

*Gary J. Fernandes* was appointed as a director of Blockbuster in December 2004. He has served as Chairman of FLF Investments, a family business involved with the acquisition and management of commercial real estate properties and other assets, since 1999. Since his retirement as Vice Chairman from Electronic Data Systems Corporation in 1998, he founded Convergent Partners, a venture capital fund focusing on buyouts of technology enabled companies. In addition, from 2000 to 2001, Mr. Fernandes served as Chairman and CEO of GroceryWorks.com, an internet grocery fulfillment company. In November 1998, he founded Voyagers The Travel Store Holdings, Inc., a chain of travel agencies, and was President and sole shareholder of Voyagers. Mr. Fernandes serves on the board of directors of BancTec, Inc. and Computer Associates International, Inc. He is also a member of the board of governors of the Boys & Girls Clubs of America and serves as a trustee for the O'Hara Trust and the Hall-Voyer Foundation.

*Jules Haimovitz* was appointed as a director of Blockbuster in May 2006. Mr. Haimovitz currently serves as President of Haimovitz Consulting Group. From 2002 to 2007, Mr. Haimovitz served as Vice Chairman and Managing Partner of Dick Clark Productions Inc., a producer of programming for television, cable networks and syndicators. From June 1999 to July 2004, Mr. Haimovitz served in various capacities at Metro Goldwyn Mayer Inc., including President of MGM Networks Inc., a wholly-owned subsidiary, Executive Consultant to the CEO, and Chair of the Library Task Force. From July 1997 to February 1999, he served as President and Chief Operating Officer of King World Productions, Inc., a worldwide distributor of first-run programming. Mr. Haimovitz has also

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served in executive positions at Diva Systems Corporation, ITC Entertainment Group, Spelling Entertainment Inc. and Viacom Inc. Mr. Haimovitz is on the board of directors of Infospace, Inc., a publicly traded company, TVN Entertainment Corporation, GNet Productions and ImClone Systems, Inc., a publicly traded company. Mr. Haimovitz serves on the audit committee of Infospace, Inc. and ImClone Systems, Inc.

*Carl C. Icahn* was elected as a director of Blockbuster in May 2005. Mr. Icahn has served as Chairman of the Board and a director of Starfire Holding Corporation and Chairman of the Board and a director of various subsidiaries of Starfire, since 1984. Since August 2007, through his position as Chief Executive Officer of Icahn Capital LP, a wholly-owned subsidiary of Icahn Enterprises L.P., and certain related entities, Mr. Icahn's principal occupation is managing private investment funds, including Icahn Partners LP, Icahn Partners Master Fund LP, Icahn Partners Master Fund II LP, and Icahn Partners Master Fund III LP. Between September 2004 and August 2007, Mr. Icahn conducted this occupation through his entities CCI Onshore Corp. and CCI Offshore Corp. Since November 1990, Mr. Icahn has been chairman of the Board of Icahn Enterprises G.P., Inc., the general partner of Icahn Enterprises. Icahn Enterprises is a publicly traded diversified holding company engaged in a variety of businesses, including investment management, metals, real estate, and home fashion. Mr. Icahn was also Chairman of the Board and President of Icahn & Co., Inc., a registered broker-dealer and a member of the National Association of Securities Dealers, from 1968 to 2005. Since 1994, Mr. Icahn has been the principal beneficial stockholder of American Railcar Industries, Inc., currently a publicly-traded company that is primarily engaged in the business of manufacturing covered hopper and tank railcars, and has served as Chairman of the Board and as a director of American Railcar Industries, Inc. since 1994. Since November 1990, Mr. Icahn has been Chairman of the Board of American Property Investors, Inc., the general partner of American Real Estate Partners, L.P., a public limited partnership controlled by Mr. Icahn that invests in real estate and holds various other interests, including the interests in its subsidiaries that are engaged, among other things, in the casino entertainment business and the home textile business. From October 1998 through May 2004, Mr. Icahn was the President and a director of Stratosphere Corporation, which operates the Stratosphere Hotel and Casino in Las Vegas, which is currently a subsidiary of Icahn Enterprises. Mr. Icahn has been Chairman of the Board and a director of XO Holdings, Inc. since February 2006, and was Chairman of the Board and a director of XO Communications, Inc. (XO Holdings' predecessor) from January 2003 to February 2006. XO Holdings is a publicly-traded telecommunications services provider controlled by Mr. Icahn. In October 2005, Mr. Icahn became a director of WestPoint International, Inc. a manufacturer of bed and bath home fashion products. In September 2006, Mr. Icahn became a director of ImClone Systems Incorporated, a publicly-traded biopharmaceutical company, and since October 2006, has been the Chairman of the Board of ImClone Systems Incorporated. In August 2007, Mr. Icahn became a director of WCI Communities, Inc., a publicly-traded homebuilding company, and since September 2007 has been Chairman of the Board of WCI Communities, Inc. In December 2007, Mr. Icahn became a director of Federal-Mogul Corporation, a publicly-traded supplier of automotive products, and since January 2008 has been Chairman of the Board of Federal-Mogul Corporation. Mr. Icahn has been a director of Cadus Corporation, a publicly-traded firm that holds various biotechnology patents, since 1993.

*Strauss Zelnick* was elected as a director of Blockbuster in May 2005. Mr. Zelnick founded ZelnickMedia LLC, an investment and advisory firm specializing in media and entertainment, in 2001. ZelnickMedia holds interests in an array of media enterprises, providing general management and strategic advisory services in the United States, Canada, Europe, Asia and Australia. Mr. Zelnick currently serves as Executive Chairman of Take-Two Interactive Software, Inc. From 1998 to 2000, Mr. Zelnick served as President and Chief Executive Officer of BMG Entertainment, Inc., a music and entertainment unit of Bertelsmann A.G. Mr. Zelnick served as President and Chief Executive Officer of BMG's North American business unit from 1994 through 1998. Mr. Zelnick is Chairman of the Board of CME, Inc., OTX, Inc. and ITN Networks, Inc. Mr. Zelnick is a director of Naylor, LLC.

*Thomas M. Casey* has served as our Executive Vice President and Chief Financial Officer since September 2007. From 1999 until the commencement of his employment at Blockbuster, Mr. Casey served as managing director for Deutsche Bank Securities, Inc. where he was responsible for the bank's retail industry relationships

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in North America and served as a strategic financial advisor to some of the world's largest companies in the retail entertainment, food and drug, convenience store, food wholesale and foodservice industries. Prior to Deutsche Bank, Mr. Casey held positions with Citigroup, Merrill Lynch and Dillon Read & Co.

*Eric H. Peterson* has served as our Executive Vice President, General Counsel and Secretary since October 2007. Prior to his employment at Blockbuster, Mr. Peterson served as Executive Vice President and General Counsel for the former TXU Corp. from 2002 until 2006. From 2000 to 2002, Mr. Peterson served as Senior Vice President and General Counsel for DTE Energy Company, a Michigan-based energy company. Prior to his employment at DTE Energy, Mr. Peterson was a partner in the law firm of Worsham, Forsythe & Woolridge LLP (now known as Hunton & Williams).

## **Available Information, Investor Relations and Certifications**

We file annual, quarterly and current reports, information statements and other information with the Securities and Exchange Commission (SEC). The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is <http://www.sec.gov>.

The address of our Internet website is [www.blockbuster.com](http://www.blockbuster.com), and the Investor Relations section of Blockbuster's website may be accessed directly at <http://investor.blockbuster.com>. Through links on the Investor Relations portion of our website, we make available free of charge our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. Such material is made available through our website as soon as reasonably practicable after we electronically file the material with, or furnish it to, the SEC. The information contained on our website does not constitute part of this annual report on Form 10-K.

### ***Stock Transfer Agency***

American Stock Transfer & Trust Company, LLC

59 Maiden Lane

New York, NY 10038

Questions and inquiries via telephone or AST's website:

(800) 937-5449

<http://www.amstock.com>

### ***Independent Registered Public Accounting Firm***

PricewaterhouseCoopers LLP

2001 Ross Avenue

Suite 1800

Dallas, TX 75201

### ***Stock Listing***

Blockbuster Inc. Class A and Class B common stock trades on the New York Stock Exchange under the symbols BBI and BBI.B, respectively.

### ***Certifications***

## Edgar Filing: BLOCKBUSTER INC - Form 10-K

We have submitted to the New York Stock Exchange the certification of our Chief Executive Officer, dated as of June 24, 2008, as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual.



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We have filed with the SEC the certifications of our Chief Executive Officer and our Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act of 2002 with respect to this Annual Report on Form 10-K. The certifications are attached hereto as Exhibits 31.1 and 31.2.

**Item 1A. Risk Factors**

*In addition to the information set forth elsewhere in this report, including under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, the factors described below should be considered carefully in making any investment decisions with respect to our securities. These factors could materially affect our business, financial condition, results of operations or liquidity and cause investors in our securities to lose part or all of their investments.*

**Risks Relating to Economic Conditions and the Financial Markets**

*The obligation of the lenders to fund the \$250 million amended credit facility is subject to the satisfaction of certain conditions, and there can be no assurances that these conditions will be satisfied. Even if the amended credit facility is funded upon the terms contemplated, we may not have sufficient liquidity to finance the ongoing obligations of our business, which raises substantial doubt about our ability to continue as a going concern.*

Our revolving credit facility and Term A loan facility are each scheduled to expire in August 2009. Given the impending expiration of both our revolving credit facility and Term A loan facility, on April 2, 2009, we amended our revolving credit facility, Term A loan facility and Term B loan facility to include commitments from certain of our lenders and certain new lenders to (a) replace the existing revolving credit facility with a \$250 million revolving credit facility with a maturity date of September 30, 2010 and (b) amend certain financial covenants, other covenants and other terms in our existing revolving credit facility, Term A loan facility and Term B loan facility. The obligation of the lenders to fund the \$250 million amended credit facility and effectuate such amendments is subject to the satisfaction of certain conditions set forth in the amendment. While we believe that all such conditions will be met and that we will be in a position to close on the amended credit facility on or about May 11, 2009, there can be no assurance regarding these matters.

The risk that we may not successfully complete this refinancing and obtain the related amendment of certain financial covenants included therein, and/or the risk that we may not have adequate liquidity to fund our operations as a result of not meeting our projected financial results, even if the refinancing is completed within the time and upon the terms contemplated, raise substantial doubt about our ability to continue as a going concern.

Our plans with respect to addressing these matters are discussed in greater detail under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources and in Note 1 to our consolidated financial statements, but generally include the closing of the amendment and extension of our revolving credit facility, as well as a cash management strategy intended to enhance and preserve as much of our liquidity as possible. Our future viability is dependent on our ability to execute these plans successfully or otherwise address our liquidity shortfall. If we fail to do so for any reason, we would not have adequate liquidity to fund our operations, would not be able to continue as a going concern and could potentially be forced to seek relief through a filing under the U.S. Bankruptcy Code.

*Our failure to comply with any of the restrictions in our debt agreements could result in acceleration of our debt. Were this to occur, we might not have, or be able to obtain, sufficient cash to pay our accelerated indebtedness.*

The operating and financial restrictions and covenants in our debt agreements, including our credit agreement and the indenture governing our senior subordinated notes, may adversely affect our ability to finance

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future operations or capital needs or to engage in new business activities. The debt agreements restrict our ability to, among other things:

declare dividends or redeem or repurchase capital stock;

prepay, redeem or repurchase other debt;

incur liens;

make loans, guarantees, acquisitions and investments;

incur additional indebtedness;

engage in sale and leaseback transactions;

amend or otherwise alter debt and other material agreements;

engage in mergers, acquisitions or asset sales; and

transact with affiliates.

In addition, our debt covenants require that we maintain certain financial measures and ratios. As a result of these covenants and ratios, we are limited in the manner in which we can conduct our business, and we may be unable to engage in favorable business activities or finance future operations or capital needs. Accordingly, these restrictions may limit our ability to successfully operate our business. A failure to comply with these restrictions or to maintain the financial measures and ratios contained in the debt agreements could lead to an event of default that could result in an acceleration of the indebtedness. During 2007, we were required to enter into an amendment to our credit agreement to modify or waive compliance with financial covenants thereunder. For an additional discussion of this amendment, please refer to Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Capital Structure.

Should the outstanding obligations under our credit agreement be accelerated and become due and payable because of our failure to comply with the applicable debt covenants in the future, we would be required to search for alternative measures to finance current and ongoing obligations of our business. If amounts outstanding under the credit agreement were called by the lenders due to a covenant violation, amounts under other agreements, such as the indenture governing our senior subordinated notes, could also become due and payable immediately. There can be no assurance that such financing will be available on acceptable terms, if at all. Our ability to obtain future financing or to sell assets could be adversely affected because a very large majority of our assets have been secured as collateral under the credit agreement. In addition, our financial results, our substantial indebtedness, our credit ratings and the declining in-store rental industry in which we operate could adversely affect the availability and terms of our financing. Further, uncertainty surrounding our ability to finance our obligations has in the past caused some of our trade creditors to impose increasingly less favorable terms and future uncertainty could similarly result in unfavorable terms from our trade creditors. In addition, there are other situations (including a change in the composition of our Board of Directors, whereby the majority of directors who were serving on the Board at the time we entered into our credit agreement and indenture (or their successors or nominees) are no longer serving on the Board) where our debt may be accelerated and we may be unable to repay such debt. Any of these scenarios could adversely impact our liquidity and results of operations or force us to file for protection under the U.S. Bankruptcy Code.

***Our level of indebtedness may make it more difficult for us to pay our debts and more necessary for us to divert our cash flow from operations to debt service payments.***

## Edgar Filing: BLOCKBUSTER INC - Form 10-K

Our total debt under our credit facilities and senior subordinated notes as of January 4, 2009 was \$780.9 million. Our debt service obligations could have an adverse impact on our earnings and cash flows for as long as the indebtedness is outstanding.

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Our indebtedness could have important consequences for our business. For example, it could:

make it more difficult for us to pay our debts as they become due during general adverse economic and market or industry conditions because any related decrease in revenues could cause us to not have sufficient cash flows from operations to make our scheduled debt payments;

limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate, including limiting our ability to invest in certain strategic initiatives, and, consequently, place us at a competitive disadvantage to our competitors;

require a substantial portion of our cash flows from operations to be used for debt service payments, thereby reducing the availability of our cash flow to fund working capital requirements including inventory, capital expenditures, acquisitions and other general corporate purposes;

cause our trade creditors to change their terms for payment on goods and services provided to us, thereby negatively impacting our ability to receive products and services on acceptable terms; and

result in higher interest expense in the event of increases in interest rates since some of our borrowings are, and will continue to be, at variable rates of interest.

Additionally, we could incur additional indebtedness in the future and, if new debt is added to our current debt levels, the risks above could intensify. Additional debt would further increase the possibility that we may not generate sufficient cash to pay, when due, interest on and other amounts due in respect of our indebtedness, and would further reduce our funds available for operations, working capital, capital expenditures, acquisitions and other general purposes. Additional debt may also decrease our ability to refinance or restructure our indebtedness, and further limit our ability to adjust to changing market conditions. If we or our subsidiaries add new debt to our current debt levels, the related risks that we and they now face could increase.

***We may not have sufficient cash flows from operating activities, cash on hand and available borrowings under our credit facilities to service our indebtedness.***

Our ability to make payments on and to refinance our indebtedness will depend on our ability to generate cash in the future. This, to some extent, is subject to general economic, financial, competitive, industry and other factors that are beyond our control. We cannot assure you that our future cash flow will be sufficient to meet our obligations and commitments. If we are unable to generate sufficient cash flow from operations in the future to service our indebtedness and to meet our other commitments, we will be required to adopt one or more alternatives, such as refinancing or restructuring our indebtedness, selling material assets or operations, reducing, deferring or eliminating certain capital expenditures or operating expenses or seeking to raise additional debt or equity capital. In connection with our cash management plan we have initiated certain actions discussed elsewhere herein to eliminate or reduce certain expenses. However, we cannot assure you that any of these actions could be effected on a timely basis or on satisfactory terms or maintained once initiated, or that these actions would enable us to continue to satisfy our capital requirements. In addition, our existing debt agreements, including the indenture governing our senior subordinated notes and our credit agreement, contain restrictive covenants which may prohibit us from adopting one or more of these alternatives, and any future debt agreements may contain similar restrictive covenants. Our failure to comply with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all of our debts, which we may be unable to repay. If we are unable to repay our debt upon acceleration we may be forced to file for protection under the U.S. Bankruptcy Code.

***Past and potential further downgrades in our debt ratings may adversely affect our cost of borrowing and related margins, liquidity, competitive position and access to capital markets.***

The major debt-rating agencies routinely evaluate our debt and rate our debt according to a number of factors, among which are, our perceived financial strength and transparency with rating agencies and timeliness



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of financial reporting. On August 14, 2008, Moody's Investors Service downgraded our probability of default rating to Caa1 from B3 based on refinancing challenges. However, Moody's Investors Service upgraded the rating on our credit facility to B1 from B3 on the same date as a result of our operating improvements. The downgrade in our probability of default rating could adversely affect our cost of funds and related margins, liquidity, competitive position and access to capital markets. On March 4, 2009, Standard & Poor's Ratings Service placed our credit ratings on credit watch in light of the pending maturities of our revolving credit facility and Term A loan facility in August 2009. Any downgrade in our credit ratings by Standard & Poor's could further adversely affect our ability to access capital upon acceptable terms and conditions.

**Risks Relating to Our Business Operations**

*We cannot predict the impact that the following may have on our business: (i) new or improved technologies or video formats, (ii) alternative methods of content delivery or (iii) changes in consumer behavior facilitated by these technologies or formats and alternative methods of content delivery. We also compete generally for the consumer's entertainment dollar and leisure time.*

Advances in technologies such as video-on-demand, new video formats, downloading or alternative methods of content delivery or certain changes in consumer behavior driven by these or other technologies and methods of delivery could have a negative effect on our business. In particular, our business could be adversely impacted if:

newly released movies were to be made widely available by the studios to these technologies or these formats at the same time or before they are made available to home video retailers for rental; and

these technologies or new formats were to be widely accepted by consumers.

Although we are pursuing, and may pursue in the future, initiatives related to alternative methods of content availability and delivery and believe that certain of these initiatives may be successfully integrated into our business model, we have limited experience with certain of these initiatives and cannot assure that they will be successful or profitable.

The widespread availability of additional channels on satellite and digital cable systems may significantly reduce public demand for our products. Advances in direct broadcast satellite and cable technologies may also adversely affect consumer demand for video store rentals and sales. Direct broadcast satellite providers transmit numerous channels of programs by satellite transmission into subscribers' homes. In addition, cable providers are taking advantage of digital technology to transmit many additional channels of television programs over cable lines to subscribers' homes. Because of their increased availability of channels, direct broadcast satellite and digital cable providers have been able to enhance their pay-per-view businesses by:

substantially increasing the number and variety of movies they can offer their subscribers on a pay-per-view basis; and

providing more frequent and convenient start times for the most popular movies.

In addition, pay-per-view allows the consumer to avoid trips to the video store for rentals and returns of movies. However, newly released movies are currently made available by the studios for rental prior to being made available on a pay-per-view basis. In addition, pay-per-view does not currently provide the same start, stop and rewind capabilities as DVD or video. If, however, direct broadcast satellite and digital cable services, including enhanced pay-per-view services, were to become more widely available and accepted, this could have a negative effect on our video store business. This is because a smaller number of movies may be rented or sold if viewers were to favor the expanded number of conventional channels and expanded content, including movies, specialty programming and sporting events, offered through these services. Additionally, increases in the size of the pay-per-view market could lead to an earlier distribution window for movies on pay-per-view if the studios were to perceive this to be a better way to maximize their revenues.

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The availability of content through personal video recorders, video-on-demand and other technologies may significantly reduce the demand for our products or otherwise negatively affect our business. Any method for delivery of entertainment content that serves as an alternative to obtaining product or services from our stores or our online DVD rental service can impact our business. Examples of delivery methods that have impacted, or could impact, our business include:

personal video recorders,

video-on-demand,

download-to-burn DVDs,

video vending machines and download-to-burn kiosks,

video downloads to portable devices and personal computers, and

disposable DVDs.

Moreover, technology and consumer offerings continue to develop, and we expect that new or enhanced technologies and consumer offerings will be available in the future. We may pursue certain of those technologies and consumer offerings if we believe they offer a sustainable customer proposition, are accretive to earnings and can be successfully integrated into our business model. However, we cannot predict consumer acceptance of these delivery channels or their impact on our business.

We also compete generally for the consumer's entertainment dollar and leisure time with, among others, (i) movie theaters; (ii) Internet browsing, online gaming and other Internet-related activities; (iii) consumers' existing personal movie libraries; (iv) live theater; (v) sporting events; and (vi) music entertainment. Our results can therefore fluctuate depending on the desirability of other forms of entertainment.

***Overall revenues generated from the in-store home video industry are projected to continue to decline. A faster than anticipated decline in the in-store industry has, in the past and may in the future, adversely affect our business and our ability to implement our strategic initiatives, particularly when considering sustained decreases in consumer spending attributable to the unprecedented decline in overall economic conditions, the reversal of which cannot be accurately determined.***

We continue to experience challenges caused by the faster than anticipated decline in the worldwide in-store home video rental industry. We believe that the faster than anticipated declines are caused primarily by (i) a weak slate of titles released to home video; (ii) increased competition from retail mass merchant sales of low-priced DVDs, online rentals, kiosk and vending rental and sales and other sources of in-home entertainment such as digital video recorders and other devices that are capable of downloading content for in-home viewing; (iii) competition from piracy in certain international markets; and (iv) competition from other forms of leisure entertainment. A faster than anticipated decline in the worldwide in-store home video rental industry in the future may similarly negatively impact our business and our ability to implement our strategic initiatives.

***There can be no assurance that we will fully develop an ability to respond to changing consumer preferences, including with respect to new technologies and alternative methods of content delivery, to effectively adjust our product mix, service offerings and marketing and merchandising initiatives, or to selectively develop and maintain strategic alliances for products and services that meet and anticipate advances in technology and market trends.***

We have implemented and expect to continue to implement initiatives that are designed to enhance efficiency, customer convenience and our product offerings. In doing so, we are competing in markets for products and services that are highly competitive and subject to evolving industry standards and rapid adoption of technical innovation and product enhancements by competitors. The implementation of new initiatives has involved, and will continue to involve, significant investments by us of time and money and could be adversely





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impacted by (i) our inability to timely implement and maintain the necessary information technology systems and infrastructure to support shifts in consumer preferences and any corresponding changes to our operating model, including continued support for our initiatives and (ii) the extent and timing of our continued investment of incremental operating expenses and capital expenditures to continue to develop and implement our initiatives and our corresponding ability to effectively control overall operating expenses and capital expenditures.

We are currently pursuing certain initiatives that are related to digital content distribution, kiosk vending and consumer electronic devices. In these areas we face substantial competition from companies that have significant technical, marketing, distribution and other resources, as well as established hardware, software, and digital supplier relationships. We expect competition to intensify as competitors individually and collaboratively adopt new technologies to offer integrated solutions in these areas. Because we have limited experience with some of our new customer proposition initiatives, we cannot assure you that they will be profitable or successful in retaining customers. Our ability to effectively and timely prioritize and implement our initiatives will also affect when and if they will have a positive impact on our profitability.

***If the average sales and rental prices for our product are not at or above expected prices, our expected gross margins may be adversely affected.***

To achieve our expected revenues and gross margins, we need to sell and rent, as applicable, our product, including previously rented, retail and rental (whether in-store or online) product at or above expected prices. If the average sales or rental prices of such product are not at or above these expected prices, our revenues and gross margins may be adversely affected.

It is also important that we maximize our gross margins through our allocation of store space. We may need to turn our inventory of previously rented and retail product more quickly in the future in order to make room in our stores for additional DVDs, new customer proposition initiatives or to downsize the store. Therefore, we cannot assure you that in the future we will be able to rent or sell, on average, our product at or above the expected price.

Other factors that could affect our ability to rent or sell our product at expected prices include:

consumer desire to rent any of our movies and games;

consumer desire to own a particular movie or game;

the amount of product available for rental or sale by others to the public; and

changes in the price of product by the studios or changes by other retailers, particularly mass merchant retailers.

***Our financial results are impacted by seasonality, including the adverse impact caused by improved weather conditions.***

There is a distinct seasonal pattern to the home video and video games business, with slower business in April and May, due in part to improved weather and Daylight Saving Time, and in September and October, due in part to the start of school and the introduction of new television programs. The months of November and December have historically been our highest revenue months. While we expect these months to continue to make the largest contributions to our rental revenues, we believe the strength of rental revenues in these months has been and will continue to be negatively affected, to some degree, by consumers purchasing DVDs during the holiday season. Although our online and in-store rental subscription offerings have helped us mitigate, to some extent, the impact of seasonality and weather conditions on our business by providing a more steady revenue stream across all months, seasonality and weather are expected to continue to impact our business and our period-to-period financial results in the future.

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***Our revenues could be adversely affected due to the variability in consumer appeal of the movie titles and game software released for rental and sale, as well as the effect of game platform cycles.***

The quality of movie titles and game software released for rental and sale is not within our control, and our results of operations have from time to time reflected the variability in consumer appeal for such items. We cannot assure you that future releases of movie titles and game software will appeal to consumers and, as a result, our revenues and profitability may be adversely affected.

***Our financial results could be adversely affected if we are unable to manage our inventory effectively or if we are unable to reach agreements with service, product and content providers on favorable commercial terms, including on such matters as copy depth and uses of product.***

Our purchasing decisions are influenced by many factors, including, among others, gross margin considerations and supplier product return policies. While much of our retail movie product in the United States, but not outside the United States, is returnable to vendors, our investments in retail movie inventory may result in excess inventories in the event anticipated sales fail to materialize. In addition, returns of our games inventory, which is prone to obsolescence risks because of the nature of the industry, are subject to negotiation with vendors.

Our purchasing decisions also involve predictions of consumer demand. While the historical growth of our in-store and online subscription programs and the free in-store rentals provided by our BLOCKBUSTER Total Access program have increased consumer demand for our products, these programs have increased the complexity of our purchasing decisions. In addition, the prevalence of multiple game platforms adds to the difficulty of accurately predicting consumer demand with respect to video games. The nature of and market for our products, particularly games and DVDs, also makes them prone to risk of theft and loss.

Our operating results could therefore suffer if we are not able to:

obtain or maintain favorable terms from our suppliers with respect to such matters as copy depth, use of product, including without limitation fulfillment of online orders, and product returns;

maintain adequate copy depth to maintain customer satisfaction;

control shrinkage resulting from theft or loss; or

avoid significant inventory excesses that could force us to sell products at a discount or loss.

Further, as discussed below, uncertainty surrounding our ability to finance our obligations has in the past caused some of our trade creditors to impose increasingly less favorable terms and future uncertainty could similarly result in unfavorable terms from our trade creditors.

***Our business would lose a competitive advantage if the movie studios were to shorten or eliminate the home video retailer distribution window or otherwise adversely change their current practices with respect to the timing of the release of movies to the various distribution channels.***

A competitive advantage that home video retailers currently enjoy over most other movie distribution channels, except theatrical release, is the early timing of the home video retailers' distribution window. After the initial theatrical release of a movie, the studios' current practice is to generally make their movies available to home video retailers (for rental and retail, including by mass merchant retailers) for specified periods of time. This distribution window has traditionally been exclusive against most other forms of non-theatrical movie distribution, such as pay-per-view, video-on-demand, premium television, basic cable, and network and syndicated television. The length of this exclusive distribution window for home video retailers varies, but since the mid-1990s has averaged between 34 and 58 days for domestic home video retailers. Thereafter, movies are made sequentially available to television distribution channels. The studios' traditional practices with respect to the distribution windows could change at any time.



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Our business could be negatively affected if:

the home video retailer distribution windows were no longer the first following the theatrical release;

the length of the home video retailer distribution windows were shortened; or

the home video retailer distribution windows were no longer as exclusive as they are now.

This is because newly released movies would be made available earlier on these other forms of non-theatrical movie distribution, and consumers might no longer need to wait until after the home video retailer distribution window to view a newly released movie on one or more of these other distribution channels. In such event, we would need to address additional competition. According to industry statistics, more movies are now being released to pay-per-view at the shorter end of the home video retailer distribution window range than at the longer end. In addition, many of the major movie studios have entered into various ventures to provide video-on-demand or similar services of their own. Increased studio participation in or support of these types of services could impact their decisions with respect to the timing and exclusivity of the home video retailer distribution window.

Recently, there has been increasing experimentation by studios and various movie content aggregators and retailers with the traditional distribution windows, including simultaneous video-on-demand and DVD releases. For example, although movie selections tend to be limited at present, consumers can now download to their computers certain available movies on the same day that the movie's DVD is released by the studios nationwide in retail stores for rental or sale, and, in some cases, consumers can also burn the downloaded movie to a blank DVD for playback in a DVD player, allowing them to watch the movies on their TVs or portable devices. We expect that the movie studios will continue to assess the traditional release windows and it is possible that the studios may decide to alter the traditional home video retailer distribution window for an increasing number of movies, particularly in connection with simultaneous video-on-demand distribution of movies and DVD release dates.

We believe that the studios have a significant interest in maintaining a viable home video retail industry. However, because the order, length and exclusivity of each window for each distribution channel are determined solely by the studio releasing the movie, we cannot predict the impact, if any, of any future decisions by the studios. In addition, any consolidation or vertical integration of media companies to include both content providers and digital distributors could pose a risk to the continuation of the home video retailer distribution window.

***Changes in studio pricing policies have resulted in increased competition, in particular from mass merchant retailers, which has impacted consumer rental and purchasing behavior. We cannot control or predict future studio decisions or resulting consumer behavior, and future changes could negatively impact our profitability.***

The studios' current practice is generally to sequentially release their movies to different distribution channels. After the initial theatrical release of a movie, studios generally make their movies available to home video retailers (for rental and retail, including by mass merchant retailers) for a specified period of time. This distribution channel is typically exclusive against other forms of non-theatrical movie distribution, including cable and satellite distribution, and is commonly referred to as the home video retailers' distribution window.

Historically, at the beginning of a particular movie title's distribution window, the movie in VHS format would be priced to home video retailers based on the applicable studio's decision to promote the movie to the consumer either primarily for rental, or for both rental and sale, at the beginning of the distribution window. In order to promote a movie title primarily for rental at the beginning of the distribution window, a studio would initially release the title to home video retailers at a price that was too high to enable them to sell the title to consumers at an affordable price. As rental demand subsided, the studio would reduce the pricing for the movie,

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which would then enable retailers to sell the title to consumers at an affordable price. The time during which the studios released the title at the higher pricing was commonly referred to as the rental window. Currently, substantially all DVD titles are initially released to home video retailers at a price that is low enough to allow them to offer movies at affordable prices to the consumer from the beginning of the home video retailers distribution window. This method of pricing is commonly referred to as sell-through pricing, and has improved our ability to purchase rental product at lower prices. However, the studios sell-through pricing policy has also led to increasing competition from other retailers, in particular mass merchants such as Wal-Mart, Best Buy and Target. It has also led to increased competition from online retailers. These other retailers are able, due to the lower sell-through prices, to purchase DVDs for sale to consumers at the same time as traditional home video retailers, who, like us, purchase product for rental. In addition, some retailers lower their sales prices in order to increase overall traffic to their stores or businesses, and mass merchants may be more willing to sell at lower, or even below wholesale, prices to drive traffic and thereby increase sales of their other inventory items. All of these factors have increased consumer interest in purchasing DVDs, which has resulted in increased competition and reduced the significance of the historical rental window.

We believe that the increased consumer purchases of movies have been due in part to consumer interest in building DVD libraries of classic movies and personal favorites and that the studios will remain dependent on traditional home video retailers to generate revenues for the studios from titles that are not classics or current box office hits. We therefore believe the importance of the video rental industry to the studios will continue to be a factor in studio pricing decisions. However, we cannot control or predict studio pricing policies with certainty, and we cannot assure you that consumers will not, as a result of further decreases in studio sell-through pricing and/or sustained or further depressed pricing by competitors, increasingly desire to purchase rather than rent movies. Personal DVD libraries could also cause consumers to rent or purchase fewer movies in the future. Our profitability could, therefore, be negatively affected further if, in light of any such consumer behavior, we were unable to (i) maintain or increase our rental business; (ii) replace gross profits from generally higher-margin rentals with gross profits from increased sales of generally lower-margin sell-through product; or (iii) otherwise positively affect gross profits, such as through price increases or cost reductions. Our ability to achieve one or more of these objectives is subject to risks, including the risk that we may not be able to compete effectively with other DVD retailers, some of whom may have competitive advantages such as the pricing flexibility described above or favorable consumer perceptions regarding value.

Our profitability is also dependent on our ability to enter into arrangements with the studios that effectively balance cost considerations and the number of copies of a title stocked by us. Each type of arrangement provides different advantages and challenges for us. Our profitability could be negatively affected if studios were to make other changes in their pricing policies, which could include changes in revenue-sharing arrangements, pricing or rental windows for DVDs or expanded exploitation by studios of international two-tiered pricing laws, which allow studios to charge different prices for movies intended for rental to consumers, as opposed to sale. In addition, we cannot predict what use the studios might make of current or future alternative supply methods, such as downloading to stores or consumers, or what impact the use of such supply chain changes by us or our competitors might have on our profitability.

***Industry consolidation in the in-store home video rental industry has occurred and may continue. If we are not successful in capitalizing on this industry consolidation, our financial results may be adversely affected.***

Based upon current industry projections, we believe that over-capacity exists in the video rental market and that, as a result, many video stores, including some of our own stores, will be forced to close in the future. If we are unable to capitalize on the store closings of our competitors, we may be unable to grow our market share and our financial results may be adversely affected. In addition, we have historically closed underperforming video stores and will continue to consider the closure of underperforming stores. We are currently reviewing many of our store leases and evaluating certain sites to close or downsize based on store profitability.

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***Investment in new business strategies and initiatives could disrupt our ongoing business and present risks not originally contemplated.***

We have invested, and in the future may invest, in new business strategies and initiatives. Such opportunities may also involve significant risks and uncertainties, including distraction of management from current operations, insufficient revenue to offset expenses associated with the strategy or initiative, inadequate return of capital, and unidentified issues not initially contemplated or discovered. Because these new strategies and initiatives may be relatively new for us, no assurance can be given that such strategies and initiatives will be successful and will not have a material adverse effect on our financial condition and operating results.

***For certain of our customer proposition initiatives we may rely on third-party digital content, which may not be available to us on commercially reasonable terms or at all.***

In addition to offering our own digital content from time to time we may contract with third parties to offer their digital content through our stores or alternative aggregation and content delivery products and services. In those cases, we could pay substantial fees to obtain rights to offer such content. Our licensing arrangements with these third-party content providers may be short-term and may not guarantee the continuation or renewal of these arrangements on reasonable terms. Some third-party content providers may also offer competing products and services, or offer similar content to our competitors, and could take action to make it more difficult for us to license their content in the future. If we are unable to continue to offer a wide variety of content at reasonable prices with acceptable usage rules, or continue to expand our systems and platforms and customer offerings for these relatively new customer proposition initiatives, our financial condition and operating results may be materially adversely affected.

Third-party content providers may require that we provide certain digital rights management and other security solutions. If these requirements change we may have to develop or license new technology to provide such solutions. There is no assurance that we will be able to develop or license such solutions at a reasonable cost and in a timely manner.

***Any failure or inadequacy of our information technology infrastructure could harm our business.***

The capacity, reliability and security of our information technology hardware and software infrastructure and our ability to expand and update this infrastructure in response to our changing needs are important to the continued implementation of our new customer proposition initiatives, as well as the operation of our business generally. To avoid technology obsolescence and enable future cost savings and customer enhancements, we are continually updating our information technology infrastructure. In addition, we intend to add new features and functionality to our products, services and systems that could result in the need to develop, license or integrate additional technologies. Our inability to add additional software and hardware or to upgrade our technology infrastructure could have adverse consequences, which could include the delayed implementation of our new customer proposition initiatives, service interruptions, impaired quality or speed of the users' experience and the diversion of development resources. Our failure to provide new features or functionality to our systems also could result in these consequences. We may not be able to effectively upgrade and expand our systems, or add new systems, in a timely and cost effective manner and we may not be able to smoothly integrate any newly developed or purchased technologies with our existing systems. These difficulties could harm or limit our ability to improve our business. In addition, any failure of our existing information technology infrastructure could result in significant additional costs to us. Certain of our information technology services and support functions are performed by third parties. Service interruptions, contract disputes or the effect of general market conditions on these service providers could adversely impact the availability and reliability of service and support.

***Our results of operations could be materially adversely affected if our franchisees failed to pay our franchise fees.***

In certain areas within the United States and internationally, we rely on our franchisees to offer our products and services. A portion of our revenues are derived from royalty fees through our franchising program. Many of

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our franchisees have been negatively affected by the depressed economic conditions over the past 12 months. We may experience difficulties in collecting our franchise fees on a timely basis, or at all, for a variety of reasons, including the inability of our franchisees to achieve sufficient revenues and cash flows from their stores or to otherwise effectively operate their stores under challenging industry conditions. Some of our franchisees have perceived certain of our recent customer proposition initiatives as conflicting with their business interests. Lawsuits and other disputes with our franchisees may also reduce the amount of our royalties from franchise fees. Any failure by our franchisees to pay their franchise fees to us on time or at all could materially adversely affect our results of operations.

***Piracy of the products we offer or the disregard of release dates by other retailers may adversely affect our operations.***

Although piracy is illegal, it is a significant threat to the home video industry. The primary methods of piracy affecting the home video industry are (i) the illegal copying of theatrical films at the time they are first run; (ii) the illegal copying of DVDs that are authorized by the studios solely for retail sale and/or rental by authorized retailers; and (iii) the illegal online downloading of movies. These methods of piracy enable the low-cost sale of DVDs as well as the free viewing and sharing of DVDs, both of which compete with rentals and sales by authorized retailers like us. Competition from piracy has increased in recent years due in part to developments in technology that allow for faster copying and downloading of DVDs.

Although piracy is a concern in the United States, it is having a more significant adverse affect on the home video industry in international markets. We cannot assure you that movie studios and others with rights in the product that we rent or sell can, or will, take steps to enforce their rights against piracy or that they will be successful in preventing the distribution of pirated content. Increases in piracy could continue to negatively affect our revenues. For example, in 2006, we closed all of our store locations in Spain, driven in part by the impact of piracy in that market.

Another risk that we face is the disregard by other home video retailers of the studios' specified release dates for their titles. If other home video retailers rent or sell product before the specified release dates (i.e., before us), we can be adversely affected, as the first weeks after a movie title's release typically represent a significant portion of the demand for that title. We cannot assure you that the studios can or will control such distribution and release practices, particularly in countries outside of the United States.

***Our business model is substantially dependent on the functionality of our distribution centers.***

Our domestic distribution system for our store-based operations is centralized. We ship a substantial portion of the products to our U.S. company-operated stores through our distribution center. We also have 38 regional U.S. distribution centers to support our domestic online DVD subscription service. If our distribution centers became non-operational for any reason, we could incur significantly higher costs and longer lead times associated with distributing our movies and other products. In international markets, we utilize a variety of distribution methodologies with similar risks to those in the United States.

***The application of SFAS No. 142, Goodwill and Other Intangible Assets, resulted in the recognition of a significant non-cash impairment charge for the quarter ended January 4, 2009, which has materially adversely affected our results of operations for the fourth quarter and the 2008 fiscal year. The application and impact of existing and future accounting policies or interpretations of existing accounting policies for future economic developments may further negatively impact our financial results.***

In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* referred to as SFAS 142, we test goodwill and other intangible assets for impairment during the fourth quarter of each year and on an interim date should factors or indicators become apparent that would require an interim test. In recent periods we have taken significant charges relating to the impairment of goodwill. See Note

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2 to the consolidated financial statements and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates in this Form 10-K.

As discussed in Note 2 to the consolidated financial statements, we performed our annual impairment test as of October 31, 2008. The test indicated that the goodwill associated with our domestic reporting unit was impaired. Therefore, we recognized a \$432.6 million goodwill impairment charge during the fourth quarter of 2008.

The market price of our Class A common stock has been subject to substantial volatility and has decreased significantly during the first quarter of 2009. We believe that the need for an interim impairment test may be triggered by, among other factors, declines in the media entertainment industry, a reduction in our profitability, or a sustained decline in our stock price. Consequently, we may need to perform an interim impairment test and may recognize an additional non-cash goodwill impairment charge during 2009. Our goodwill balance totaled \$338.1 million as of January 4, 2009. Any additional required non-cash impairment charge could significantly reduce this balance and have a material impact on our reported financial position and results of operations.

### **Risks Relating to Our Common Stock**

*The significant price and volume volatility in our common stock may continue not only as a result of generally depressed market conditions but also any change in sentiment in the market regarding our operations, business model, business prospects or ability to refinance our debt obligations.*

The price at which our common stock has traded in recent periods has fluctuated greatly, and most recently has declined significantly. The price may continue to be volatile due to a number of factors including the following, some of which are beyond our control:

variations in our operating results;

variations between our actual operating results and the expectations of securities analysts, investors and the financial community;

announcements of developments affecting our business, systems or expansion plans of others;

competition, including the introduction of new competitors, their pricing strategies and services;

perceptions regarding the current and long-term viability of our business model and the success of ongoing and proposed strategic initiatives;

market volatility in general; and

the operating results of our competitors.

As a result of these and other factors, investors in our common stock may not be able to resell their shares at or above their original purchase price.

Following certain periods of volatility in the market price of our securities, we have become the subject of securities litigation. We may experience more of such litigation following future periods of volatility. This type of litigation may result in substantial costs and a diversion of management's attention and resources.

*We may not be able to remain in compliance with the New York Stock Exchange's continued listing criteria.*



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Our Class A and Class B common stock are traded on the New York Stock Exchange ( Exchange ) and are thereby subject to certain continued listing criteria established by the Exchange in order to maintain listing on the Exchange. Among such criteria is the requirement that the Class A stock maintain a \$1.00 minimum average

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closing price. If the average closing price of the Class A stock is below \$1.00 for any consecutive 30-trading-day period, the Class A and Class B stock will be delisted and moved to the Exchange's ARCA electronic exchange.

The price at which the Class A stock has traded in recent periods has fluctuated greatly, and most recently has declined significantly, trading at prices at or below \$1.00. If we are unable to maintain the Exchange listing for the Class A and Class B stock as a result of our failure to continue to comply with this, or any, minimum listing requirement, the Class A and Class B shares may be perceived as a less desirable investment, negatively affecting the market for the stock, which could decrease our ability to issue new stock and attract further equity investment. A delisting could also worsen the perception of the company's financial distress among our lenders, trade creditors, business partners, vendors, analysts and the media, which could cause some of our trade creditors to impose increasingly less favorable terms and make it more difficult for us to obtain future financing and develop strategic alliances. In February 2009, the NYSE suspended its \$1 minimum average closing price requirement on a temporary basis, initially through June 30, 2009. The effect of this suspension is that companies that fall below the \$1 minimum price criteria during the suspension period will not be deemed to be below the Exchange's continued listing criteria while the suspension is in place.

**Other Business Risks**

***Our success depends largely on our ability to attract and retain key personnel. If we lose key senior management or are unable to attract and retain the talent required for our business, our operating results could suffer.***

During 2007 we hired new members of our senior management team from outside of Blockbuster, including our Chief Executive Officer, Chief Financial Officer and General Counsel. Our performance depends in part on the ability of this largely new senior management team to coalesce, motivate our employees and address the changes presented by our dynamic industry and the challenging economic conditions. Additionally, we rely upon the continued service and availability of skilled personnel in technical, operations and staff positions. The unexpected future loss of services of one or more members of our senior management team could have an adverse effect on our business. We will need to attract and retain additional qualified personnel and develop, train and manage management-level employees. We have relied on equity awards as one means for recruiting and retaining highly skilled talent. Accounting regulations requiring the expensing of stock options have resulted in increased stock-based compensation expense, which could cause us to reduce the number of stock-based awards issued to employees and could negatively affect our ability to attract and retain key personnel. Additionally, significant adverse volatility in our stock price could result in a stock option's exercise price exceeding the underlying stock's market value, thus lessening the effectiveness of retaining employees through stock-based awards. In addition, recent cost containment initiatives affecting our compensation practices that have been adopted in response to the current economic environment will also impact our ability to attract and maintain personnel to some extent, depending upon the length of time during which these initiatives remain in effect. As a result of these factors, we cannot assure you that we will be able to continue to attract and retain personnel as needed in the future.

***We are subject to governmental regulation particular to the retail home video industry and changes in U.S. or international laws may adversely affect us.***

Any finding that we have been, or are, in noncompliance with respect to, or otherwise liable under, the laws affecting our business could result in costs, including, among other things, governmental penalties or private litigant damages, which could have a material adverse effect on us. We are subject to various international and U.S. federal and state laws that govern the offer and sale of our franchises because we act as a franchisor. In addition, because we operate video stores and develop new video stores, we are subject to various international and U.S. federal and state laws that govern, among other things, the disclosure and retention of our video rental records and access to and use of our video stores by disabled persons, and are subject to various international, U.S. federal, state and local advertising, consumer protection, credit protection, franchising, licensing, zoning,

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land use, construction, trading activities, second-hand dealer, minimum wage and labor and other employment regulations, as well as laws and regulations relating to the protection and cleanup of the environment and health and safety matters. The international home video and video game industry varies from country to country due to, among other things, legal standards and regulations, such as those relating to foreign ownership rights; unauthorized copying; intellectual property rights; movie ratings, which in many countries are legal standards unlike the voluntary standards of the United States; labor and employment matters; trade regulation and business practices; franchising and taxation; environmental matters; and format and technical standards. Our obligation to comply with, and the effects of, the above governmental regulations are increased by the magnitude of our operations.

Changes in existing laws, including environmental and employment laws, adoption of new laws or increases in the minimum wage, may increase our costs or otherwise adversely affect us. For example, the repeal or limitation in the United States of certain favorable copyright laws would have an adverse impact in the United States on our rental business. Similarly, the adoption or expansion of laws in any other country to allow copyright owners to charge retailers more for rental product than for sell-through product could have an adverse impact on our rental business in that country.

### ***We are subject to business risks of international operations.***

We derive a material portion of our revenue through our international operations. As a result, our financial condition and operating results could be significantly affected by risks associated with international activities, including economic and labor conditions, political instability, tax laws (including U.S. taxes on foreign operations), and changes in the value of the U.S. dollar relative to local currencies. Margins on the sale and rental of our products in foreign countries could be materially adversely affected by foreign currency exchange rate fluctuations and by international trade regulations.

### ***We have assumed obligations pursuant to agreements with Viacom relating to certain real estate leases guaranteed by Viacom, which obligations may adversely affect our ability to negotiate renewals or modifications to a subset of such leases.***

In October 2004, we completed our divestiture from Viacom. We entered into an amended and restated initial public offering and split-off agreement with Viacom in connection with this divestiture. This agreement, which is referred to as the IPO agreement, imposes various restrictions and limitations on our ability to renew or modify, in a manner that increases Viacom's potential liability, a subset of the leases guaranteed by Viacom, which could make it more difficult and expensive, and in some cases impossible, to renew or modify certain of these leases.

### ***We have also assumed obligations pursuant to the IPO agreement to maintain letters of credit in favor of Viacom, which obligations reduce our borrowing capacity.***

Pursuant to the IPO agreement, we have provided letters of credit, at Viacom's expense, for the benefit of Viacom to support Viacom's potential liability for certain real estate lease obligations of ours. On October 24, 2008, we entered into an amendment to the IPO Agreement. Pursuant to the amendment, the face amount of the letters of credit required to be provided by us for the benefit of Viacom was reduced from \$150.0 million to \$75.0 million and the conditions on which Viacom may draw on the letters of credit were amended. In addition, in the amendment, we assumed responsibility for the payment of any and all fees and expenses incurred in connection with the establishment and maintenance of the letters of credit. As a result of the amendment our available borrowing capacity increased by \$75.0 million. See Note 6 to the consolidated financial statements and the Liquidity and Capital Resources section of the MD&A in this Form 10-K.

Until the letters of credit or any renewals thereof are terminated, we anticipate any future or additional lenders may treat our letter of credit obligation as if it were outstanding indebtedness when assessing our

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borrowing capacity. Furthermore, if we are unable to renew or otherwise replace the letters of credit prior to their expiration as required by the IPO agreement, Viacom has the right to draw down the full amount of the outstanding letters of credit, which may cause us to borrow funds under our credit facility to reimburse the issuing bank. In either case, our obligation to maintain the letters of credit may restrict or prevent us from being able to borrow amounts necessary to engage in favorable business activities, consummate strategic acquisitions or otherwise fund capital needs.

*We are subject to various litigation matters that could, if judgments were to be rendered against us, have an adverse effect on our operating results.*

We are subject to various legal proceedings and claims that have arisen in the ordinary conduct of our business and are not yet resolved and additional claims may arise in the future. Results of legal proceedings cannot be predicted with certainty. Regardless of its merit, litigation may be both time consuming and disruptive to our operations and cause significant expense and diversion of management attention. In recognition of these considerations, we may from time to time enter into material settlements. Should we fail to prevail in certain matters, or should several of these matters be resolved against us in the same reporting period, we may be faced with significant monetary damages or injunctive relief that could materially adversely affect a portion of our business and might materially affect our financial condition and operating results. See Note 8 to the consolidated financial statements for a discussion of certain pending material litigation matters relating to our business.

*Provisions in our charter documents and Delaware law could make it more difficult to acquire our Company.*

Our second amended and restated certificate of incorporation ( certificate of incorporation ) and amended and restated bylaws ( bylaws ) contain provisions that may discourage, delay or prevent a third party from acquiring us, even if doing so would be beneficial to our stockholders. Our bylaws limit who may call special meetings of stockholders to any officer at the request of a majority of our Board of Directors, the Chairman of the Board or the Chief Executive Officer of the Company. Our certificate of incorporation and bylaws provide that the bylaws may be altered, amended or repealed by the Board of Directors.

Pursuant to our certificate of incorporation, the Board of Directors may by resolution establish one or more series of preferred stock, having such number of shares, designation, relative voting rights, dividend rates, liquidation or other rights, preferences and limitations as may be fixed by the Board of Directors without any further stockholder approval. Such rights, preferences, privileges and limitations as may be established could have the effect of impeding or discouraging the acquisition of control of us, which could adversely affect the price of our equity securities.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Our corporate headquarters are located at 1201 Elm Street, Dallas, Texas 75270 and consist of 242,615 square feet of space leased pursuant to an agreement that expires on June 30, 2017. Our primary distribution center is located at 3000 Redbud Blvd., McKinney, Texas 75069 and consists of about 850,000 square feet of space leased pursuant to an agreement that expires on December 31, 2012. We have set up our payroll and benefits center in Spartanburg, South Carolina. We also lease and operate 38 online distribution centers spread strategically throughout the United States to support our domestic online rental service.

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We have country head offices in Buenos Aires, Argentina; Toronto, Canada; Uxbridge, England; Dublin, Ireland; Milan, Italy; Herlev, Denmark; and Mexico City, Mexico. For most countries in which we have company-operated stores, we maintain offices to manage our operations within that country.

We lease substantially all of our existing store sites. Within the United States, Canada and Mexico, these leases generally have a term of three to five years. The leases in our European markets generally have a term of twenty to thirty years. We expect that most future stores will also occupy leased properties.

**Item 3. *Legal Proceedings***

Information regarding our material legal proceedings is set forth in Note 8 to the consolidated financial statements, in Item 8 of Part II of this Form 10-K, which information is incorporated herein by reference.

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

None.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The shares of Blockbuster Class A and Class B common stock are listed and traded on the New York Stock Exchange, or NYSE, under the symbols BBI and BBLB, respectively. Our Class A common stock began trading on August 11, 1999, following our initial public offering and our Class B common stock began trading on October 14, 2004, in conjunction with our divestiture from Viacom Inc. (Viacom). The following table contains, for the periods indicated, the high and low sales prices per share of our Class A and Class B common stock as reported on the NYSE composite tape and the cash dividends per share of our Class A and Class B common stock:

	Blockbuster Class A Common Stock Sales Price		Blockbuster Class B Common Stock Sales Price		Cash Dividends per share of Common Stock(1)
	High	Low	High	Low	
<b>Year Ended January 6, 2008:</b>					
Quarter Ended April 1, 2007	\$ 7.30	\$ 5.41	\$ 6.90	\$ 4.98	\$
Quarter Ended July 1, 2007	\$ 6.67	\$ 3.94	\$ 6.18	\$ 3.54	\$
Quarter Ended September 30, 2007	\$ 5.71	\$ 3.96	\$ 5.00	\$ 3.57	\$
Quarter Ended January 6, 2008	\$ 5.80	\$ 2.99	\$ 5.12	\$ 2.57	\$
<b>Year Ended January 4, 2009:</b>					
Quarter Ended April 6, 2008	\$ 3.70	\$ 2.66	\$ 3.49	\$ 2.25	\$
Quarter Ended July 6, 2008	\$ 3.55	\$ 2.38	\$ 2.92	\$ 1.92	\$
Quarter Ended October 5, 2008	\$ 3.19	\$ 1.86	\$ 2.44	\$ 1.09	\$
Quarter Ended January 4, 2009	\$ 2.00	\$ 0.72	\$ 1.59	\$ 0.18	\$

(1) We have not paid a dividend since the second quarter of 2005. Our Board of Directors may evaluate declaring quarterly cash dividends in the future.

The terms of our debt agreements, as discussed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources, limit our ability to repurchase common stock and pay dividends. Subject to these limitations, our Board of Directors may change our dividend practices from time to time and decrease or increase the dividend paid, or not pay a dividend, on our common stock based on factors such as results of operations, financial condition, cash requirements and future prospects and other factors deemed relevant by our Board of Directors.

The number of holders on record of shares of our Class A and Class B common stock as of March 30, 2009 was 1,116 and 793, respectively.

For information regarding our equity compensation plans, refer to the proxy statement to be filed for our 2009 annual meeting of stockholders incorporated by reference into Item 12 of Part III of this Form 10-K.

**Table of Contents****Stock Performance Graphs**

*The following stock performance graphs and related information shall not be deemed soliciting material or filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, except to the extent that Blockbuster specifically incorporates it by reference into such filing.*

The following graph compares the cumulative total stockholder return on our Class A common stock over the five-year period ended December 31, 2008, the cumulative total return during such period of the Standard and Poor's 500 Stock Index ( S&P 500 Index ) and the Hemscott Industry Group Index 743-Music & Video Stores ( Hemscott Group Index ). The comparison assumes \$100 was invested on December 31, 2003, in our Class A common stock and in each of the foregoing indices and assumes reinvestment of dividends. The stock performance shown on the graph below represents historical stock performance and is not necessarily indicative of future stock price performance.

	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08
Blockbuster Inc. Class A common stock	100.00	84.74	33.45	47.19	34.79	11.24
Hemscott Group Index*	100.00	73.93	60.61	67.62	62.16	50.79
S&P 500 Index	100.00	110.88	116.33	134.70	142.10	89.53

\* The Hemscott Group Index consists of the following issuers: Blockbuster Inc. (Class A and Class B common stock); Hastings Entertainment, Inc.; Netflix, Inc.; and Trans World Entertainment Corporation.

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The following graph compares the cumulative total stockholder return on our Class B common stock over the period from October 14, 2004 to December 31, 2008, with the cumulative total return during such period of the S&P 500 Index and the Hemscott Group Index. The comparison assumes \$100 was invested on October 14, 2004 in our Class B common stock and in each of the foregoing indices and assumes reinvestment of dividends. The stock performance shown on the graph below represents historical stock performance and is not necessarily indicative of future stock price performance.

	10/14/04	12/31/04	6/30/05	12/31/05	6/30/06	12/31/06	6/30/07	12/31/07	6/30/08	12/31/08
Blockbuster Inc. Class B common stock	100.00	115.51	113.00	43.86	57.82	64.53	51.50	45.31	26.60	8.56
Hemscott Group Index*	100.00	100.79	104.71	82.14	92.59	91.45	70.65	83.98	72.07	67.87
S&P 500 Index	100.00	109.23	108.35	114.60	117.70	132.70	141.93	139.99	123.31	88.20

\* The Hemscott Group Index consists of the following issuers: Blockbuster Inc. (Class A and Class B common stock); Hastings Entertainment, Inc.; Netflix, Inc.; and Trans World Entertainment Corporation.

**Item 6. Selected Financial Data**

The following table sets forth our selected consolidated historical financial data as of the dates and for the periods indicated. The selected consolidated statement of operations and balance sheet data for fiscal years 2004 through 2008 are derived from our consolidated financial statements. The financial information herein may not necessarily reflect our results of operations, financial position and cash flows in the future or what our results of operations, financial position and cash flows would have been had Viacom not owned a large majority of our equity and voting interest until October 2004.



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**BLOCKBUSTER SELECTED CONSOLIDATED HISTORICAL  
FINANCIAL DATA**

The following data should be read in conjunction with, and is qualified by reference to, the consolidated financial statements and related notes, and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this document.

	Fiscal Year Ended or at Year End				
	2008(1)	2007(2)(3)	2006(4)(5)	2005(6)(7)	2004(8)(9)(10)
(In millions, except per share amounts)					
<b>Statement of Operations Data:</b>					
Revenues	\$ 5,287.9	\$ 5,542.4	\$ 5,522.2	\$ 5,721.8	\$ 5,932.8
Gross profit	\$ 2,722.5	\$ 2,864.6	\$ 3,042.5	\$ 3,160.8	\$ 3,545.0
Impairment of goodwill and other long-lived assets(11)	\$ 435.0	\$ 2.2	\$ 5.1	\$ 341.9	\$ 1,499.7
Operating income (loss)	\$ (293.3)	\$ 39.1	\$ 73.6	\$ (382.9)	\$ (1,242.0)
Income (loss) before discontinued operations and cumulative effect of change in accounting principle	\$ (373.8)	\$ (74.2)	\$ 63.7	\$ (544.1)	\$ (1,251.2)
Income (loss) per common share before discontinued operations and cumulative effect of change in accounting principle basic and diluted	\$ (2.01)	\$ (0.45)	\$ 0.28	\$ (2.96)	\$ (6.91)
Income (loss) from discontinued operations, net of tax(12)	\$ (0.3)	\$ 0.4	\$ (13.2)	\$ (39.8)	\$ 4.9
Net income (loss)	\$ (374.1)	\$ (73.8)	\$ 50.5	\$ (583.9)	\$ (1,246.3)
Preferred stock dividends(13)	\$ (11.3)	\$ (11.3)	\$ (11.3)	\$	\$
Net income (loss) applicable to common stockholders	\$ (385.4)	\$ (85.1)	\$ 39.2	\$ (583.9)	\$ (1,246.3)
Net income (loss) per common share basic and diluted	\$ (2.01)	\$ (0.45)	\$ 0.21	\$ (3.18)	\$ (6.88)
Cash dividends per common share	\$	\$	\$	\$ 0.04	\$ 0.08
Special distribution per share	\$	\$	\$	\$	\$ 5.00
Weighted average shares outstanding basic	191.8	190.3	187.1	183.9	181.2
Weighted average shares outstanding diluted	191.8	190.3	189.0	183.9	181.2
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 154.9	\$ 184.6	\$ 394.9	\$ 276.2	\$ 330.3
Total assets	\$ 2,154.5	\$ 2,733.6	\$ 3,134.6	\$ 3,184.0	\$ 3,991.5
Long-term debt, including capital leases	\$ 611.3	\$ 703.0	\$ 899.5	\$ 1,121.6	\$ 1,119.7
Stockholders' equity	\$ 214.3	\$ 655.7	\$ 723.3	\$ 637.6	\$ 1,062.9

- (1) During 2008, we recognized \$14.1 million of compensation expense related to share-based compensation as required by Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised), *Share-Based Payments* ( SFAS 123R ).
- (2) During 2007, we recorded an \$81.5 million gain on sale of Gamestation and a \$6.3 million gain on sale of our Australian subsidiary, both of which are included in Operating income (loss).
- (3) During 2007, we recognized \$14.6 million of compensation expense related to share-based compensation as required by SFAS 123R.
- (4) During 2006, we recorded \$111.9 million in tax benefits resulting from the resolution of multi-year income tax audits.
- (5) During 2006, we recognized \$25.5 million of compensation expense related to share-based compensation as required by SFAS 123R.

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- (6) During 2005, we recorded a valuation allowance on our deferred tax assets in various jurisdictions. See Note 7 to our consolidated financial statements.
- (7) During 2005, we recognized \$39.1 million of compensation expense related to share-based compensation as required by SFAS 123R.
- (8) During 2004, we recognized a \$37.1 million tax benefit as a result of specific federal income tax audit issues resolved during 2004.
- (9) In conjunction with our adoption of SFAS 123R, we recognized \$18.3 million of compensation expense related to share-based compensation in 2004. We also adopted the expense recognition provisions of FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans* ( FIN 28 ) as of January 1, 2004. Because we applied the disclosure-only provisions of SFAS 123 through September 30, 2004, the cumulative effect of change in accounting principle of \$23.1 million, net of tax, recognized upon adoption of the expense recognition provisions of FIN 28 has not been reflected in our Consolidated Statements of Operations for the year ended December 31, 2004.
- (10) During the third quarter of 2004, we paid a \$5.00 special distribution per share prior to our divestiture from Viacom.
- (11) We have recognized non-cash charges to impair goodwill and other long-lived assets in accordance with SFAS 142 and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ). See Note 2 to the consolidated financial statements for a discussion of impairment charges.
- (12) During 2006, we completed the divestiture of Movie Brands Inc. and MOVIE TRADING CO.<sup>®</sup> in addition to closing all of our store locations in Spain. In January 2007, we also completed the sale of RHINO VIDEO GAMES<sup>®</sup>. In accordance with SFAS 144, these operations have been classified as discontinued operations.
- (13) During the third quarter of 2005, we completed a private placement of Series A cumulative convertible perpetual preferred stock. The first dividend payment was declared and paid in the first quarter of 2006.

**Item 7. *Managements Discussion and Analysis of Financial Condition and Results of Operations***

**(Tabular Dollars in Millions)**

Unless otherwise noted, the following discussion and analysis relates only to results from continuing operations. The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes appearing elsewhere in this document. We have the intent and ability to take actions necessary for the Company to continue as a going concern, as discussed herein, and accordingly our consolidated financial statements have been prepared assuming that we will continue as a going concern. Our revolving credit facility and Term A loan facility are each scheduled to expire in August 2009. Given the impending expiration of both our revolving credit facility and Term A loan facility, on April 2, 2009, we amended our revolving credit facility, Term A loan facility and Term B loan facility to include commitments from certain of our lenders and certain new lenders to (a) replace the existing revolving credit facility with a \$250 million revolving credit facility with a maturity date of September 30, 2010 (the amended credit facility ), and (b) amend certain financial covenants, other covenants and other terms in our existing revolving credit facility, Term A loan facility and Term B loan facility. The obligation of the lenders to fund the \$250 million revolving credit facility and effectuate such amendments is subject to the satisfaction of certain conditions set forth in the amendment. While we believe that all such conditions will be met and that we will be in a position to close on the amended credit facility on or about May 11, 2009, there can be no assurance regarding these matters. The risk that we may not successfully complete this refinancing and obtain the related amendment of certain financial covenants included therein, and/or the risk that we may not have adequate liquidity to fund our operations as a result of not meeting our projected financial results, even if the refinancing is completed within the time and upon the terms contemplated, raise substantial doubt about our ability to continue as a going concern. Management's plans concerning these matters are also discussed under *Liquidity and Capital Resources* below and in Note 1 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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### **Change in Fiscal Year End**

On October 12, 2006, our Board of Directors approved a change in our fiscal year from a calendar year ending on December 31<sup>st</sup> to a 52/53 week fiscal year ending on the first Sunday following December 30<sup>th</sup>. The change in our fiscal year took effect on January 1, 2007 and, therefore, there was no transition period in connection with this change of fiscal year-end. Fiscal year 2008 includes the 52 weeks ended January 4, 2009, while fiscal year 2007 includes the 53 weeks ended January 6, 2008, and fiscal year 2006 includes the calendar year ended December 31, 2006.

### **Overview**

Blockbuster Inc. is a leading global provider of in-home rental and retail movie and game entertainment, with over 7,400 stores in the United States, its territories and 20 other countries as of January 4, 2009. We also offer rental and retail movie entertainment through the Internet and by mail in the United States.

While the overall media entertainment industry has remained stable over the past few years, it has experienced a channel shift primarily driven by the emergence of new methods of distribution. Recognizing that shift, we have broadened our focus beyond DVD rental to providing convenient access to media entertainment across five channels of distribution:

in-store,

by mail,

vending and kiosks,

online, and

at home (direct to the TV).

In 2008, we have continued to build on the series of actions we took during the second half of 2007 that were designed to both improve short-term profitability and position us to achieve our strategic objectives.

### ***2008 Strategic Objectives and Accomplishments***

#### *Leverage and grow our leadership position in the movie and game rental business*

**Greatly enhance product availability** We have increased our in-stock availability on new releases and have expanded Blu-ray to all stores with prominent positioning.

**Improve the customer experience** We are currently testing a number of store prototypes in approximately 600 stores that range from a refreshed and modernized look and feel of typical BLOCKBUSTER stores to Rock-the-Block stores that emphasize gaming, beverages and snacks and video-enabled electronic devices, all of which are designed to improve the in-store customer experience.

**Innovatively merchandise our product offerings** We are cross-merchandising retail and rental product in high-traffic areas in our stores.

*Enhance retail and merchandising opportunities*

We are leveraging our leadership position in the rental market to increase sales of movies, games and other complementary entertainment-related products by cross-merchandising retail and rental product in high-traffic areas in our stores.

We have broadened our product assortment to include Blu-ray, and completed a roll out of games software, hardware and accessories in all our U.S. corporate-owned stores during the second quarter of 2008.

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We also have rolled out a focused assortment of consumer electronics to approximately 1,900 of our domestic stores.

In December 2008, we announced a three-year agreement that makes BLOCKBUSTER stores the exclusive physical retail ticket outlet for Live Nation Ticketing, beginning with the start of the 2009 concert season.

*Develop digital solutions*

We have launched digital downloading on blockbuster.com, which enables our customers to download entertainment content for both rental and purchase.

We launched BLOCKBUSTER OnDemand in November 2008 with the 2Wire MediaPoint digital media player, an easy-to-use, on-demand video solution that offers movie fans instant access through their television sets to BLOCKBUSTER OnDemand content, including thousands of titles from the latest movie releases to classic favorites.

We are also testing digital delivery through kiosks in select stores to digitally deliver entertainment content to our customers' portable devices.

*Implement cost controls* We have surpassed our goal of reducing annualized overhead costs by \$100 million through the elimination of staffing and operational redundancies in our in-store and online corporate support structure and through operational improvements. Our primary focus has been on cost reductions through:

outsourcing,

lease renegotiations to generate significant reductions in future store occupancy costs, and

elimination of operational redundancies.

***Key Financial Points for 2008***

Reported net loss of \$374.1 million, driven by non-cash impairment charges to our goodwill and other long-lived assets of \$435.0 million.

Same-store revenues increased 3.9%.

Selling, general and administrative expenses decreased by \$291 million or 11%.

Estimated impact of the 53<sup>rd</sup> week in fiscal 2007:

Revenues decreased by \$102 million.

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Gross profit decreased by \$52 million.

Operating income decreased by \$7 million.

The worldwide economic downturn in late 2008 had a negative impact on our results of operations, especially in our international markets.

### **Outlook**

While we continue to be committed to improving our financial results through the operational and strategic initiatives discussed above, due to the recent extraordinary and unexpected limitations in domestic and international capital and credit markets, we have temporarily deferred or limited our spending on certain of these initiatives while we take prudent actions that are intended to provide that cash on hand, cash from operations and available borrowings under our amended revolving credit facility (assuming that we close on such facility) will be sufficient to fund our cash requirements. These actions include, but are not limited to, adjusting capital expenditures and inventory levels, evaluating expenditures for strategic initiatives and continuing to implement

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ongoing cost controls. We intend that any such actions will remain in effect only until such time as improvements in the capital and credit markets provide additional options for sources of financing. Additionally, we continue to consider options for divesting certain non-core assets, including selling and/or licensing some of our international operations.

In 2009 we expect to continue facing the challenges of a depressed economy and the fragmentation of the media entertainment industry. Our current 2009 plan contemplates that worldwide same-store revenues will be lower than what we experienced in the fourth quarter of 2008. We believe that the actions we have taken to reduce costs and diversify our product offerings will help mitigate these challenges. However, there can be no assurances that conditions currently affecting the worldwide economic environment and other macroeconomic factors that could influence consumer confidence and spending behavior will not further alter our strategic objectives.

See Liquidity and Capital Resources below and Note 6 to the consolidated financial statements for discussion of our amended revolving credit facility, Term A loan facility and Term B loan facility.

**Table of Contents****Results of Operations****Consolidated Results**

The following table sets forth a summary of consolidated results of certain operating and other financial data.

	January 4, 2009	Fiscal Year Ended January 6, 2008	December 31, 2006
	(In millions, except worldwide store data)		
<b>Statement of Operations Data:</b>			
Revenues	\$ 5,287.9	\$ 5,542.4	\$ 5,522.2
Cost of sales	2,565.4	2,677.8	2,479.7
Gross profit	2,722.5	2,864.6	3,042.5
Operating expenses(1)	3,015.8	2,825.5	2,968.9
Operating income (loss)	(293.3)	39.1	73.6
Interest expense	(73.0)	(88.7)	(101.6)
Interest income	2.5	6.5	9.9
Other items, net(2)	15.6	(1.5)	5.4
Income (loss) before income taxes	(348.2)	(44.6)	(12.7)
Benefit (provision) for income taxes(3)	(25.6)	(29.6)	76.4
Income (loss) before discontinued operations	(373.8)	(74.2)	63.7
Income (loss) from discontinued operations, net of tax(4)	(0.3)	0.4	(13.2)
Net income (loss)	\$ (374.1)	\$ (73.8)	\$ 50.5
<b>Cash Flow Data:</b>			
Cash flows provided by (used for) operating activities	\$ 51.0	\$ (56.2)	\$ 329.4
Cash flows provided by (used for) investing activities	\$ (116.5)	\$ 76.7	\$ (41.0)
Cash flows provided by (used for) financing activities	\$ 49.4	\$ (241.0)	\$ (183.2)
<b>Other Data:</b>			
Depreciation and intangible amortization	\$ 152.2	\$ 185.7	\$ 210.9
Impairment of goodwill and other long-lived assets	\$ 435.0	\$ 2.2	\$ 5.1
<b>Margins:</b>			
Rental margin(5)	62.1%	60.7%	65.2%
Merchandise margin(6)	20.9%	23.3%	24.9%
Gross margin(7)	51.5%	51.7%	55.1%
<b>Worldwide Store Data:</b>			
Same-store revenues increase (decrease)(8)	3.9%	(2.3)%	(4.2)%
Company-operated stores at end of year	5,806	6,073	6,551
Franchised and joint venture stores at end of year	1,599	1,757	1,809
Total stores at end of year	7,405	7,830	8,360
	<b>Total Number</b>	<b>Avg Sq. Footage (in thousands)</b>	<b>Total Sq. Footage (in thousands)</b>
<b>Real Estate Data at January 4, 2009:</b>			
Domestic			
Company-operated stores	3,878	5.5	21,484



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Distribution centers	39	N/A	1,121
Corporate/regional offices	12	N/A	416
International			
Company-operated stores	1,928	3.1	5,943
Distribution centers	7	N/A	199
Corporate/regional offices	7	N/A	117

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(1) Operating expenses include:

non-cash charges to impair goodwill and other long-lived assets in accordance with SFAS 142 and SFAS 144 totaling \$435.0 million, \$2.2 million and \$5.1 million for fiscal years 2008, 2007 and 2006, respectively; and

a gain on sale of Gamestation of \$81.5 million for fiscal 2007.

- (2) Other items, net include the favorable impact of \$15.5 million of foreign currency exchange gains related primarily to intercompany loans denominated in currencies other than the U.S. dollar in 2008.
- (3) The benefit for income taxes in 2006 mainly relates to a benefit recorded in the first and second quarters of 2006 from the resolution of multi-year income tax audits.
- (4) During 2006, we completed the divestiture of Movie Brands Inc. ( MBI ) and MOVIE TRADING CO. ( MTC ) in addition to closing all of our store locations in Spain. During January 2007, we also completed the sale of RHINO VIDEO GAMES ( RHINO ). In accordance with SFAS 144, these operations have been classified as discontinued operations.
- (5) Rental gross profit (rental revenues less cost of rental revenues) as a percentage of rental revenues.
- (6) Merchandise gross profit (merchandise sales less cost of merchandise sold) as a percentage of merchandise sales.
- (7) Gross profit as a percentage of total revenues.
- (8) A store is included in the same-store revenues calculation after it has been opened and operated by us for more than 52 weeks. An acquired store becomes part of the same-store base in the 53<sup>rd</sup> week after its acquisition and conversion. The percentage change is computed by comparing total net revenues for same-stores at the end of the applicable reporting period with total net revenues from these same-stores for the comparable period in the prior year. The same-store revenues calculation does not include the impact of foreign exchange or by-mail subscription revenue. The method of calculating same-store revenues varies across the retail industry; therefore, our method of calculating same-store revenues may not be the same as other retailers' methods.

**Segments**

Beginning in the fourth quarter of fiscal 2007, we operate our business in two reportable segments: Domestic and International. We identify segments based on how management makes operating decisions, assesses performance and allocates resources.

The Domestic segment is comprised of all U.S. store operations and by-mail subscription service operations in addition to the digital delivery of movies through blockbuster.com. As of January 4, 2009, we had 4,585 stores operating under the BLOCKBUSTER brand in the United States and its territories. Of these stores, 707 stores were operated through our franchisees.

The International segment is comprised of all non-U.S. store operations including operations in Europe, Latin America, Australia, Canada, Mexico and Asia. As of January 4, 2009, we had 2,820 stores operating under the BLOCKBUSTER brand and other brand names owned by us located in 20 markets outside of the United States. Of these stores, 892 stores were operated through our franchisees. In the Republic of Ireland and Northern Ireland, we operate under the XTRA-VISION® brand name due to its strong local brand awareness. In Canada, Italy, Mexico and Denmark, we also operate freestanding and store-in-store game locations under the GAME RUSH brand. During 2007, we sold our freestanding game locations which operated under the brand name GAMESTATION® and we retained 34 Gamestation locations that operate as a store-in-store within BLOCKBUSTER stores. Additionally, during 2006, 2007 and 2008, we sold our Taiwanese, Australian and Chilean subsidiaries, respectively, each coupled with a license agreement. The results of Gamestation, Taiwan, Australia and Chile have been included in continuing operations through the period in which they were sold.

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The following table is a summary of operating income (loss) by business segment.

	Domestic Segment	International Segment	Unallocated/ Corporate	Total
<b>Statement of Operations Data:</b>				
<b>Fiscal Year Ended January 4, 2009</b>				
Revenues	\$ 3,590.8	\$ 1,697.1	\$	\$ 5,287.9
Cost of sales	1,673.4	892.0		2,565.4
Gross profit	1,917.4	805.1		2,722.5
Operating expenses	2,143.3	727.6	144.9	3,015.8
Operating income (loss)	\$ (225.9)	\$ 77.5	\$ (144.9)	\$ (293.3)
<b>Fiscal Year Ended January 6, 2008</b>				
Revenues	\$ 3,607.9	\$ 1,934.5	\$	\$ 5,542.4
Cost of sales	1,638.9	1,038.9		2,677.8
Gross profit	1,969.0	895.6		2,864.6
Operating expenses	1,907.9	734.7	182.9	2,825.5
Operating income (loss)	\$ 61.1	\$ 160.9	\$ (182.9)	\$ 39.1
<b>Fiscal Year Ended December 31, 2006</b>				
Revenues	\$ 3,617.2	\$ 1,905.0	\$	\$ 5,522.2
Cost of sales	1,452.5	1,027.2		2,479.7
Gross profit	2,164.7	877.8		3,042.5
Operating expenses	1,930.9	833.9	204.1	2,968.9
Operating income (loss)	\$ 233.8	\$ 43.9	\$ (204.1)	\$ 73.6

**Table of Contents****Comparison of Fiscal 2008 (52 Weeks) to Fiscal 2007 (53 Weeks)**

*Domestic Segment.* The following table is a summary of domestic results of operations.

	Fiscal Year Ended January 4, 2009 (52 Weeks)		Fiscal Year Ended January 6, 2008 (53 Weeks)		Increase/ (Decrease)	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Dollar	Percent
<b>Revenues:</b>						
Rental revenues:						
Movies	\$ 2,272.4	63.4%	\$ 2,389.3	66.3%	\$ (116.9)	(4.9)%
Games	219.9	6.1%	220.6	6.1%	(0.7)	(0.3)%
Previously rented product ( PRP )	492.7	13.7%	527.3	14.6%	(34.6)	(6.6)%
Total rental revenues	2,985.0	83.2%	3,137.2	87.0%	(152.2)	(4.9)%
Merchandise sales:						
Movies	227.4	6.3%	221.2	6.1%	6.2	2.8%
Games	155.0	4.3%	47.4	1.3%	107.6	227.0%
General merchandise	200.1	5.6%	177.9	4.9%	22.2	12.5%
Total merchandise sales	582.5	16.2%	446.5	12.3%	136.0	30.5%
Royalties and other	23.3	0.6%	24.2	0.7%	(0.9)	(3.7)%
<b>Total revenues</b>	<b>3,590.8</b>	<b>100.0%</b>	<b>3,607.9</b>	<b>100.0%</b>	<b>(17.1)</b>	<b>(0.5)%</b>
<b>Cost of sales:</b>						
Cost of rental revenues	1,196.9	33.3%	1,314.3	36.4%	(117.4)	(8.9)%
Cost of merchandise sold	476.5	13.3%	324.6	9.0%	151.9	46.8%
	1,673.4	46.6%	1,638.9	45.4%	34.5	2.1%
Gross profit	1,917.4	53.4%	1,969.0	54.6%	(51.6)	(2.6)%
<b>Operating expenses:</b>						
General and administrative:						
Stores	1,338.2	37.2%	1,402.5	38.9%	(64.3)	(4.6)%
Corporate and field	178.3	5.0%	230.3	6.4%	(52.0)	(22.6)%
Total general and administrative	1,516.5	42.2%	1,632.8	45.3%	(116.3)	(7.1)%
Advertising	85.9	2.4%	150.5	4.2%	(64.6)	(42.9)%
Depreciation and intangible amortization	105.9	2.9%	122.4	3.3%	(16.5)	(13.5)%
Impairment of goodwill and other long-lived assets	435.0	12.2%	2.2	0.1%	432.8	N/A
	2,143.3	59.7%	1,907.9	52.9%	235.4	12.3%
<b>Operating income (loss)</b>	<b>\$ (225.9)</b>	<b>(6.3)%</b>	<b>\$ 61.1</b>	<b>1.7%</b>	<b>\$ (287.0)</b>	<b>N/A</b>
<b>Margins:</b>						
Rental margin		59.9%		58.1%		

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Merchandise margin	18.2%	27.3%
Gross margin	53.4%	54.6%

**Fiscal Year Ended  
January 4, 2009**

<b>Same-store revenues increase/(decrease)</b>	
Store only:	
Rental revenues	1.2%
Merchandise revenues	37.4%
Total revenues	6.4%

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*Domestic Rental revenues*

Rental revenues decreased mainly as a result of:

a \$60 million decrease in by-mail revenues driven by a 26% average decline in by-mail subscribers, which is more than offset by related cost reductions described below under Domestic Gross profit;

an estimated \$55 million decrease due to the 53<sup>rd</sup> week included in fiscal 2007 results; and

a 3.2% decline in company-operated stores due primarily to the continued selective closure of unprofitable stores;

offset by the favorable impact of price increases which contributed to a same-store revenue increase of \$28.7 million or 1.2%.

Although we expect the in-store movie rental industry to continue declining in 2009, we believe that our initiatives to maximize product availability of new releases, simplify pricing terms, improve customer service, obtain exclusive content and innovatively merchandise our product offerings will help at least partially offset this trend.

We have launched a pilot program during the first quarter of 2009, which allows select BLOCKBUSTER Total Access online customers to rent video games, as well as movies, through the mail as part of their subscription plan.

*Domestic Merchandise sales*

Same-store game sales increased \$108.0 million or 244.9%, representing the favorable impact of:

the expansion of games software, hardware and accessories to all stores;

cross-merchandising games hardware, software and accessories to prominent positions in our stores; and

a 37% higher average selling price per unit of games software due to an increase in games software sold for next generation game platforms that carry a higher average selling price than the older game platforms sold in 2007.

Same-store general merchandise sales, which include sales of confections and other movie and game-related products, increased \$30.3 million or 18.2% due to:

our strategy of having an assortment of licensed merchandise product available for major theatrical releases; and

the roll-out of framed entertainment posters to our stores during the first quarter of 2008.

The following partially offset the increases to merchandise sales discussed above:

the 3.2% decline in company-operated stores discussed above; and

an approximately \$11 million decrease in total merchandise sales due to the 53rd week included in fiscal 2007 results.

*Domestic Gross profit*

Rental gross profit decreased due to the decrease in rental revenues, offset by:

reduced estimated costs for our by-mail offering of \$150 million, including the favorable impact of approximately 50% fewer free in-store exchanges for BLOCKBUSTER Total Access ( Total Access ) subscribers; and

favorable nonrecurring contractual settlements with vendors of \$15.1 million.

Merchandise gross margin decreased from 27.3% to 18.2% due to a change in product mix. As a percentage of sales, there has been an increase in games hardware and software sales which, due to the competitive prices at which we are selling them, negatively impacted our overall merchandise gross

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margin. In addition, DVD margin decreased due to more competitive consumer pricing. We may continue to experience lower merchandise gross margins as we continue to adjust our retail pricing models and invest in our retail growth.

The 53<sup>rd</sup> week included in fiscal 2007 results accounted for approximately \$37 million of the decrease in total gross profit.

*Domestic Operating expenses*

Stores general and administrative expense decreased mainly due to our focus on closing less profitable stores and renegotiating leases, leading to decreased occupancy costs and store labor costs from prior year.

Corporate and field general and administrative expense, which includes expenses incurred at the field and regional levels for store operations along with our by-mail offering, decreased due primarily to our cost-savings measures.

Advertising expense, which includes by-mail subscriber acquisition costs, decreased 42.9% due to a reduction in our advertising spend to promote Total Access.

Depreciation and intangible amortization decreased 13.5% primarily due to certain store assets becoming fully depreciated in addition to the decreased store count discussed above.

Impairment of goodwill and other long-lived assets had the single largest impact on our operating expense increase over prior year with a 2008 impairment charge of \$435.0 million compared to a \$2.2 million impairment charge in 2007. For further discussion, see Critical Accounting Estimates below and Note 2 to our consolidated financial statements.

The 53<sup>rd</sup> week included in fiscal 2007 resulted in a reduction of approximately \$29 million in total operating expenses.



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*International Segment.* The following table is a summary of international results of operations.

	Fiscal Year Ended January 4, 2009 (52 Weeks)		Fiscal Year Ended January 6, 2008 (53 Weeks)		Increase/ (Decrease)	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Dollar	Percent
<b>Revenues:</b>						
Rental revenues:						
Movies	\$ 688.6	40.6%	\$ 756.9	39.1%	\$ (68.3)	(9.0)%
Games	57.6	3.4%	59.4	3.1%	(1.8)	(3.0)%
Previously rented product ( PRP )	134.6	7.9%	129.0	6.7%	5.6	4.3%
Total rental revenues	880.8	51.9%	945.3	48.9%	(64.5)	(6.8)%
Merchandise sales:						
Movies	195.1	11.5%	222.9	11.5%	(27.8)	(12.5)%
Games	433.2	25.5%	549.1	28.4%	(115.9)	(21.1)%
General merchandise	178.6	10.5%	181.6	9.4%	(3.0)	(1.7)%
Total merchandise sales	806.9	47.5%	953.6	49.3%	(146.7)	(15.4)%
Royalties and other	9.4	0.6%	35.6	1.8%	(26.2)	(73.6)%
<b>Total revenues</b>	<b>1,697.1</b>	<b>100.0%</b>	<b>1,934.5</b>	<b>100.0%</b>	<b>(237.4)</b>	<b>(12.3)%</b>
<b>Cost of sales:</b>						
Cost of rental revenues	270.1	16.0%	289.7	15.0%	(19.6)	(6.8)%
Cost of merchandise sold	621.9	36.6%	749.2	38.7%	(127.3)	(17.0)%
	892.0	52.6%	1,038.9	53.7%	(146.9)	(14.1)%
Gross profit	805.1	47.4%	895.6	46.3%	(90.5)	(10.1)%
<b>Operating expenses:</b>						
General and administrative	652.0	38.4%	724.8	37.5%	(72.8)	(10.0)%
Advertising	36.1	2.1%	43.5	2.2%	(7.4)	(17.0)%
Depreciation and intangible amortization	39.5	2.3%	47.9	2.5%	(8.4)	(17.5)%
Gain on sale of Gamestation		0.0%	(81.5)	(4.2)%	81.5	100.0%
	727.6	42.8%	734.7	38.0%	(7.1)	(1.0)%
<b>Operating income (loss)</b>	<b>\$ 77.5</b>	<b>4.6%</b>	<b>\$ 160.9</b>	<b>8.3%</b>	<b>\$ (83.4)</b>	<b>(51.8)%</b>
<b>Margins:</b>						
Rental margin		69.3%		69.4%		
Merchandise margin		22.9%		21.4%		
Gross margin		47.4%		46.3%		

Fiscal Year Ended  
January 4, 2009

Same-store revenues increase/(decrease)(1)

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Rental revenues	(2.8)%
Merchandise revenues	2.4%
Total revenues	(0.4)%

- (1) Changes in international same-store revenues do not include the impact of foreign exchange.

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*International Rental revenues*

Movie rental revenues decreased primarily due to:

a 6.8% decline in company-operated stores due primarily to the continued selective closure of less profitable stores;

a same-store sales for movie rentals decrease of \$29.3 million or 3.4%, impacted by a price decrease in select European markets due to competition from low retail prices and reduced traffic due to the economic downturn; and

a decrease in movie rental transactions due to competition from more popular TV offerings compared to 2007.

Rental mix changed with more customers purchasing PRP due to increased promotional activity designed to move older product. Our international markets purchase a majority of their rental product under traditional purchase agreements and therefore their PRP title availability is not as limited by revenue sharing agreements as it is domestically.

The 53<sup>rd</sup> week included in fiscal 2007 results accounted for approximately \$15 million of the decrease in total rental revenues.

We experienced an unfavorable foreign currency exchange impact of \$4.5 million.

*International Merchandise sales*

Movie sales decreased primarily due to:

a same-store sales decrease of \$21.9 million or 10.1% due to the economic downturn, fewer large box office titles, and increased competition primarily in the United Kingdom and Canada; and

the reduced store count as discussed above.

Game sales, including sales of new and traded games software, hardware consoles and accessories decreased in total due to:

the sale of 217 Gamestation stores during the second quarter of 2007, which accounted for an estimated \$150 million of the decrease; and

the 6.8% reduction in company-operated stores in 2008;

offset by a same-store games sales increase of \$47.8 million or 12.4% due to increased inventory levels in all of our international markets and the successful roll out of our Game Rush store-in-store concept to many stores in our Latin

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American and European markets.

We experienced an unfavorable foreign currency exchange impact of \$29.5 million.

The 53<sup>rd</sup> week included in fiscal 2007 results accounted for approximately \$21 million of the decrease in total merchandise sales.  
*International Royalties and other revenues*

We received \$25 million in connection with the termination and relicensing of our Brazilian franchise in 2007.  
*International Gross profit*

Rental and merchandise gross profit decreased due primarily to the decrease in revenues discussed above, including:

a \$30 million estimated decrease due to the sale of 217 Gamestation stores during the second quarter of 2007;

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a \$15 million estimated decrease due to the impact of the 53<sup>rd</sup> week included in fiscal 2007 results; and

the 6.8% decline in company-operated stores in 2008.

Royalties gross profit decreased approximately \$25 million due to the 2007 Brazilian franchise payment discussed above.

We experienced an unfavorable foreign currency exchange impact of \$10.4 million.

*International Operating expenses*

Operating expenses decreased primarily due to:

a \$42.9 million or 11.5% decrease in compensation expense due to a reduction in head count, excluding the impact of foreign currency exchange;

an estimated \$30 million decrease due to the sale of 217 Gamestation stores in 2007;

a \$24.0 million or 9.2% decrease in occupancy costs driven by the 6.8% reduction in company-operated stores discussed above, excluding the impact of foreign currency exchange;

the impact of 53<sup>rd</sup> week included in 2007 results of \$13 million; and

a favorable foreign currency exchange impact of \$2.7 million;

offset by the 2007 gain on the sale of Gamestation of \$81.5 million and the gain on sale of our operations in Australia of \$6.3 million, which is recorded as a reduction to General and administrative expenses.

*Unallocated Corporate.* The following table is a summary of corporate operating expenses that are not allocated to either business segment.

	Fiscal Year Ended		Increase/(Decrease)	
	January 4, 2009 (52 Weeks)	January 6, 2008 (53 Weeks)	Dollar	Percent
General and administrative	\$ 138.1	\$ 167.5	\$ (29.4)	(17.6)%
Depreciation and intangible amortization	6.8	15.4	(8.6)	(55.8)%
<b>Operating expenses</b>	<b>\$ 144.9</b>	<b>\$ 182.9</b>	<b>\$ (38.0)</b>	<b>(20.8)%</b>

Operating expenses decreased primarily due to:

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a reduction in general and administrative expense due to:

a \$14.2 million or 74.7% reduction in severance costs;

a \$12.6 million or 19.7% reduction in other general and administrative expenses primarily related to professional fees;

a \$9.2 million or 12.9% decrease in corporate compensation expense, related primarily to our 2007 changes in senior management;

offset by an estimated \$6.0 million increase in our outsourcing costs; and

a reduction of depreciation expense due to certain assets becoming fully depreciated.

### ***Additional Consolidated Results***

Interest expense decreased primarily due to lower average interest rates during 2008.

Foreign currency exchange on intercompany loans denominated in currencies other than U.S. dollars contributed a favorable impact of \$15.5 million to other income.

**Table of Contents****Comparison of Fiscal 2007 (53 Weeks) to Fiscal 2006 (Calendar Year)**

*Domestic Segment.* The following table is a summary of domestic results of operations.

	Fiscal Year Ended January 6, 2008 (53 Weeks)		Fiscal Year Ended December 31, 2006 (Calendar Year)		Increase/ (Decrease)	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Dollar	Percent
<b>Revenues:</b>						
Rental revenues:						
Movies	\$ 2,389.3	66.3%	\$ 2,359.8	65.2%	\$ 29.5	1.3%
Games	220.6	6.1%	246.4	6.8%	(25.8)	(10.5)%
Previously rented product ( PRP )	527.3	14.6%	494.8	13.7%	32.5	6.6%
Total rental revenues	3,137.2	87.0%	3,101.0	85.7%	36.2	1.2%
Merchandise sales:						
Movies	221.2	6.1%	234.7	6.5%	(13.5)	(5.8)%
Games	47.4	1.3%	77.5	2.1%	(30.1)	(38.8)%
General merchandise	177.9	4.9%	161.6	4.5%	16.3	10.1%
Total merchandise sales	446.5	12.3%	473.8	13.1%	(27.3)	(5.8)%
Royalties and other	24.2	0.7%	42.4	1.2%	(18.2)	(42.9)%
<b>Total revenues</b>	<b>3,607.9</b>	<b>100.0%</b>	<b>3,617.2</b>	<b>100.0%</b>	<b>(9.3)</b>	<b>(0.3)%</b>
<b>Cost of sales:</b>						
Cost of rental revenues	1,314.3	36.4%	1,111.5	30.7%	202.8	18.2%
Cost of merchandise sold	324.6	9.0%	341.0	9.5%	(16.4)	(4.8)%
	1,638.9	45.4%	1,452.5	40.2%	186.4	12.8%
Gross profit	1,969.0	54.6%	2,164.7	59.8%	(195.7)	(9.0)%
<b>Operating expenses:</b>						
General and administrative:						
Stores	1,402.5	38.9%	1,479.5	40.9%	(77.0)	(5.2)%
Corporate and field	230.3	6.4%	195.9	5.4%	34.4	17.6%
Total general and administrative	1,632.8	45.3%	1,675.4	46.3%	(42.6)	(2.5)%
Advertising	150.5	4.2%	118.7	3.3%	31.8	26.8%
Depreciation and intangible amortization	122.4	3.3%	136.8	3.8%	(14.4)	(10.5)%
Impairment of goodwill and other long-lived assets	2.2	0.1%		0.0%	2.2	0.0%
	1,907.9	52.9%	1,930.9	53.4%	(23.0)	(1.2)%
<b>Operating income (loss)</b>	<b>\$ 61.1</b>	<b>1.7%</b>	<b>\$ 233.8</b>	<b>6.4%</b>	<b>\$(172.7)</b>	<b>(73.9)%</b>
<b>Margins:</b>						
Rental margin		58.1%		64.2%		

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Merchandise margin	27.3%	28.0%
Gross margin	54.6%	59.8%

	<b>Fiscal Year Ended January 6, 2008</b>
<b>Same-store revenues increase/(decrease)</b>	
Store only:	
Rental revenues	(7.2)%
Merchandise revenues	(3.7)%
Total revenues	(6.9)%



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*Domestic Rental revenues*

We focused on driving BLOCKBUSTER Total Access subscriber growth early in fiscal 2007, which significantly increased subscription revenues.

Base movie rental revenues decreased due to the transition of in-store only customers to BLOCKBUSTER Total Access customers who transact both online and in-store. Additionally, the in-store movie rental industry remained under pressure during 2007.

Base game rentals decreased as the rentals of older game platforms declined more than the growth of rentals in the next-generation game platforms.

PRP revenues increased due primarily to an increase of 8.5% in same-store sales for movie PRP.

53<sup>rd</sup> week included in fiscal 2007 results accounted for an estimated \$56 million of the increase in total rental revenues.

*Domestic Merchandise sales*

Game sales, including sales of new and traded game software, hardware consoles and accessories, decreased due primarily to a reduction in our retail game inventory which led to a 37.2% decrease in same-store game sales for 2007.

The increase in general merchandise sales was driven by an increase in both confection and licensed merchandise sales.

The overall decrease was offset by an approximately \$11 million increase in total merchandise sales due to the 53<sup>rd</sup> week included in fiscal 2007 results.

*Domestic Royalties and other revenues*

Royalties and fees received from our franchisees decreased \$10.4 million due to:

a reduction in royalty rates charged to franchisees during 2007 and

a decrease in total revenues generated by our franchisees.

In-store advertising sales decreased \$8.7 million.

*Domestic Gross profit*

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Rental gross margin decreased from 64.2% in 2006 to 58.1% in 2007 primarily due to an increase in cost of sales associated with the purchase of additional movie rental product to support BLOCKBUSTER Total Access.

Merchandise gross margin of 27.3% for 2007 remained relatively flat from 2006.

The decrease in total gross profit was partially offset by an estimated \$37 million due to the 53<sup>rd</sup> week included in fiscal 2007 results.  
*Domestic Operating expenses*

Stores general and administrative expense, which includes expenses incurred both in-store and online:

decreased due to the closure of company-owned stores;

increased due to the impact of the 53<sup>rd</sup> week;

increased due to \$9.6 million lower gains recognized during 2007 from sales of store operations and property and equipment;  
and

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increased due to the increase in costs associated with the growth of BLOCKBUSTER Total Access.

Corporate and field general and administrative expense, which includes expenses incurred at the field and regional levels for store operations, decreased due primarily to:

lower bonus expense in 2007 and

our continued cost reduction efforts in 2007.

Advertising expense, which includes online subscriber acquisition costs, increased primarily due to the increase in our advertising spend during the first quarter of 2007 to support BLOCKBUSTER Total Access.

Depreciation and intangible amortization decreased primarily due to certain store assets becoming fully depreciated in 2007 as well as decreased store count.

The 53<sup>rd</sup> week included in fiscal 2007 results partially offset the decrease in operating expenses by approximately \$29 million.

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*International Segment.* The following table is a summary of international results of operations.

	Fiscal Year Ended January 6, 2008 (53 Weeks)		Fiscal Year Ended December 31, 2006 (Calendar Year)		Increase/ (Decrease)	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Dollar	Percent
<b>Revenues:</b>						
Rental revenues:						
Movies	\$ 756.9	39.1%	\$ 745.1	39.1%	\$ 11.8	1.6%
Games	59.4	3.1%	61.8	3.2%	(2.4)	(3.9)%
Previously rented product ( PRP )	129.0	6.7%	121.2	6.4%	7.8	6.4%
Total rental revenues	945.3	48.9%	928.1	48.7%	17.2	1.9%
Merchandise sales:						
Movies	222.9	11.5%	205.9	10.8%	17.0	8.3%
Games	549.1	28.4%	587.9	30.9%	(38.8)	(6.6)%
General merchandise	181.6	9.4%	164.3	8.6%	17.3	10.5%
Total merchandise sales	953.6	49.3%	958.1	50.3%	(4.5)	(0.5)%
Royalties and other	35.6	1.8%	18.8	1.0%	16.8	89.4%
<b>Total revenues</b>	<b>1,934.5</b>	<b>100.0%</b>	<b>1,905.0</b>	<b>100.0%</b>	<b>29.5</b>	<b>1.5%</b>
<b>Cost of sales:</b>						
Cost of rental revenues	289.7	15.0%	292.4	15.3%	(2.7)	(0.9)%
Cost of merchandise sold	749.2	38.7%	734.8	38.6%	14.4	2.0%
	1,038.9	53.7%	1,027.2	53.9%	11.7	1.1%
Gross profit	895.6	46.3%	877.8	46.1%	17.8	2.0%
<b>Operating expenses:</b>						
General and administrative	724.8	37.5%	732.8	38.5%	(8.0)	(1.1)%
Advertising	43.5	2.2%	35.6	1.9%	7.9	22.2%
Depreciation and intangible amortization	47.9	2.5%	60.4	3.1%	(12.5)	(20.7)%
Impairment of goodwill and other long-lived assets		0.0%	5.1	0.3%	(5.1)	(100.0)%
Gain on sale of Gamestation	(81.5)	(4.2)%		0.0%	(81.5)	0.0%
	734.7	38.0%	833.9	43.8%	(99.2)	(11.9)%
<b>Operating income (loss)</b>	<b>\$ 160.9</b>	<b>8.3%</b>	<b>\$ 43.9</b>	<b>2.3%</b>	<b>\$ 117.0</b>	<b>266.5%</b>
<b>Margins:</b>						
Rental margin		69.4%		68.5%		
Merchandise margin		21.4%		23.3%		
Gross margin		46.3%		46.1%		

Fiscal Year Ended  
January 6, 2008

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<b>Same-store revenues increase/(decrease)(1)</b>	
Rental revenues	(2.8)%
Merchandise revenues	23.3%
Total revenues	7.5%

- (1) Changes in international same-store revenues do not include the impact of foreign exchange.

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*International Rental revenues*

Favorable foreign currency exchange impact of \$60.4 million.

The 53<sup>rd</sup> week included in fiscal 2007 results had a favorable impact of approximately \$15 million.

Same-store base game rental revenues decreased 11.0% driven primarily by our U.K. operations as they shifted their focus to selling new games.

*International Merchandise sales*

Favorable foreign currency exchange impact of \$73.9 million.

The 53<sup>rd</sup> week included in fiscal 2007 results had a favorable impact of approximately \$21 million.

Game sales, including sales of new and traded game software, hardware consoles and accessories:

decreased due to the sale of Gamestation in second quarter of 2007;

increased due to an increase of 65.9% in same-store game sales driven by continued demand for new and traded games in various markets, resulting mainly from the introduction of next-generation game platforms during the first quarter of 2007; and

increased due to favorable foreign currency exchange.

General merchandise sales, which include sales of confections, other movie and game-related products and product sales to franchisees increased primarily due to favorable foreign currency exchange.

*International Royalties and other revenues*

We received \$25 million in connection with the termination and relicensing of our Brazilian franchise in 2007.

*International Gross profit*

Unfavorable foreign currency exchange impact of \$76.5 million.

The 53<sup>rd</sup> week included in fiscal 2007 results had a favorable impact of approximately \$15 million.

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Merchandise gross margin decreased from 23.3% in 2006 to 21.4% in 2007. The decrease in merchandise gross margin and increase in cost of merchandise sold is due primarily to the mix of our DVD and games sales shifting from higher margin used products to the lower margin new products.

Rental gross margin of 69.4% for 2007 remained relatively flat from 2006.

### *International Operating expenses*

Unfavorable foreign currency exchange impact of \$52.1 million.

General and administrative expenses remained relatively flat because the costs savings associated with the sale of Gamestation and the closure of company-stores was offset by unfavorable foreign currency exchange and the impact of the 53<sup>rd</sup> week.

Advertising expense increased due to:

several markets increasing their advertising spend to promote sales of merchandise inventory, and

unfavorable foreign currency exchange.

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Depreciation and intangible amortization expense decreased due to the sale of Gamestation and the closure of company-owned stores.

In 2007, we recorded \$81.5 million gain on the sale of Gamestation and \$6.3 million gain on the sale of operations in Australia, which is recorded as a reduction to General and administrative expenses.

The 53<sup>rd</sup> week included in 2007 results had an unfavorable impact of approximately \$13 million.

**Unallocated Corporate.** The following table is a summary of corporate operating expenses that are not allocated to either business segment.

	Fiscal Year Ended		Increase/(Decrease)	
	January 6, 2008 (53 Weeks)	December 31, 2006 (Calendar Year)	Dollar	Percent
General and administrative	\$ 167.5	\$ 190.4	\$ (22.9)	(12.0)%
Depreciation and intangible amortization	15.4	13.7	1.7	12.4%
Operating expenses	\$ 182.9	\$ 204.1	\$ (21.2)	(10.4)%

General and administrative expenses decreased primarily due to:

lower bonus expense in 2007;

lower stock-based compensation expense in 2007; and

continued cost-savings efforts.

**Additional Consolidated Results**

Interest expense decreased primarily due to lower average outstanding debt balances during 2007 than 2006.

Interest income decreased due to lower average cash balances.

Benefit (provision) for income taxes for 2006 included a tax benefit of \$111.9 million resulting from the resolution of multi-year income tax audits. The \$111.9 million benefit is reflected as a \$97.9 million tax benefit in Benefit (provision) for income taxes and a \$14.0 million tax benefit within Income (loss) from discontinued operations.

Income (loss) from discontinued operations for 2007 primarily contains the results of operations for RHINO. The 2006 amounts contain the results of operations for Spain, MTC, MBI, and RHINO.

**Liquidity and Capital Resources**



**General**

We generate cash from operations predominantly from the rental and retail sale of movies and games, and most of our revenue is received in cash and cash equivalents. Working capital requirements, including rental library purchases and normal capital expenditures, are generally funded with cash from operations.

As discussed in greater detail below under **Capital Structure**, our principal external sources of liquidity are our revolving credit facility which expires in August 2009, Term A loan facility which expires in August 2009, Term B loan facility which expires in August 2011 and our outstanding senior subordinated notes which expire in September 2012. Given the impending expiration of both our revolving credit facility and Term A loan facility, on April 2, 2009, we amended our revolving credit facility, Term A loan facility and Term B loan facility to include commitments from certain of our lenders and certain new lenders to (a) replace the existing revolving credit facility with a \$250 million revolving credit facility with a maturity date of September 30, 2010, and

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(b) amend certain financial covenants, other covenants and other terms in our existing revolving credit facility, Term A loan facility and Term B loan facility. The obligation of the lenders to fund the \$250 million revolving credit facility and effectuate such amendments is subject to the negotiation and execution of definitive documentation, as well as the satisfaction of certain conditions set forth in the amendment. While we believe that all such conditions will be met and that we will be in a position to close on the amended credit facility on or about May 11, 2009, there can be no assurance regarding these matters.

The risk that we may not successfully complete this refinancing and obtain the related amendment of certain financial covenants included therein, and/or the risk that we may not have adequate liquidity to fund our operations as a result of not meeting our projected financial results, even if the refinancing is completed within the time and upon the terms contemplated, raise substantial doubt about our ability to continue as a going concern.

If we close on our amended credit facility, this amended facility and our other indebtedness will impact our business by, among other things:

requiring that a substantial portion of our cash flows from operations be used for debt service payments, thereby reducing the availability of cash flows to fund working capital requirements including inventory purchases, capital expenditures, acquisitions and other general corporate purposes;

making us vulnerable to deterioration in our results of operations and to general adverse economic, market or industry conditions which could impact our ability to make our debt payments;

limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate including limiting our ability to invest in certain strategic initiatives, consequently placing us at a competitive disadvantage to our competitors; and

providing liquidity at or near minimum cash levels required to operate the business during certain periods of time during 2009.

We believe that cash on hand, cash from operations and available borrowings under the amended credit facility (assuming that we close on such facility) will be sufficient to fund our anticipated cash requirements for working capital purposes and normal capital expenditures, and that we will remain in compliance with the financial covenants contained in our amended debt agreements, for at least the next twelve months. However, there can be no assurance regarding these matters given the current state of the global economy, which has negatively impacted our ability to accurately forecast our results of operations and cash position, and which may result in deterioration of our revenues beyond what we anticipate. Our current 2009 plan contemplates that worldwide same-store revenues will be lower than what we experienced in the fourth quarter of 2008. Further deterioration would expose us to declining margins as a result of an imbalance between our inventory levels and customer demand. Additionally, if our trade creditors were to impose unfavorable terms on us, it would negatively impact our ability to obtain products and services on acceptable terms and operate our business.

Our independent registered public accounting firm has issued an opinion on our fiscal 2008 consolidated financial statements that includes an explanatory paragraph that expresses substantial doubt about our ability to continue as a going concern. As part of the amendment discussed above, and not subject to closing of the amended credit facility, our lenders have agreed to waive the requirement in our credit agreement that our fiscal 2008 audit opinion not include a going concern explanatory paragraph or like qualification.

If we are unable to generate sufficient cash flow from operations to service our indebtedness and remain in compliance with our financial covenants, we would be in default under one or more of our debt agreements, which if not cured or waived, could result in the acceleration of all of our debt due to cross-default provisions contained in such agreements and in certain of our leases. In such event, we would be required to search for alternative sources of liquidity to refinance the debt, which may not be available to us on acceptable terms, if at all. Our ability to obtain alternative financing would likely be adversely affected because substantially all of our assets have been secured as collateral for our existing debt and because our financial results, substantial

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indebtedness and credit ratings could each adversely affect the availability and terms of any such financing. If we were unable to repay our debt upon acceleration, we could be forced to file for protection under the U.S. Bankruptcy Code. In addition, as discussed above, our financing arrangements are relatively short-term in nature. As a result, we will face additional refinancing pressures over the next several years.

In order to reduce our exposure to these risks, we have also embarked on a cash management strategy to enhance and preserve as much of our liquidity as possible. This plan contemplates us, among other things:

reducing our capital expenditures by eliminating, delaying or curtailing discretionary and non-essential spending;

aggressively pursuing options for the divestiture of certain non-core assets, including selling and/or licensing some of our international operations;

managing our working capital through the optimization of inventory levels;

reducing advertising expenses;

continuing to renegotiate leases to generate significant reductions in future store occupancy costs;

reducing expenditures on consultants and professional service providers;

restructuring and reengineering our organization and processes to reduce our operating costs and increase efficiency;

working to further reduce our obligations in connection with the provision of letters of credit;

exploring our options with respect to borrowing against unpledged assets in certain international markets;

exploring the availability of issuing additional equity securities; and

considering making future payments of preferred stock dividends in-kind as opposed to in cash.

We cannot make assurances as to whether any of these actions can be effected on a timely basis, on satisfactory terms or maintained once initiated, and if successful, our cash management strategy may limit certain of our operational and strategic initiatives designed to grow our business over the long term.

Adverse future developments regarding our pending and any future legal proceedings and other contingencies may also have a material adverse impact on our liquidity and results of operations. See Note 8 to the consolidated financial statements for further discussion of these items.

***Contractual Obligations***

As described more fully in Notes 6 and 8 to the consolidated financial statements, at January 4, 2009, our contractual obligations, were as follows:

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<b>Contractual Obligations(1)</b>	<b>&lt; 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	<b>After 5 Years</b>	<b>Total</b>
Operating leases	\$ 481.4	\$ 625.6	\$ 283.6	\$ 146.8	\$ 1,537.4
Capital lease obligations(2)	11.0	16.0	9.3	10.0	46.3
Purchase obligations(3)	156.7	21.4	4.2	7.3	189.6
Revenue-sharing obligations(4)	119.6				119.6
Long-term debt	198.0	283.0	300.0		781.0
Interest expense on long-term debt(5)	53.6	73.3	20.5		147.4
Preferred stock dividends(6)	11.3	22.5	22.5		56.3
	\$ 1,031.6	\$ 1,041.8	\$ 640.1	\$ 164.1	\$ 2,877.6

- (1) Due to the uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at January 4, 2009, we are unable to make reasonably reliable estimates of the period of cash

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settlement with the respective taxing authority. Therefore, \$2.2 million of unrecognized tax benefits, including accrued interest, have been excluded from the contractual obligations table above. See Note 7 to the consolidated financial statements for a discussion on income taxes.

- (2) Includes both principal and interest.
- (3) Purchase obligations include agreements to purchase goods or services as of January 4, 2009 that are legally binding on us and that specify all significant terms, including fixed or minimum quantities to be purchased, fixed, minimum or variable price provisions and the approximate timing of the transaction. Purchase obligations that can be cancelled without penalty have been excluded. In addition, these amounts exclude revenue-sharing obligations, which are included on the Revenue-sharing obligations line above, and outstanding accounts payable or accrued liabilities. For information about outstanding accounts payable and accrued liabilities, see the Consolidated Balance Sheets and Note 4 to the consolidated financial statements.
- (4) As of January 4, 2009, we were a party to revenue-sharing arrangements with various studios that expire between February 2009 and December 2010. These contracts include minimum purchase requirements, based upon the box office results of the title, at a lower initial product cost as compared to traditional purchases. In addition, these contracts require net rental revenues to be shared with the studios over an agreed upon period of time. We have included an estimate of our contractual obligation under these agreements for minimum purchase requirements and performance guarantees for the period in which they can reasonably be estimated, which is usually two to four months in the future. Although these contracts may extend beyond the estimated two to four month period, we cannot reasonably estimate these amounts due to the uncertainty of purchases that will be made under these agreements. The amounts presented above do not include revenue-sharing accruals for rental revenues recorded during fiscal 2008. For information on revenue-sharing accruals for fiscal 2008 and 2007, see Note 4 to the consolidated financial statements.
- (5) Calculated based on scheduled payments of our outstanding balances as of January 4, 2009. Borrowings under our senior secured credit facility are subject to variable rates of interest. Interest payments on these variable rate borrowings for future years were calculated using a weighted-average interest rate of 6.0% based on the LIBOR rate in effect at January 4, 2009. See Note 6 to the consolidated financial statements for further discussion.
- (6) Our shares of preferred stock do not mature; therefore, amounts are provided for the next five years only. Our policy has been to pay these quarterly dividends in cash. However, we may choose to pay some future dividends in shares of our Class A common stock or to not declare dividends for some quarters. Any unpaid quarterly dividends will accumulate until declared and paid. See Note 3 to our consolidated financial statements for further information.

**Capital Structure**

On August 20, 2004, we entered into \$1,150.0 million in senior secured credit facilities with a syndicate of lenders (the Credit Facilities), consisting of (i) a five-year \$500.0 million revolving credit facility (revolver), of which \$150.0 million was reserved for issuance of the Viacom Letters of Credit, at Viacom's expense (the Viacom Letters of Credit), described in Note 6 to the consolidated financial statements; (ii) a five-year \$100.0 million term loan A facility (the Term A Loan Facility); and (iii) a seven-year \$550.0 million term loan B facility (the Term B Loan Facility), and we issued \$300.0 million aggregate principal amount of 9% senior subordinated notes due 2012 (the Senior Subordinated Notes). These borrowings are described in Note 6 to the consolidated financial statements. Proceeds from the Credit Facilities and the Senior Subordinated Notes were used (i) to fund the payment of the special distribution in August 2004; (ii) to finance transaction costs and expenses in connection with our divestiture from Viacom and the special distribution; (iii) to repay amounts outstanding under our prior credit agreement; and (iv) for working capital and other general corporate purposes.

On April 18, 2007, we entered into an amendment to our amended and restated credit agreement which provided for additional sales, transfers or other dispositions of assets with a cumulative aggregate fair market value of up to \$150 million, and required us to make prepayments on the Credit Facilities in an amount equal to 100% of the net proceeds received from such additional sales, transfers or other dispositions of assets.

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On July 2, 2007, we entered into an additional amendment (the "Second Amendment") to our amended and restated credit agreement which became effective on July 13, 2007 and which:

accelerated reductions in the revolving commitments that were previously scheduled to occur on October 1, 2007 and January 1, 2008, which effectively reduced the total amount of the revolving commitments from \$500 million to \$450 million;

modified the applicable interest rate margins;

amended the definition of Consolidated EBITDA;

amended the asset sale baskets and the related mandatory prepayment requirements;

provided for a premium of 1.0% in the event of certain refinancings through April 6, 2008;

deferred the applicability of the Fixed Charge Coverage Ratio and Leverage Ratio requirements from fiscal 2008 to fiscal 2009;

provided for a one-time fee payable by Blockbuster to the administrative agent, for the accounts of the lenders, in an amount equal to (a) 0.25% of the aggregate amount of revolving commitments and outstanding term loans on April 6, 2008, if the Leverage Ratio on such date exceeds 3.00 to 1.00 but does not exceed 3.50 to 1.00 or (b) 0.50% of the aggregate amount of revolving commitments and outstanding term loans on April 6, 2008, if the Leverage Ratio on such date exceeds 3.50 to 1.00 (we did not meet either criterion, therefore no payment was required);

amended the Consolidated EBITDA requirements such that we may not permit Consolidated EBITDA for any period of four consecutive fiscal quarters to be less than (a) \$140 million for the periods ending July 1, 2007 and September 30, 2007, (b) \$165 million for the period ending January 6, 2008, (c) \$180 million for the period ending April 6, 2008, (d) \$200 million for the period ending July 6, 2008, (e) \$225 million for the period ending October 5, 2008, and (f) \$250 million for the period ending January 4, 2009; and

waived any default resulting from our failure to comply with the Consolidated EBITDA requirement with respect to the period of four consecutive fiscal quarters ending July 1, 2007.

The Credit Facilities currently require compliance with a minimum EBITDA covenant through January 4, 2009, a maximum capital expenditure covenant for the remaining term of the credit agreement and maximum leverage ratio and minimum fixed charge coverage ratio covenants from 2009 through 2011. Additionally, the Credit Facilities and Senior Subordinated Notes contain certain restrictive covenants, which, among other things, limit, during the terms of the Credit Facilities and the Senior Subordinated Notes, (i) the amount of dividends that we may pay, (ii) the amount of our common stock that we may repurchase and (iii) the amount of other distributions that we may make in respect to our common stock.

On October 24, 2008, we entered into Amendment No. 1 (the "Amendment") to the Amended and Restated Initial Public Offering and Split-Off Agreement dated as of June 18, 2004 with Viacom. Pursuant to the Amendment, the face amount of the letters of credit required to be provided by us for the benefit of Viacom was reduced from \$150.0 million to \$75.0 million and the conditions on which Viacom may draw on the letters of credit were amended. In addition, in the Amendment, we assumed responsibility for the payment of any and all fees and expenses incurred in connection with the establishment and maintenance of the letters of credit. The fees are calculated at an annual rate of 3.625% of the face amount of the letters of credit. As a result of the Amendment, on October 24, 2008, our available borrowing capacity increased by \$75.0 million.

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The borrowing availability under the Revolving Credit Facility is being automatically reduced by quarterly installments of 5% of the original borrowing availability beginning October 2007 through July 2009 and will terminate in full in August 2009. The Term A Loan Facility is payable in quarterly installments of 3.75% of the original principal balance from October 2005 through July 2008, and 13.75% of the original principal balance

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beginning October 2008 through August 2009. The Term B Loan Facility is payable in quarterly installments of 0.25% of the original principal balance from October 2005 through July 2008, 2.5% of the original principal balance beginning October 2008 through July 2010 and 19.25% of the original principal balance beginning October 2010 through August 2011. The term loans are subject to mandatory prepayments from a portion of proceeds from asset sales and excess cash flow. The scheduled principal payments for the Term A and B Loan Facility has and will continue to be adjusted to reflect any prepayments resulting from excess cash flow we generated as discussed below.

As a result of a significant reduction in our gross leverage ratio determined by our results of operations for the period ending April 6, 2008, our borrowing rate decreased 50 basis points during the second quarter of 2008.

On August 14, 2008, Moody's Investors Service downgraded our probability of default rating to Caa1 from B3 based on perceived refinancing challenges given current and anticipated market conditions and the general unavailability of capital on favorable terms. However, Moody's Investors Service upgraded the rating on our credit facility to B1 from B3 on the same date as a result of our operating improvements. As a result of the upgrade on our credit facility, our borrowing rate decreased 25 basis points during the third quarter of 2008. On March 4, 2009, Standard & Poor's Ratings Service placed our credit ratings on credit watch in light of the pending maturities of our revolving credit facility and Term A loan facility in August 2009. Any downgrade in our credit ratings could adversely affect our ability to access capital upon acceptable terms and conditions.

Beginning with fiscal 2005, we have been required to make prepayments on the Credit Facilities in an aggregate amount equal to 50% of annual excess cash flow, as defined by the amended and restated credit agreement. Such payments are due at the end of the first quarter of the following year. In fiscal 2008, we generated excess cash flow, as defined by our credit agreement and made a prepayment of \$25.1 million on April 6, 2009, which was classified as Current portion of long-term debt in our Consolidated Balance Sheets as of January 4, 2009. We did not generate excess cash flow in fiscal 2007. In fiscal 2006, we generated excess cash flow, as defined, and made a prepayment during the first quarter of fiscal 2007. During 2007, primarily as a result of our excess cash flows from fiscal 2006 and the completed divestiture of Gamestation in fiscal 2007, we paid down \$214.1 million in debt. Additionally, we are required to make prepayments on the Credit Facilities related to sales of store operations and property and equipment, as defined by the amended and restated credit agreement. The following table summarizes payment activity regarding the term loan A and B facilities during fiscal 2008 and 2007:

	Fiscal 2008	Fiscal 2007
Scheduled payments	\$ 44.3	\$ 20.4
Sale of store operations and property and equipment	5.1	148.1
Excess cash flow (based on prior year cash flow)		45.6
	\$ 49.4	\$ 214.1

As of January 4, 2009, our available borrowing capacity under our Credit Facilities, excluding the \$75.0 million reserved for issuance of the Viacom Letters of Credit and \$44.6 million reserved to support other letters of credit, totaled \$110.4 million. On March 11, 2009, we accessed our available borrowing capacity of \$60 million in principal amount as a precaution against prevailing economic conditions and ongoing uncertainty in the credit market, and as a cushion in the event we require incremental capital in the coming months to cover our typical working capital, general corporate and operating needs.



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The following table sets forth the current portion of our long-term debt and capital lease obligations:

	January 4, 2009	January 6, 2008
<b>Credit Facilities:</b>		
Revolving credit facility, interest rate ranging from 5.8% to 6.7% at January 4, 2009	\$ 120.0	\$
Term A Loan Facility, interest rate of 5.8% at January 4, 2009	18.6	24.0
Term B Loan Facility, interest rate ranging from 5.4% to 6.6% at January 4, 2009	59.4	20.7
<b>Total current portion of long-term debt</b>	<b>198.0</b>	<b>44.7</b>
Current portion of capital lease obligations	8.5	10.1
	<b>\$ 206.5</b>	<b>\$ 54.8</b>

The following table sets forth our long-term debt and capital lease obligations, less current portion:

	January 4, 2009	January 6, 2008
<b>Credit Facilities:</b>		
Term A Loan Facility	\$	\$ 18.8
Term B Loan Facility, interest rate ranging from 5.4% to 6.6% at January 4, 2009	283.0	346.8
Senior Subordinated Notes, interest rate of 9.0% at January 4, 2009	300.0	300.0
<b>Total long-term debt, less current portion</b>	<b>583.0</b>	<b>665.6</b>
Capital lease obligations, less current portion	28.3	37.4
	<b>\$ 611.3</b>	<b>\$ 703.0</b>

**Amended Credit Facility**

On April 2, 2009, we amended our revolving credit facility, Term A loan facility and Term B loan facility to include commitments from certain of our lenders and certain new lenders to (a) replace the existing revolving credit facility with a \$250 million revolving credit facility with a maturity date of September 30, 2010 and (b) amend certain financial covenants, other covenants and other terms in our existing revolving credit facility, Term A loan facility and Term B loan facility. The obligation of the lenders to fund the \$250 million revolving credit facility and effectuate such amendments is subject to the satisfaction of certain conditions set forth in the amendment. While we believe that all such conditions will be met and that we will be in a position to close on the amended revolving credit and term loan facility on or about May 11, 2009, there can be no assurance regarding these matters. The \$250 million amended revolving credit facility (the "amended revolver") will mature on September 30, 2010, and will require that we make the following amortization payments prior to and on such date:

\$25 million will be due and payable on December 15, 2009;

\$20 million will be due and payable on January 31, 2010;

\$20 million will be due and payable on February 28, 2010;

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\$20 million will be due and payable on March 31, 2010;

\$10 million will be due and payable on April 30, 2010;

\$15 million will be due and payable on May 31, 2010;

\$50 million will be due and payable on June 30, 2010;

\$10 million will be due and payable on July 31, 2010;

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\$10 million will be due and payable on August 31, 2010; and

any remaining outstanding amounts will be due and payable on September 30, 2010.

Up to \$12.5 million in voluntary prepayments made prior to December 15, 2009 may be applied to the foregoing scheduled amortization payments in their direct order of maturity, and any remainder would be applied to the amounts due in the reverse order of maturity. These payments will require a substantial portion of our cash flows from operations, thereby reducing the availability of cash flows to fund working capital requirements, including inventory purchases, capital expenditures, acquisitions and other general corporate purposes.

We will borrow the full availability under the amended revolver through the term thereof. Borrowings under the amended revolver will bear interest at a base rate (with a floor of 4.5%) plus 9% or at LIBOR (with a floor of 3.5%) plus 10%, at our discretion, which interest payments will be due and payable monthly. Should we be in default of the credit agreement, a default rate of interest of an additional 300 basis points on amounts outstanding under the amended revolver, Term A loans and Term B loans would also be payable.

In connection with the amended revolver, certain other provisions of our credit agreement will be amended as follows:

we will no longer be required to make prepayments on our term loan facilities upon sales, transfers or other dispositions of assets;

we will no longer be subject to a mandatory available cash sweep;

we will be required to make certain prepayments on our revolving loans based on excess cash flow;

the letters of credit issued under our existing revolving credit facility will be continued and renewed when applicable and will be cash-collateralized, and we will be restricted with respect to the issuance of any new letters of credit;

to the extent cash collateral is released with respect to the letters of credit in an amount in excess of \$52.5 million, we will be required to repay the revolving loans with such amounts, allocated to the amortization schedule in reverse order of maturity;

80% of the net proceeds of any foreign indebtedness incurred will be required to be used to repay the revolving loans, allocated to the amortization schedule in reverse order of maturity;

with respect to certain extraordinary receipts received (which do not include disposition proceeds or insurance or condemnation proceeds), we will be required to apply the net proceeds to repay the revolving loans, allocated to the amortization schedule in reverse order of maturity;

with respect to certain other indebtedness and equity offerings, we will be required to repay the revolving loans (x) with 75% of any net proceeds greater than \$25 million and less than \$50 million and (y) with 50% of any net proceeds greater than \$50 million;

to the extent that the outstanding principal balance of the revolving loans on April 30, 2010 is in excess of \$75 million, we will be required to pay a fee to the revolving lenders equal to the lesser of \$5 million and 10% of such excess;

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we will be permitted to enter into the sale and leaseback of our domestic store locations, provided that the fair market value of all property sold does not exceed \$28 million, and after giving effect to such sale the Leverage Ratio does not exceed 2.50 to 1.00;

we will be restricted against paying dividends on our common stock until the revolving loans are paid in full;

we will be restricted from making additional investments in Foreign Subsidiaries in excess of \$20 million;

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we will be permitted to enter into certain intercompany affiliate transactions with non-loan parties on an arms length basis;

our Fixed Charge Coverage Ratio will be amended such that we will be required to maintain a Fixed Charge Coverage Ratio of not less than 1.25 to 1.00 for periods ending March 31, 2009 through January 3, 2010, and of not less than 1.30 to 1.00 for periods ending March 31, 2010 and thereafter;

our Leverage Ratio will be amended such that we will be required to maintain a maximum Leverage Ratio of 2.75 to 1.00, tested on a quarterly basis; and

we will be restricted from making capital expenditures (a) in excess of \$30 million in the 2009 fiscal year, (b) in excess of \$40 million in the 2010 fiscal year, plus up to \$10 million of amounts unused in the 2009 fiscal year, and (c) in excess of \$80 million in the 2011 fiscal year.

We will pay the following fees in connection with the amendment to our credit agreement and amended revolver:

an amendment fee of 25 basis points to all consenting term lenders;

a commitment fee of up to 2% to certain of the lenders who provided early commitments to fund the amended revolver (the specified lenders );

a funding fee of 8.0% to the specified lenders funding the amended revolver, and a funding fee of 11.25% to the other lenders funding the amended revolver, which is payable at closing;

an exit fee of 3% on all repayments under the amended revolver; and

a work fee of \$250,000, which will be credited toward deposit and other expenses.

In addition, as part of the amendment, and not subject to closing of the amended credit facility, our lenders have agreed to waive the requirement in our credit agreement that our fiscal 2008 audit opinion not include a going concern explanatory paragraph or like qualification or exception.

***Consolidated Cash Flows***

*Operating Activities.* Net cash flows from operating activities increased \$107.2 million to \$51.0 million of cash provided by operating activities in fiscal year 2008 from \$56.2 million of cash used for operating activities in 2007, primarily because of:

increased net income as adjusted for non-cash items; and

a \$98.8 million decrease in rental inventory purchases;

offset by a \$71.9 million higher net increase in merchandise inventories in order to improve the selection and availability of product in our stores.

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*Investing Activities.* Net cash flows from investing activities decreased \$193.2 million to \$116.5 million of cash used for investing activities in fiscal year 2008 from \$76.7 million provided by investing activities in 2007, due mainly to:

\$147.7 million of net proceeds on the sale of Gamestation in 2007;

a \$43.7 million increase in capital expenditures, due mainly to upgrades and remodels of many domestic stores; and

\$17.8 million lower proceeds from sales of store operations than in 2007;

offset by payments of \$7.4 million to acquire patent rights in 2007.

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*Financing Activities.* Net cash flows from financing activities increased \$290.4 million to \$49.4 million of cash provided by financing activities in 2008 from \$241.0 million of cash used for financing activities in 2007. This change was primarily due to net proceeds from debt under our credit facilities of \$70.7 million in 2008 as compared to net repayments of \$214.1 million in 2007.

### **General Economic Trends, Quarterly Results of Operations and Seasonality**

Our business is affected by general economic and other consumer trends, and is subject to fluctuations in future operating results due to a variety of factors, many of which are outside of our control. These fluctuations may be caused by, among other things, a distinct seasonal pattern to the home video and video games business, particularly weaker business in April and May, due in part to improved weather and Daylight Saving Time, and in September and October, due in part to the start of school and the introduction of new television programs, and those factors set forth above under Item 1A. Risk Factors. The months of November and December have historically been our highest revenue months. While we expect these months to continue to make the largest contributions to our rental revenues, we believe the strength of rental revenues in these months has been and will continue to be negatively affected, to some degree, by consumers purchasing DVDs during the holiday season. Additionally, while we have diversified our product offerings in an effort to partially mitigate the impact of seasonality and weather conditions on our business, they are expected to continue to impact our business and our period-to-period financial results in the future. While we believe the current worldwide economic downturn will impact our future operational trends, we cannot predict the timing or extent to which this will occur.

### **Critical Accounting Estimates**

The preparation of our consolidated financial statements, in conformity with accounting principles generally accepted in the United States, requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to the useful lives and residual values surrounding our rental library, estimated accruals related to revenue-sharing titles subject to performance guarantees, merchandise inventory reserves, revenues generated by customer programs and incentives, useful lives of property and equipment, income taxes, impairment of our long-lived assets, including goodwill, share-based compensation and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may materially differ from these estimates under different assumptions or conditions.

We believe the following accounting policies require more significant judgments and estimates and that changes in these estimates or the use of different estimates could have a material impact on our results of operations or financial position.

#### ***Rental Library Amortization***

We have established amortization policies with respect to our rental library that most closely allow for the matching of product costs with the related revenues generated by the utilization of our rental library product. These policies require that we make significant estimates based upon our experience as to the ultimate revenue and the timing of the revenue to be generated by our rental library product. We utilize the accelerated method of amortization because it approximates the pattern of demand for the product, which is generally high when the product is initially released for rental by the studios and declines over time. In establishing residual values for our rental library product, we consider the sales prices and volume of our previously rented product and other used product.

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Based upon these estimates and our current customer propositions and offerings, we currently amortize the cost of our in-store and online rental library, which includes movies and games, over periods ranging from six months to twenty-four months to estimated residual values ranging from \$0 to \$8 per unit, according to the product category.

We also review the carrying value of our rental library to ensure that estimated future cash flows exceed the carrying value. We record adjustments to the value of previously rented product primarily for estimated obsolete or excess product based upon changes in our original assumptions about future demand and market conditions. If future demand or actual market conditions are less favorable than those estimated by management, additional adjustments, including adjustments to rental amortization periods or residual values, may be required. We continually evaluate the estimates surrounding the useful lives and residual values used in amortizing our rental library. Changes to these estimates resulting from changes in consumer demand, changes in our customer propositions or the price or availability of retail video product may materially impact the carrying value of our rental library and our rental margins.

### ***Merchandise Inventory***

Our merchandise inventory, which includes new and traded movies and games and other general merchandise, including confections, is stated at the lower of cost or market. We record adjustments to the value of inventory primarily for estimated obsolete or excess inventory equal to the difference between the carrying value of inventory and the estimated market value based upon assumptions about future demand and market conditions. If future demand or actual market conditions are less favorable than those projected by management, additional inventory adjustments may be required. Our estimate for inventory shrinkage is based on the actual historical shrink results of our most recent physical inventories adjusted, if necessary, for current economic conditions. These estimates are compared with actual results as physical inventory counts are taken and reconciled to the general ledger. DVD and video game products are susceptible to shrinkage due to their portability and popularity.

### ***Income Taxes***

In determining net income for financial statement purposes, we make certain estimates and judgments in the calculation of tax expense and the resulting tax liabilities and in the recoverability of deferred tax assets that arise from temporary differences between the tax and financial statement recognition of revenue and expense.

We record deferred tax assets and liabilities for future income tax consequences that are attributable to differences between financial statement carrying amounts of assets and liabilities and their income tax bases. We base the measurement of deferred tax assets and liabilities on enacted tax rates that we expect will apply to taxable income in the year when we expect to settle or recover those temporary differences. We recognize the effect on deferred tax assets and liabilities of any change in income tax rates in the period that includes the enactment date.

As of January 1, 2007, we adopted Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, we may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities. The determination is based on the technical merits of the position and presumes that each uncertain tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information. We recognize interest and penalties relating to income taxes as components of income tax expense. See Note 7 to our consolidated financial statements.

We record valuation allowances to reduce our deferred tax assets to amounts that are more likely than not to be realized. In 2005, we determined that it was unclear as to the timing of when we will generate sufficient



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taxable income to realize our deferred tax assets. This was primarily due to the negative industry trends, which caused our actual and anticipated financial performance to be significantly worse than we originally projected. Accordingly, we recorded a valuation allowance against our deferred tax assets in the United States and certain foreign jurisdictions. Until we determine that it is more likely than not that we will generate sufficient taxable income to realize our deferred income tax assets in certain markets, income tax benefits associated with current period losses will not be recognized.

***Impairment of Goodwill***

In accordance with SFAS 142, we test goodwill and intangible assets with indefinite lives for impairment at the reporting unit level during the fourth quarter of each year and on an interim date if events occur or circumstances change that would more likely than not reduce the fair value below its carrying amount.

Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is to identify a potential impairment by comparing the book values of our reporting units, domestic and international, to their estimated fair values at the test dates. The estimates of fair value of our reporting units are computed using the present value of estimated future cash flows. This analysis utilizes a multi-year forecast of estimated cash flows and a terminal value at the end of the cash flow period. The forecast period assumptions consist of internal projections that are based on our budget and long-range strategic plan. The discount rate used at the test date is our weighted-average cost of capital which reflects the overall level of inherent risk of the reporting unit and the rate of return an outside investor would expect to earn. The sum of the fair values of the reporting units is reconciled to our current market capitalization (based upon our stock price) plus an estimated control premium.

If the fair value of a reporting unit exceeds its book value, goodwill of the reporting unit is not deemed impaired and the second step of the impairment test is not performed. If the book value of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. The implied fair value of goodwill is determined by allocating the estimated fair value of the reporting unit to the estimated fair value of our existing tangible assets and liabilities as well as existing identified intangible assets and previously unrecognized intangible assets in a manner similar to a purchase price allocation. The unallocated portion of the estimated fair value of the reporting unit is the implied fair value of goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

As discussed in Note 2 to the consolidated financial statements, we performed our annual impairment test as of October 31, 2008. The test indicated that the goodwill associated with our domestic reporting unit was impaired. Therefore, we recognized a \$432.6 million goodwill impairment charge during the fourth quarter of 2008. The assumptions included in the impairment test require judgment; and changes to these inputs could materially impact the results of the calculation. Other than management's internal projections of future earnings, the primary assumptions used in the impairment test were the weighted-average cost of capital, long-term growth rates and the control premium. The test is most sensitive to changes in the weighted-average cost of capital. Holding all other assumptions constant at the test date, a 100 basis point increase in the weighted-average cost of capital would reduce the enterprise value for the domestic and international reporting units by approximately 6%. A 6% decrease in the enterprise value of the domestic reporting unit as of the test date would result in an approximately \$50 million increase in the impairment charge. A 6% decrease in the enterprise value of the international reporting unit as of the test date would not have caused the goodwill associated with the international reporting unit to be impaired.

Although our cash flow forecasts are based on assumptions that are considered reasonable by management and consistent with the plans and estimates we are using to manage the underlying businesses, there is significant

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judgment in determining the expected future cash flows attributable to these businesses. In addition, as discussed above, the determination of fair value requires that we make certain judgments, estimates and assumptions. While we believe the fair values we have estimated are reasonable, actual performance in the short-term and long-term could be materially different from our forecasts, which could impact future estimates of fair value of our reporting units and may result in additional impairments of goodwill.

The market price of our Class A common stock has been subject to substantial volatility and has decreased significantly during the first quarter of 2009. We believe that the need for an interim impairment test may be triggered by, among other factors, declines in the media entertainment industry, a reduction in our profitability, or a sustained decline in our stock price. Consequently, we may need to perform an interim impairment test and may recognize an additional non-cash goodwill impairment charge during 2009. Our goodwill balance totaled \$338.1 million as of January 4, 2009. Any additional required non-cash impairment charge could significantly reduce this balance and have a material impact on our reported financial position and results of operations.

### ***Share-Based Compensation***

In 2004, we adopted SFAS 123R, which requires us to recognize compensation expense for all share-based payments made to employees based on the fair value of the share-based payment on the date of grant. We elected to use the modified prospective method for adoption, which requires compensation expense to be recorded for all unvested stock options and restricted shares beginning in the first quarter of adoption. For all unvested options outstanding as of October 1, 2004, the previously measured but unrecognized compensation expense, based on the fair value at the original grant date, is recognized on an accelerated basis in the Consolidated Statements of Operations over the remaining vesting period. For share-based payments granted subsequent to October 1, 2004, compensation expense, based on the fair value on the date of grant, is recognized in the Consolidated Statements of Operations on an accelerated basis over the vesting period. In determining the fair value of stock options, we use the Black-Scholes option pricing model that employs the following assumptions:

Expected volatility based on the weekly historical volatility of our stock price, over the expected life of the option.

Expected term of the option based on the vesting terms and the contractual life of the respective option.

Risk-free rate based upon the rate on a zero coupon U.S. Treasury bill, for periods within the contractual life of the option, in effect at the time of grant.

Dividend yield calculated as the ratio of historical dividends paid per share of common stock to the stock price on the date of grant. Our stock price volatility and option lives involve management's best estimates at that time, both of which impact the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the life of the option.

The fair value of most of our restricted shares is based on the price of a share of our Class A common stock on the date of grant. Our performance-based awards of restricted shares and restricted share units are based on the price of a share of our Class A common stock on the date the award is approved and marked to market at each reporting period if we believe it is probable that the performance criteria will be met. Once the performance criteria are met, these awards will be granted and the fair value will be based on the share price at that date. The fair value of our grants of restricted shares and restricted share units that are subject to hold provisions is discounted for the lack of marketability due to such post-vesting restrictions.

SFAS 123R also requires that we recognize compensation expense for only the portion of options or restricted shares that are expected to vest. Therefore, we apply estimated forfeiture rates that are derived from historical employee termination behavior using a stratified model based on the employee's position within

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Blockbuster and the vesting period of the respective stock options or restricted shares. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

### **Market Risk**

We are exposed to various market risks including interest rates on our debt and foreign exchange rates, and we monitor these risks throughout the normal course of business. Significant fluctuations in our interest rates or foreign exchange rates could cause us to adjust our financing and operating strategies to mitigate these risks. At January 4, 2009 and January 6, 2008, we did not have any interest rate or foreign exchange hedging instruments in place.

#### ***Interest Rate Risk***

Our primary exposure to interest rate risk results from outstanding borrowings under our credit agreement. Interest rates for the credit agreement are based on LIBOR plus an applicable margin or the prime rate or the federal funds rate plus applicable margins, at our option at the time of borrowing. The applicable margins vary based on the borrowing and specified leverage ratios. Our borrowings under the credit agreement totaled \$481.0 million as of January 4, 2009, and the weighted-average interest rate for these borrowings was 6.0%. Our vulnerability to changes in LIBOR or other applicable rates could result in material changes to our interest expense, as a one percentage point increase or decrease in LIBOR or the other applicable rates would have a \$4.9 million impact on our interest expense annually. In addition, a change in our gross leverage ratio, which could be driven by a change in our debt balance or our income, could result in an increase or decrease in the applicable margins on our Term A loan, Term B loan and revolving credit facility, thereby impacting our annual interest expense.

#### ***Foreign Exchange Risk***

Operating in international markets involves exposure to movements in currency exchange rates. Currency exchange rate movements typically also reflect economic growth, inflation, interest rates, government actions and other factors. As currency exchange rates fluctuate, translation of the statements of operations of our international businesses into U.S. dollars may affect year-over-year comparability and could cause us to adjust our financing and operating strategies. Revenues and operating income would have increased by \$34.1 million and \$7.7 million, respectively, for 2008 if foreign exchange rates in 2008 were consistent with 2007.

Our operations outside the United States, mainly in Europe and Canada, constituted 32%, 35%, and 34% of our total revenues in fiscal years 2008, 2007, and 2006, respectively. Consequently, we have foreign exchange rate exposure to movements in exchange rates primarily for the British Pound, the Euro and the Canadian Dollar.

### **Recent Accounting Pronouncements**

See Note 1 to the consolidated financial statements for a discussion of recently issued accounting pronouncements.

### **Off-Balance Sheet Arrangements**

None.

### **Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

The response to this item is included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Market Risk.

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**Item 8. *Financial Statements and Supplementary Data***

**BLOCKBUSTER INC.**

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All supplementary financial statement schedules have been omitted

because the information required to be set forth therein is either not applicable

or is shown in the consolidated financial statements or notes thereto.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and

Stockholders of Blockbuster Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Blockbuster Inc. and its subsidiaries at January 4, 2009 and January 6, 2008, and the results of their operations and their cash flows for each of the three years in the period ended January 4, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 4, 2009, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the risk the Company may not successfully complete a refinancing of its credit facility scheduled to mature in August 2009 and obtain related amendments of financial covenants included therein, and/or the risk the Company may not have adequate liquidity to fund their operations raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 7 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertain tax positions as of January 1, 2007.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Dallas, Texas

April 6, 2009

**Table of Contents****BLOCKBUSTER INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In millions, except per share amounts)

	January 4, 2009	Fiscal Year Ended January 6, 2008	December 31, 2006
<b>Revenues:</b>			
Base rental revenues	\$ 3,238.5	\$ 3,426.2	\$ 3,413.1
Previously rented product ( PRP ) revenues	627.3	656.3	616.0
Total rental revenues	3,865.8	4,082.5	4,029.1
Merchandise sales	1,389.4	1,400.1	1,431.9
Other revenues	32.7	59.8	61.2
	5,287.9	5,542.4	5,522.2

**Cost of sales:**