



## LOVEFiLM INTERNATIONAL LIMITED

**Annual report  
for the year ended 31 December 2007**

Registered Company Number 04392195

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# **Lovefilm International Limited**

## **Annual report for the year ended 31 December 2007**

<b>Directors and advisers</b>	<b>1</b>
<b>Directors' report</b>	<b>2 – 3</b>
<b>Statement of directors' responsibilities for the preparation of the financial statements</b>	<b>4</b>
<b>Business review</b>	<b>5 – 6</b>
<b>Independent auditors' report to the members Lovefilm International Limited</b>	<b>7</b>
<b>Consolidated income statement and Consolidated statement of recognised income and expense</b>	<b>8</b>
<b>Balance sheets</b>	<b>9</b>
<b>Cash flow statements</b>	<b>10</b>
<b>Notes to the financial statements</b>	<b>11 – 41</b>

**Directors and advisers**

**Directors**

Charles Gurassa  
Nicholas Buckle  
Simon Calver  
Simon Cook  
Greg Greeley  
Thomas Høegh

**Company secretary**

David Martin

**Registered office**

Unit 9  
6 Portal Way  
London  
W3 6RU

**Independent auditors**

PricewaterhouseCoopers LLP  
1 Embankment Place  
London  
WC2N 6RH

## Directors' report for the year ended 31 December 2007

The directors present their annual report and the audited financial statements of the Group and Company for the year ended 31 December 2007. The comparative period was for the 18 month period ended 31 December 2006.

### Principal activity

The principal activity of the Group is the provision to the general public of online home entertainment services, including DVD rentals, DVD retail and movie downloads.

### Review of business

The results for the year and financial position of the Company are shown in the income statement and balance sheet and a review of the Group's business activities is provided in the Business Review.

### Events after the balance sheet date

On 25 April 2008, the Group acquired the online DVD rental businesses of Amazon EU Sarl in the United Kingdom and Germany for a total consideration of £61 million. As part of this transaction, Amazon EU Sarl will make a cash investment and become the largest shareholder in the Group. The two companies will also enter into a multi-year marketing agreement in which Amazon EU Sarl will promote the Group's services to its United Kingdom and German customers.

### Results and dividends

The Group's loss for the year was £8.8 million (2006: £11.1 million). The directors do not recommend the payment of a dividend. The loss for the year has been transferred to reserves.

### Directors

The directors who served the Company during the year and to the date of this report were:

			Date of appointment	Date of resignation
Charles Gurassa	Chairman	(Non-executive)		
Simon Calver	Chief Executive Officer			
George Coelho		(Non-executive)		25 April 2008
Simon Cook		(Non-executive)		
Thomas Høegh		(Non-executive)		
Daniel Rimer		(Non-executive)		8 April 2008
Howard Kiedaisch		(Non-executive)		25 April 2008
Anthony Bates		(Non-executive)		21 April 2008
Nicholas Buckle	Chief Financial Officer			
William Reeve	Chief Operating Officer			25 April 2008
Greg Greeley		(Non-executive)	25 April 2008	

### Directors' indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its directors which were in force during the year and remained in force at the date of this report.

### Disabled persons

Applications for employment by disabled persons are always fully considered, bearing in mind the respective aptitudes and abilities of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and the appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of a disabled person should, as far as possible, be identical to that of a person who does not suffer from a disability.

### Employee involvement

The Group is also committed to providing employees with information on matters of concern to them on a regular basis, so that the views of employees can be taken into account when making decisions that are likely to affect their interests.

**Directors' report for the year ended 31 December 2007**

(continued)

**Equal opportunities**

The Group is committed to the principle of equal opportunities. All decisions relating to employment practices are objective, free from bias and based upon work criteria and individual merit.

**Going concern**

The directors consider that the Group and the Company have adequate resources to remain in operation for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. As with all business forecasts, the directors' statement cannot guarantee that the going concern basis will remain appropriate given the inherent uncertainty about future events.

**Statement of disclosure of information to auditors**

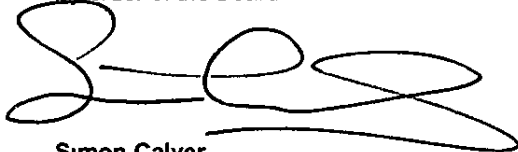
For each of the persons who were directors at the time this report was prepared, the following applies:

- So far as the directors are aware, there is no relevant information of which the Company's auditors are unaware, and
- The directors have taken steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

**Auditors**

PricewaterhouseCoopers LLP have indicated their willingness to continue in office as auditors.

By order of the Board

A handwritten signature in black ink, appearing to read 'Simon Calver', written over a horizontal line.

**Simon Calver**  
Chief Executive Officer  
22 October 2008

**Statement of directors' responsibilities for the preparation of the financial statements**

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards and applicable law. The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year.

In preparing those financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable International Financial Reporting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

## Business review for the year ended 31 December 2007

LOVEFiLM International Limited is an online, home entertainment business, focused on online DVD rental, DVD retail services and digital downloads. The Group operates under the LOVEFiLM brand in the UK, Sweden, Denmark and Germany and as BRAFiLM in Norway, serving over 600,000 customers.

Revenue for the year was £49.3 million (18 months to 2006: £41.4 million). The operating loss before exceptional items and before amortisation of intangibles was £4.5 million (18 months to 2006: £2.7 million) and the statutory operating loss was £7.4 million (18 months to 2006: £12.3 million). The Group had a pre-tax loss for the year of £9.4 million (18 months to 2006: £13.5 million).

Following the acquisition of Video Island Inc and Boxman in 2006, this was the Group's first full year of operating following the successful integration of those businesses. The Group focused on increasing customer numbers through investment in marketing activities, thus raising awareness of the brand and of online rental as a concept. In addition, the Group invested in improving the customer experience through significant service improvements, increased investments on its DVD library (£11.9 million compared to £9.9 million in the prior 18 month period), and technical development of the service. This meant that although the Group generated an additional £7.7 million of gross profit compared to the prior period, this was reinvested in customer acquisition, brand and service improvements.

Cash inflow from operating activities was £5.3 million (2006: £4.5 million). The Group took on additional borrowing in order to finance increased marketing and increased investment in the DVD library.

### Business model and market environment

LOVEFiLM's objective is to help its customers find films that they want to watch and then provide them with a convenient and cost effective way to watch them. Whilst the majority of customers choose online DVD rental, they can also buy DVDs or view content digitally, either purchased ('download to own') or rented ('download to rent').

Online rental operates as follows:

- Customers sign up either to a monthly subscription or a prepaid rental package, with varying numbers of DVDs rented at once, and with varying levels of usage, subscriptions range from two rentals per month (£3.99 in the UK, €6.99 in Germany) to unlimited usage packages at over £15 per month. Customers can also rent games.
- Customers can recommend and rate films, post reviews, watch interviews with leading actors and directors and access the latest film news.
- Customers maintain online a prioritised list of films and games that they want to rent, chosen from the LOVEFiLM catalogue.
- We send DVDs and games from the list by post, with the number of discs provided at one time dependent on the subscription level.
- Customers watch the DVDs when they want and return them to us in reply paid envelopes.
- When we receive the returns, we send more from the list back to the customer.

The Group operates in the highly competitive home entertainment sector. Traditionally this has meant focusing on store rental, and retail, as principle competitors but as LOVEFiLM's household penetration has increased, so the competitor set has broadened to encompass other media and entertainment companies who compete for a share of consumer spending on home entertainment.

The UK is the Group's main geographic market and we anticipate this to continue for the foreseeable future. In addition to the operations in Germany and Scandinavia, the Group also has an option to acquire DVD rentals ie Limited which trades as Screenclick in Ireland and holds a 5% investment in Home Entertainment Services SA, which trades as DVD Post in Belgium and the Netherlands.

Although the business primarily operates under the LOVEFiLM brand, we also have a number of long term white label partnerships, including Tesco DVD rentals, Easy Cinema, Sofa Cinema (The Guardian) and Odeon Direct.

## Business review (continued)

### Future developments

The Group's strategy is to offer customers a wide choice in how they consume film and other home entertainment, supported by market-leading editorial content, recommendations and social interaction. LOVEFiLM will continue to provide video content to rent, to buy and free, supported by advertising. We expect to maintain our share of the growing online DVD rental sector, to establish a complementary DVD retail business and, over time, to exploit new digital technologies which are enabling the download of film and TV content direct to the PC and, ultimately, to the television.

LOVEFiLM was one of the first European companies to launch legal download services – firstly 'download to rent' in November 2005, followed by 'download to own' in April 2006. By launching these services, our strategy is to be at the forefront of innovation in the sector and to position LOVEFiLM as a leading provider of digital film content in the future as consumer habits evolve. However, in the medium term, we see digital services as complementing rather than replacing the DVD, as adoption remains slow at present given existing constraints (network speeds, network reliability and capital investment requirements) are yet to be overcome.

### Principal risk and uncertainties

The management of the business and the execution of the Group's strategy are subject to a number of risks. The main risks and mitigating factors are set out below.

#### *Postal services*

The successful operation of the core DVD rental business is dependent on the uninterrupted provision of universal postal services in the markets we serve. In each of our markets, there is currently only one provider of post delivery to the doorstep. Consequently, the business is vulnerable to protracted industrial action within a national postal service. Over time, as deregulation increases, we anticipate that greater competition across Europe will lead to alternative sources of supply and, potentially, lower costs.

#### *Customer experience*

In order to remain competitive against alternative entertainment offerings, it is important that we deliver excellent quality of service at competitive prices. If we do not do this, we will experience high levels of churn and a decline in customer numbers. Delivering continuous improvements in the customer experience, and continuing to enhance our value proposition, are key priorities for the business.

#### *Competition*

LOVEFiLM currently operates in a fast moving, highly competitive home entertainment sector and it is possible that either an existing competitor or a new entrant could launch services that may inhibit future growth and profitability. To date, however, LOVEFiLM's operational focus has enabled it to maintain growth and position itself to capitalise on future growth opportunities. However, broader competition will continue to come from retail, via reducing in-store prices, and broadcast multi-channel TV.

#### *Technological and market changes*

Whilst DVD rental is forecast to remain a substantial market in Europe for the next five years and beyond, it is possible that new digital technologies will take hold quicker than currently envisaged and that LOVEFiLM may be unable to maintain the same market strength in downloads as it currently holds in DVD rental. To date, however, LOVEFiLM has been at the forefront of new technological developments in this sector.

#### *Financial*

LOVEFiLM has significant operations outside the United Kingdom and as such is exposed to movements in exchange rates. Moreover, LOVEFiLM is exposed to other financial risks, primarily credit, liquidity and capital management that are discussed further in note 26.



## Independent auditors' report to the members of Lovefilm International Limited

We have audited the Group and parent Company financial statements (the "financial statements") of LOVEFILM International Limited for the year ended 31 December 2007 which comprise the Consolidated Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985. In addition, we report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' Report and Business Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

### Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 December 2007 and of the Group's loss and cash flows for the year then ended,
- the parent Company financial statements give a true and fair view, in accordance with IFRS, as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent Company's affairs as at 31 December 2007 and cash flows for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.

*PricewaterhouseCoopers LLP*

PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
London

27 October 2008

**Consolidated income statement for the year ended 31 December 2007**

		12 months to 31 December 2007 £'000	18 months to 31 December 2006 £'000
	Note		
<b>Continuing operations</b>			
Revenue	1,5	49,252	41,418
Cost of sales		(21,103)	(20,986)
<b>Gross profit</b>		<b>28,149</b>	<b>20,432</b>
Other income		-	258
Operating expenses		(35,583)	(33,011)
<b>Operating loss</b>	5,6	<b>(7,434)</b>	<b>(12,321)</b>
Operating loss before amortisation of intangibles and exceptional items		(4,477)	(2,668)
Amortisation of intangibles	13	(2,957)	(8,269)
Exceptional items	9	-	(1,384)
		<b>(7,434)</b>	<b>(12,321)</b>
Finance costs	10	(2,150)	(1,336)
Finance income	11	186	109
<b>Loss before taxation</b>		<b>(9,398)</b>	<b>(13,548)</b>
Taxation	12	596	2,425
<b>Loss for the financial period attributable to equity shareholders</b>	22	<b>(8,802)</b>	<b>(11,123)</b>

**Consolidated statement of recognised income and expense for the year ended 31 December 2007**

		12 months to 31 December 2007 £'000	18 months to 31 December 2006 £'000
	Note		
Loss for the financial period	22	(8,802)	(11,123)
Exchange differences	22	617	44
<b>Total recognised losses for the period</b>		<b>(8,185)</b>	<b>(11,079)</b>

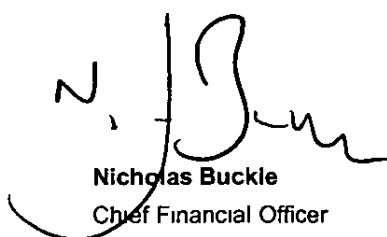
## Balance sheets as at 31 December 2007

	Note	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
<b>Assets</b>					
<b>Non-current assets</b>					
Intangible assets	13	38,000	40,319	-	5
Property, plant and equipment	14	12,440	8,951	8,695	3,219
Investments in subsidiaries	15	77	-	43,338	43,261
		<u>50,517</u>	<u>49,270</u>	<u>52,033</u>	<u>46,485</u>
<b>Current assets</b>					
Trade and other receivables	16	3,725	3,076	6,750	3,316
Cash at bank and in hand	24	3,060	2,563	1,507	605
		<u>6,785</u>	<u>5,639</u>	<u>8,257</u>	<u>3,921</u>
<b>Liabilities</b>					
<b>Current liabilities</b>					
Trade and other payables	17	(13,962)	(11,883)	(8,014)	(5,966)
Borrowings and overdrafts	18	(5,817)	(3,476)	(4,371)	(980)
Provisions	19	(207)	(1,003)	(147)	(117)
		<u>(19,986)</u>	<u>(16,362)</u>	<u>(12,532)</u>	<u>(7,063)</u>
<b>Net current liabilities</b>		<u>(13,201)</u>	<u>(10,723)</u>	<u>(4,275)</u>	<u>(3,142)</u>
<b>Non-current liabilities</b>					
Borrowings	18	(6,962)	(2,334)	(6,898)	(1,432)
Loan from director	17	(144)	(246)	(144)	(246)
Provisions	19	(333)	(389)	(333)	(389)
		<u>(7,439)</u>	<u>(2,969)</u>	<u>(7,375)</u>	<u>(2,067)</u>
<b>Net assets</b>		<u>29,877</u>	<u>35,578</u>	<u>40,383</u>	<u>41,276</u>
<b>Equity</b>					
Share capital	20	4	3	4	3
Share premium	22	17,617	15,905	17,617	15,905
Merger reserve	22	35,684	35,684	35,684	35,684
Other reserves	22	1,244	1,244	1,423	1,423
Translation reserve	22	661	44	-	-
Retained earnings	22	(25,333)	(17,302)	(14,345)	(11,739)
<b>Total equity</b>	22	<u>29,877</u>	<u>35,578</u>	<u>40,383</u>	<u>41,276</u>

The financial statements were approved by the board of directors and authorised for issue on 22 October 2008 and were signed on its behalf by



Simon Calver  
Chief Executive Officer



Nicholas Buckle  
Chief Financial Officer

## Cash flow statements for the year ended 31 December 2007

		Group 12 months 31 December 2007 £'000	Group 18 months 31 December 2006 £'000	Company 12 months 31 December 2007 £'000	Company 12 months 31 December 2006 £'000
	Note				
<b>Cash flows from operating activities</b>					
Cash generated from operations	23	6,880	5,076	4,891	4,040
Finance income		186	109	61	39
Finance costs		(1,791)	(645)	(1,416)	(167)
<b>Net cash from operating activities</b>		<b>5,275</b>	<b>4,540</b>	<b>3,536</b>	<b>3,912</b>
<b>Cash flows from investing activities</b>					
Acquisition expenses		-	(425)	-	(425)
Acquisition of subsidiaries		-	(121)	-	(121)
Investment in subsidiary		-	-	-	(35)
Cash at bank and in hand acquired with subsidiaries		-	2,672	-	-
Purchase of property, plant and equipment		(12,452)	(8,135)	(10,307)	(3,937)
Purchase of intangible assets		-	(47)	-	(5)
<b>Net cash used in investing activities</b>		<b>(12,452)</b>	<b>(6,056)</b>	<b>(10,307)</b>	<b>(4,523)</b>
<b>Cash flows from financing activities</b>					
Proceeds from issue of ordinary share capital		280	60	280	60
Shareholder loan		-	804	-	804
Loans to Group undertakings		-	-	(1,938)	(2,098)
Proceeds from borrowings		9,000	-	9,000	-
Repayment of obligation under borrowings		(873)	(110)	(873)	-
Proceeds from new finance leases		2,212	3,500	2,212	3,000
Repayment of obligation under finance leases		(2,942)	(1,348)	(1,008)	(528)
<b>Net cash from financing activities</b>		<b>7,677</b>	<b>2,906</b>	<b>7,673</b>	<b>1,238</b>
<b>Net increase in cash and cash equivalents</b>		<b>500</b>	<b>1,390</b>	<b>902</b>	<b>627</b>
Cash and cash equivalents at beginning of period	24	1,357	(22)	605	(22)
Effect of foreign exchange rate changes		(51)	(11)	-	-
<b>Cash and cash equivalents at end of period</b>	24	<b>1,806</b>	<b>1,357</b>	<b>1,507</b>	<b>605</b>

## Notes to the financial statements for the year ended 31 December 2007

### 1. General information

Lovefilm International Limited is a private limited Company incorporated and domiciled in the United Kingdom under the Companies Act 1985 (Registration number 04392195). The registered office is Unit 9, 6 Portal Way, London, W3 6RU, UK. The principal activities of the Group are the provision of DVD rental and retail, digital rental and retail and retail services to the general public.

### 2. Adoption of new and revised standards

In the current year, the Group has adopted IFRS 7 *Financial Instruments Disclosures* which is effective for annual reporting periods beginning on or after 1 January 2007. The impact of the adoption of IFRS 7 has been to expand the disclosures provided in these financial statements regarding the Group's financial instruments and management of capital (note 26). Two Interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current year. These are IFRIC 8 *Scope of IFRS 2*, and IFRIC 10 *Interim Financial Reporting and Impairment*. The adoption of these Interpretations has not led to any changes in the Group's accounting policies.

At the date of authorisation of these financial statements, the following Standards and Interpretations were effective during the accounting period but were not relevant to the Group's operations:

IFRS 4 *Insurance contracts*

IFRIC 7 *Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies*

IFRIC 9 *Reassessment of Embedded Derivatives*

In addition, at the date of authorisation of these financial statements, the following Standards and Interpretations were not yet effective and had not been adopted early by the Group:

IAS 23 (Revised) *Borrowing costs*

IFRS 8 *Operating segments*

IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

### 3. Significant accounting policies

The accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to both periods presented, unless otherwise stated.

#### (a) Basis of preparation of the financial statements

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and International Financial Reporting Interpretations Committee's (IFRIC) interpretations as adopted by the European Union (EU) and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

The financial statements have been prepared under the historical cost convention. A summary of the principal Group accounting policies adopted by the Directors is set out below.

#### (b) Basis of consolidation

The Group financial statements consist of the financial statements of the ultimate parent Company (Lovefilm International Limited) and all of its subsidiary undertakings for the year ended 31 December 2007. A subsidiary is an entity over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than 50% of the voting rights. The results of each subsidiary are included from the date that control commences until the date control ceases. Subsidiary accounting policies are in line with those of the Group. Intra-Group balances and transactions are eliminated in preparing the consolidated financial statements.

#### (c) Going concern

The financial statements have been prepared on a going concern basis.

**Notes to the financial statements for the year ended 31 December 2007**

**Significant accounting policies (continued)**

**(d) Business combinations and goodwill**

Acquisitions are accounted for using the purchase method of accounting. The cost of the acquisition is the cash paid together with the fair value of the assets given, equity instruments issued and liabilities incurred or assumed, plus costs directly attributable to the acquisition. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of the acquisition. The excess of the cost of acquisition over the fair value of net assets assumed is recorded as goodwill.

Goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment either annually or more frequently if events or changes in circumstances indicate a possible decline in the carrying value.

Impairment is determined by comparing the recoverable amount of the cash-generating unit or Group of cash-generating units which are expected to benefit from the acquisition in which the goodwill arose, to the carrying value of the goodwill. The recoverable amount is the greater of an asset's value in use and its fair value less costs to sell. Value in use is calculated by discounting the future cash flows expected to be derived from the assets or Group of assets in a cash-generating unit at the Group's cost of capital. Where the recoverable amount is less than the carrying value, the goodwill is considered impaired and is written down through the income statement to its recoverable amount.

**(e) Foreign currencies**

The financial statements of the Company are presented in the currency of the primary economic environment in which it operates (functional currency). For the purposes of the consolidated financial statements, the results and financial position of the Group are expressed in pounds sterling, which is the functional currency of the Company, and the presentation currency for the consolidated statements.

Income statements of overseas operations are expressed in sterling at average rates of exchange ruling during the financial year. Unrealised exchange differences arising on the translation into sterling of net assets of overseas subsidiary undertakings held at the beginning of the year, together with those differences resulting from the restatement of profits and losses from average to year-end rates, are taken to reserves.

Monetary assets and liabilities denominated in foreign currencies are expressed in sterling at the rates of exchange ruling at the balance sheet date. Exchange differences arising in the normal course of trade are included in the income statement.

**(f) Intangible fixed assets**

Intangible assets acquired as part of a business acquisition are capitalised at fair value at the date of acquisition. Purchased intangible assets acquired separately are capitalised at cost. After initial recognition, all intangible fixed assets are measured at cost less accumulated amortisation and any accumulated impairment losses. Intangible fixed assets which have been assigned a finite life are amortised and tested for impairment if events or changes in circumstances indicate that the carrying value may have declined. This is done on a similar basis to the testing of goodwill, either for individual assets or at the level of a cash generating unit. Useful lives are examined every year and adjustments are made, where applicable, on a prospective basis.

Amortisation is charged on assets with finite lives on a systematic basis over the asset's useful life, which ranges from one to two years. Where an intangible asset has been assigned an indefinite useful life, it is not amortised and is reviewed for impairment either annually or more frequently if events or changes in circumstances indicate a possible decline in the carrying value.

**(g) Property, plant and equipment**

The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition.

Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight-line basis over the expected useful economic lives of the assets concerned. The principal annual rates used for this purpose are:

DVDs	33%
Computer equipment	33 – 50%
Fixtures and fittings	20 – 25%
Leasehold improvements	over the period of the lease
Motor vehicles	25%

**Notes to the financial statements for the year ended 31 December 2007**

**Significant accounting policies (continued)**

**(h) Borrowing costs**

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost, any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The fair value of the warrants or shares granted on drawdown of borrowings are recognised at fair value, added to the value of the borrowings initially, and then amortised through the profit or loss for the period on a sum of digits allocation method.

**(i) Revenue recognition**

Revenue, which excludes value added tax and transactions between Group companies, represents the gross inflow of economic benefit from the Group's operating activities. The Group's main sources of revenue are recognised as follows:

- Subscription revenue from DVD rentals services, net of any discount given, is recognised evenly over the subscription period.
- Advertising revenue is recognised when the advertising appears on the Group's website properties.
- Retail and digital download revenues are recognised at the point of sale.

**(j) Segmental reporting**

A reportable segment, as defined by IAS14 *Segment Reporting*, is a distinguishable business or geographical component of the Group, that provides products or services that are subject to risks and rewards that are different from those of other segments. The Group considers its primary reporting format to be geographic segments. The Group considers that it has two reportable segments, being the UK and Continental Europe segments.

**(k) Operating and finance leases**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. Assets held under finance leases are recognised as assets of the Group at their fair value, or if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and a reduction of the lease obligations so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement.

All other leases are classified as operating leases. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

**(l) Share based payments**

Employees, including directors of the Group, receive part of their remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity settled transactions).

The fair value of employee share option plans are calculated at the grant date using a Black-Scholes model. In accordance with IFRS 2 'Share based payment', the resulting cost is charged to the income statement over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

**(m) Pensions**

The Group operates a defined contribution pension scheme in the United Kingdom, contributions to which are charged to the income statement as incurred. The Group has a statutory obligation to provide pension arrangements for its Swedish employees, and contributes a state calculated monthly amount into a government or similar administered pension scheme for the duration of employment.

**(n) Provisions**

Provisions for onerous leases are recognised when the Group believes unavoidable costs of meeting the lease obligations exceed the economic benefits expected to be received under the lease. Provisions are made for dilapidations of properties that have been rented.

**Notes to the financial statements for the year ended 31 December 2007****Significant accounting policies (continued)****(o) Cash and cash equivalents**

Cash and cash equivalents in the balance sheet comprise of cash at bank and in hand and short-term deposits with an original maturity of three months or less

**(p) Financial instruments**

Financial assets and liabilities are recognised on the Group's balance sheet when the Group becomes a party to contractual provisions of the instrument

- Trade receivables

Trade receivables are not interest bearing and are stated at their nominal value, reduced by appropriate allowances for estimated irrecoverable amounts

- Investments

Investments are either available-for-sale or are subsidiary undertakings. Investments are stated at cost less any provision for impairment. An impairment review is carried out on an annual basis.

- Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that gives a residual interest in the assets of the Group after deducting all of its liabilities.

- Interest bearing borrowing

Interest bearing loans and overdrafts are recorded initially at the value of the amount received, net of attributable transaction costs. Subsequent to initial recognition, interest bearing borrowings are stated at amortised cost with any difference between the cost and the redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

- Trade payables

Trade payables are not interest bearing and are stated at their nominal value.

- Equity instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

**(q) Deferred taxation**

Deferred income tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is utilised or the deferred income tax liability is settled. Deferred income tax assets are utilised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on fair value adjustments to intangible assets on business combinations in the consolidated financial statements.

**(r) Exceptional items**

Items of income or expense occur that are material to the financial results of the Group, and one-off in nature, and are disclosed separately on the face of the income statement. Such items are deemed to be material if they are of significant value and significantly affect the financial performance of the Group.



## Notes to the financial statements for the year ended 31 December 2007

**4. Critical accounting judgements and key sources of estimation uncertainty**

The preparation of the consolidated financial statements requires management to make judgements and estimates and assumptions that effect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future period if the revision affects both current and future periods.

***Critical judgements in applying the Group's accounting policies***

The following are the critical judgements and that the directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in financial statements.

**Net book value of property, plant and equipment**

Determining the net book value of disposed, lost and damaged DVDs requires an estimation of their remaining net book value. This requires the Group to use a sample of data in each six month period to ascertain an average age and, therefore, an average cost of disposed, lost and damaged discs and apply that average to the subsequent six months. Historic net book value calculations are revised once updated data has been analysed.

**Valuation of intangible assets**

Determining the initial fair value of intangible assets required management to estimate the economic benefits to the Group of acquiring customers, the Video Island and Boxman brands, and a technology platform.

**Impairment of goodwill**

Determining whether goodwill is impaired requires an estimation of the value of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate present value. The carrying amount of goodwill at the balance sheet date was £38.0 million and was not subject to an impairment charge during the year.

**Fair value of share option grants**

Management determines the fair value of share option grants using the Black-Scholes option-pricing model. Assumptions used in this calculation are disclosed in note 21.

**Depreciation rates for property, plant and equipment**

Determining the depreciation rates for different categories of fixed assets requires management to estimate those assets' useful economic lives. Depreciation rates used in the preparation of the financial statements are disclosed in note 3.

**Valuation of warrants and shares issued with borrowings**

Management places a fair value on warrants issued to creditors as part of debt financing agreements which are calculated using the Black-Scholes option-pricing model. Shares issued as part of financing agreements are valued based on an estimate of the market value of the Group's shares.

Notes to the financial statements for the year ended 31 December 2007

5. Segmental information

The continuing operations of the Group are managed in two principal business segments. The operations are based in two main geographical areas: the United Kingdom and Continental Europe. The United Kingdom is the home country of the parent. There is no secondary segment.

Primary reporting format – geographical segments

Year ended 31 December 2007 for continuing operations

	United Kingdom £'000	Continental Europe £'000	Total £'000
<b>Revenue</b>	<b>41,465</b>	<b>7,787</b>	<b>49,252</b>
Operating loss before amortisation of intangibles and exceptional items	(1,511)	(2,966)	(4,477)
Amortisation of intangibles	(2,687)	(270)	(2,957)
Exceptional items	-	-	-
<b>Operating loss</b>	<b>(4,198)</b>	<b>(3,236)</b>	<b>(7,434)</b>
Net finance costs	(1,832)	(132)	(1,964)
<b>Loss before taxation</b>	<b>(6,030)</b>	<b>(3,368)</b>	<b>(9,398)</b>
Taxation	547	49	596
<b>Loss for the financial period attributable to equity shareholders</b>	<b>(5,483)</b>	<b>(3,319)</b>	<b>(8,802)</b>
Goodwill	26,532	11,428	37,960
Other non-current assets	10,317	2,240	12,557
Current assets	5,759	1,026	6,785
Current liabilities	(16,461)	(3,525)	(19,986)
Non-current liabilities	(7,439)	-	(7,439)
<b>Net assets</b>	<b>18,708</b>	<b>11,169</b>	<b>29,877</b>
<b>Other segment items</b>			
Capital expenditure			
- Property, plant and equipment	10,307	2,145	12,452
- Intangible assets	-	-	-
Depreciation	(4,299)	(1,262)	(5,561)
Amortisation of intangibles	(2,687)	(270)	(2,957)

Notes to the financial statements for the year ended 31 December 2007

5. Segmental information (continued)

Period ended 31 December 2006 for continuing operations

	United Kingdom £'000	Continental Europe £'000	Total £'000
<b>Revenue</b>	<b>35,382</b>	<b>6,036</b>	<b>41,418</b>
Operating loss before amortisation of intangibles and exceptional items	(954)	(1,714)	(2,668)
Amortisation of intangibles	(7,634)	(635)	(8,269)
Exceptional items	(1,371)	(13)	(1,384)
<b>Operating loss</b>	<b>(9,959)</b>	<b>(2,362)</b>	<b>(12,321)</b>
Net finance costs	(1,039)	(188)	(1,227)
<b>Loss before taxation</b>	<b>(10,998)</b>	<b>(2,550)</b>	<b>(13,548)</b>
Taxation	2,290	135	2,425
<b>Loss for the financial period attributable to equity shareholders</b>	<b>(8,708)</b>	<b>(2,415)</b>	<b>(11,123)</b>
Goodwill	26,532	10,799	37,331
Other non-current assets	9,746	2,193	11,939
Current assets	3,919	1,720	5,639
Current liabilities	(12,526)	(3,836)	(16,362)
Non-current liabilities	(2,969)	-	(2,969)
<b>Net assets</b>	<b>24,702</b>	<b>10,876</b>	<b>35,578</b>
<b>Other segment items</b>			
Capital expenditure			
- Property, plant and equipment	7,001	1,134	8,135
- Intangible assets	5	42	47
Depreciation	(3,361)	(987)	(4,348)
Amortisation of intangibles	(7,632)	(637)	(8,269)
Impairment of intangibles	(496)	-	(496)

**Notes to the financial statements for the year ended 31 December 2007**

**6. Operating loss**

Operating loss is stated after charging:	12 months to 31 December 2007 £'000	18 months to 31 December 2006 £'000
Depreciation of property, plant and equipment	5,561	8,135
Loss on disposal of property, plant and equipment	3,537	2,310
Amortisation of intangible assets	2,957	8,269
Impairment of intangibles	-	496
Operating leases - land and buildings	263	536

The analysis of auditors' remuneration is as follows

The audit of the Company and consolidated financial statements	89	74
The audit of the Company's subsidiaries pursuant to legislation	24	32
Tax fees	26	28
Corporate finance services	-	27
Other services	17	20
	<u>156</u>	<u>181</u>

**7. Directors and key management remuneration**

	12 months to 31 December 2007 £'000	18 months to 31 December 2006 £'000
<b>Directors</b>		
Aggregate emoluments	754	450
Termination benefits	-	71
Share based payments	346	247
	<u>1,100</u>	<u>768</u>

No directors (2006 nil) exercised share options during the year

The aggregate remuneration of the highest paid director was £410,000 (2006 £304,000)

Aggregate remuneration for key management (including directors), being the directors and members of the Group executive team, were as follows

	12 months to 31 December 2007 £'000	18 months to 31 December 2006 £'000
<b>Key management remuneration</b>		
Aggregate emoluments	1,274	942
Termination benefits	-	116
Share based payments	375	327
	<u>1,649</u>	<u>1,385</u>

Notes to the financial statements for the year ended 31 December 2007

8. Employees

Average monthly number of staff for the Group (including executive directors) employed

	Group 12 months to 31 December 2007	Group 18 months to 31 December 2006	Company 12 months to 31 December 2007	Company 18 months to 31 December 2006
Warehouse	123	100	119	36
Professional	72	66	47	31
Customer service	38	44	21	15
Executive	14	10	12	6
	<u>247</u>	<u>220</u>	<u>199</u>	<u>88</u>

The cost incurred in respect of these employees (including directors) was

	Group 12 months to 31 December 2007 £'000	Group 18 months to 31 December 2006 £'000	Company 12 months to 31 December 2007 £'000	Company 18 months to 31 December 2006 £'000
Wages and salaries	6,476	5,775	5,127	3,880
Social security costs	1,108	725	515	412
Share based payments	771	516	673	337
Other pension costs	115	78	30	47
	<u>8,470</u>	<u>7,094</u>	<u>6,345</u>	<u>4,676</u>

9. Exceptional items

Exceptional costs comprised the following

Group	12 months to 31 December 2007 £'000	18 months to 31 December 2006 £'000
Redundancy costs	-	385
Relocating offices and warehouses	-	433
Impairment of intangible asset	-	496
Other	-	70
<b>Total exceptional items</b>	<u>-</u>	<u>1,384</u>

**Notes to the financial statements for the year ended 31 December 2007**

**10. Finance costs**

	<b>12 months to 31 December 2007 £'000</b>	<b>18 months to 31 December 2006 £'000</b>
<b>Finance costs:</b>		
Interest payable on shareholder loan	-	645
Interest payable on debt facilities and bank overdrafts	1,755	212
Interest payable on obligation under finance leases	354	434
Deemed interest on discounting of loan	41	45
	<b>2,150</b>	<b>1,336</b>

**11. Finance income**

	<b>18 months to 31 December 2007 £'000</b>	<b>12 months to 31 December 2006 £'000</b>
<b>Finance income</b>		
Interest on cash and cash equivalents	186	109
	<b>186</b>	<b>109</b>

Notes to the financial statements for the year ended 31 December 2007

12. Taxation

	12 months to 31 December 2007 £'000	18 months to 31 December 2006 £'000
<b>Analysis of charge in the period</b>		
Current tax charge	260	-
Deferred tax credit arising on acquisitions	(856)	(2,425)
	<u>(596)</u>	<u>(2,425)</u>

Factors affecting the current tax charge for the period

The table below provides a reconciliation of the current tax credit on ordinary activities for the year reported in the income statement to the current tax credit that would result from applying the relevant standard rates of tax to the loss on ordinary activities before tax

	12 months to 31 December 2007 £'000	18 months to 31 December 2006 £'000
Loss on ordinary activities before taxation	<u>(9,398)</u>	<u>(13,548)</u>
Loss on ordinary activities multiplied by the standard rate of tax of 30% (2006 30%)	(2,819)	(4,064)
Utilisation of tax losses	(538)	(1,328)
Depreciation in excess of capital allowances	1,117	1,304
Expenses not deductible for tax purposes	114	42
Temporary differences	1,293	264
Deferred tax asset not recognised	-	1,226
Amortisation	30	(11)
Overseas tax	207	142
Total current tax	<u>(596)</u>	<u>(2,425)</u>

Factors that may affect future tax charges

The Group has accumulated tax losses of approximately £13.6 million (2006 £14.2 million) which resulted in an unrecognised deferred tax asset of £3.8 million (2006 £4.3 million). No deferred tax asset has been recognised as it is uncertain as to when the benefit will arise. A potential deferred tax asset of £2.9 million (2006 £0.4 million) arises as the NBV of fixed assets is different to the tax written down value. This has not been recognised. A potential deferred tax asset of £0.4 million arises as a result of share options issued in 2006 and 2007 (2006 £0.2 million). This has not been recognised.

The standard rate of Corporation Tax in the United Kingdom changes to 28% with effect from 1 April 2008.

Notes to the financial statements for the year ended 31 December 2007

13. Intangible assets

Group	Goodwill	Subscriber base	Brand	Technology platform	Total
	£'000	£'000	£'000	£'000	£'000
<b>Cost</b>					
At 1 January 2007	37,331	8,154	2,221	882	48,588
Foreign exchange	629	-	-	18	647
<b>At 31 December 2007</b>	<b>37,960</b>	<b>8,154</b>	<b>2,221</b>	<b>900</b>	<b>49,235</b>
<b>Accumulated amortisation and impairment</b>					
At 1 January 2007	-	5,463	2,216	590	8,269
Amortisation for the period	-	2,691	5	261	2,957
Foreign exchange	-	-	-	9	9
<b>At 31 December 2007</b>	<b>-</b>	<b>8,154</b>	<b>2,221</b>	<b>860</b>	<b>11,235</b>
<b>Net book value</b>					
<b>At 31 December 2007</b>	<b>37,960</b>	<b>-</b>	<b>-</b>	<b>40</b>	<b>38,000</b>
At 31 December 2006	37,331	2,691	5	292	40,319

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from the business combination. Before recognition of impairment losses, the carrying amount of goodwill had been allocated as per note 5. The Group tests goodwill annually for impairment.

The recoverable amounts of the CGUs are determined from value in use calculations. The key assumptions for value in use calculations are those regarding the discount rates, growth rates and expected free cash flows during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGUs. The growth rates are based on standard media sector growth rates. Changes in expected free cash flows are based on past practices and expectations of future changes in the sector.

The Group prepares free cash flow forecasts derived from the most recent financial budgets approved by management for the next five years and extrapolates cash flows for eternity based on an estimated terminal growth rate of 2.25%. The rate used to discount the forecast cash flows is 20%.



Notes to the financial statements for the year ended 31 December 2007

13. Intangible assets (continued)

Company	Brand	Total
	£'000	£'000
<b>Cost</b>		
At 1 January 2007	5	5
Additions	-	-
Disposals	(5)	(5)
<b>At 31 December 2007</b>	<u>-</u>	<u>-</u>
<b>Accumulated amortisation</b>		
At 1 January 2007	-	-
Amortisation for the period	5	5
Disposals	(5)	(5)
<b>At 31 December 2007</b>	<u>-</u>	<u>-</u>
<b>Net book value</b>		
<b>At 31 December 2007</b>	<u>-</u>	<u>-</u>
At 31 December 2006	<u>5</u>	<u>5</u>

Group	Goodwill	Subscriber base	Brand	Technology platform	Other	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Cost</b>						
At 1 July 2005	-	-	-	-	700	700
Arising on acquisition	37,331	8,154	2,216	840	-	48,541
Additions	-	-	5	42	-	47
Disposals	-	-	-	-	(700)	(700)
<b>At 31 December 2006</b>	<u>37,331</u>	<u>8,154</u>	<u>2,221</u>	<u>882</u>	<u>-</u>	<u>48,588</u>
<b>Accumulated amortisation</b>						
At 1 July 2005	-	-	-	-	204	204
Amortisation for the period	-	5,463	2,216	590	-	8,269
Impairment	-	-	-	-	496	496
Disposals	-	-	-	-	(700)	(700)
<b>At 31 December 2006</b>	<u>-</u>	<u>5,463</u>	<u>2,216</u>	<u>590</u>	<u>-</u>	<u>8,269</u>
<b>Net book value</b>						
<b>At 31 December 2006</b>	<u>37,331</u>	<u>2,691</u>	<u>5</u>	<u>292</u>	<u>-</u>	<u>40,319</u>
At 30 June 2005	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>496</u>	<u>496</u>

Notes to the financial statements for the year ended 31 December 2007

13. Intangible assets (continued)

Company	Brand	Other	Total
	£'000	£'000	£'000
<b>Cost</b>			
At 1 July 2005	-	700	700
Additions	5	-	5
Disposals	-	(700)	(700)
<b>At 31 December 2006</b>	<b>5</b>	<b>-</b>	<b>5</b>
<b>Accumulated amortisation</b>			
At 1 July 2005	-	204	204
Impairment	-	496	496
Disposals	-	(700)	(700)
<b>At 31 December 2006</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net book value</b>			
<b>At 31 December 2006</b>	<b>5</b>	<b>-</b>	<b>5</b>
At 30 June 2005	-	496	496

14. Property, plant and equipment

Group	DVDs	Computer equipment	Fixtures and fittings	Motor vehicles	Leasehold improvements	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Cost</b>						
At 1 January 2007	11,235	826	553	10	737	13,361
Additions	11,944	228	131	-	149	12,452
Disposals	(7,259)	-	(1)	-	(8)	(7,268)
Exchange adjustments	327	1	18	-	1	347
<b>At 31 December 2007</b>	<b>16,247</b>	<b>1,055</b>	<b>701</b>	<b>10</b>	<b>879</b>	<b>18,892</b>
<b>Depreciation</b>						
At 1 January 2007	3,808	406	160	5	31	4,410
Charge for period	4,931	329	149	3	149	5,561
Disposals	(3,731)	-	-	-	-	(3,731)
Exchange adjustments	203	-	9	-	-	212
<b>At 31 December 2007</b>	<b>5,211</b>	<b>735</b>	<b>318</b>	<b>8</b>	<b>180</b>	<b>6,452</b>
<b>Net book value</b>						
<b>At 31 December 2007</b>	<b>11,036</b>	<b>320</b>	<b>383</b>	<b>2</b>	<b>699</b>	<b>12,440</b>
At 31 December 2006	7,427	420	393	5	706	8,951

The net book value of DVDs includes £2.8 million (2006 £2.4 million) in relation to assets held under finance leases. The average lease term is 3 years. For the year ended 31 December 2007, the average effective borrowing rate was 13% (2006 14%). Interest rates are fixed at the contract date. Leases are denominated in sterling and euros.

## Notes to the financial statements for the year ended 31 December 2007

## 14. Property, plant and equipment (continued)

Company	DVDs	Computer equipment	Fixtures and fittings	Motor vehicles	Leasehold improvements	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Cost</b>						
At 1 January 2007	4,287	706	217	10	755	5,975
Additions	9,903	222	56	-	128	10,309
Disposals	(3,191)	-	-	-	(8)	(3,199)
<b>At 31 December 2007</b>	<b>10,999</b>	<b>928</b>	<b>273</b>	<b>10</b>	<b>875</b>	<b>13,085</b>
<b>Depreciation</b>						
At 1 January 2007	2,253	355	92	5	51	2,756
Charge for period	2,369	267	51	3	147	2,837
Disposals	(1,203)	-	-	-	-	(1,203)
<b>At 31 December 2007</b>	<b>3,419</b>	<b>622</b>	<b>143</b>	<b>8</b>	<b>198</b>	<b>4,390</b>
<b>Net book value</b>						
<b>At 31 December 2007</b>	<b>7,580</b>	<b>306</b>	<b>130</b>	<b>2</b>	<b>677</b>	<b>8,695</b>
At 31 December 2006	2,034	351	125	5	704	3,219

The net book value of DVDs includes £2.5 million (2006: £1.2 million) in relation to assets held under finance leases. The average lease term is 3 years. For the year ended 31 December 2007, the average effective borrowing rate was 13% (2006: 13%). Interest rates are fixed at the contract date. Leases are denominated in sterling and euros.

Group	DVDs	Computer equipment	Fixtures and fittings	Motor vehicles	Leasehold improvements	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Cost</b>						
At 1 July 2005	3,208	374	231	-	-	3,813
Arising on acquisition	4,092	81	277	-	29	4,479
Additions	6,835	413	120	10	757	8,135
Disposals	(2,871)	(42)	(76)	-	(49)	(3,038)
Exchange adjustments	(29)	-	1	-	-	(28)
<b>At 31 December 2006</b>	<b>11,235</b>	<b>826</b>	<b>553</b>	<b>10</b>	<b>737</b>	<b>13,361</b>
<b>Depreciation</b>						
At 1 July 2005	662	90	49	-	-	801
Charge for period	3,792	324	147	5	80	4,348
Disposals	(634)	(8)	(37)	-	(49)	(728)
Exchange adjustments	(12)	-	1	-	-	(11)
<b>At 31 December 2006</b>	<b>3,808</b>	<b>406</b>	<b>160</b>	<b>5</b>	<b>31</b>	<b>4,410</b>
<b>Net book value</b>						
<b>At 31 December 2006</b>	<b>7,427</b>	<b>420</b>	<b>393</b>	<b>5</b>	<b>706</b>	<b>8,951</b>
At 30 June 2005	2,546	284	182	-	-	3,012

The net book value of DVDs includes £2.4 million (2006: £nil) in relation to assets held under finance leases.

Notes to the financial statements for the year ended 31 December 2007

14. Property, plant and equipment (continued)

Company	DVDs	Computer equipment	Fixtures and fittings	Motor vehicles	Leasehold improvements	Total
	£'000	£'000	£'000	£'000	£'000	£'000
<b>Cost</b>						
At 1 July 2005	3,208	374	231	-	-	3,813
Additions	2,759	374	39	10	755	3,937
Disposals	(1,680)	(42)	(53)	-	-	(1,775)
<b>At 31 December 2006</b>	<b>4,287</b>	<b>706</b>	<b>217</b>	<b>10</b>	<b>755</b>	<b>5,975</b>
<b>Depreciation</b>						
At 1 July 2005	662	90	49	-	-	801
Charge for period	1,864	273	68	5	51	2,261
Disposals	(273)	(8)	(25)	-	-	(306)
<b>At 31 December 2006</b>	<b>2,253</b>	<b>355</b>	<b>92</b>	<b>5</b>	<b>51</b>	<b>2,756</b>
<b>Net book value</b>						
<b>At 31 December 2006</b>	<b>2,034</b>	<b>351</b>	<b>125</b>	<b>5</b>	<b>704</b>	<b>3,219</b>
At 30 June 2005	2,546	284	182	-	-	3,012

The net book value of DVDs includes £1.2 million (2005: £nil) in relation to assets held under finance leases.

15. Investments

	Trade investments	Investments in subsidiaries	Total
	£'000	£'000	£'000
At 1 January 2007	-	43,261	43,261
Trading investments - shares	77	-	77
<b>At 31 December 2007</b>	<b>77</b>	<b>43,261</b>	<b>43,338</b>

The Company has the following principal subsidiary undertakings

Name	Country of incorporation and operations	Principal activity	Proportion of ordinary shares held
Video Island Inc	US	Holding Company	100%
Video Island Entertainment Limited *	UK	On-line film rentals	100%
ScreenSelect Limited *	UK	Dormant	100%
Brafilm Scandinavia AB *	Sweden	On-line film rentals	100%
Lovefilm Norge AS *	Norway	On-line film rentals	100%
Lovefilm Sverige AB	Sweden	On-line film rentals	100%
Lovefilm Danmark AS *	Denmark	On-line film rentals	100%
Lovefilm Deutschland AG	Germany	On-line film rentals	100%

\* These companies are held by intermediate subsidiaries

Notes to the financial statements for the year ended 31 December 2007

15. Investments (continued)

The shares included above represent an investment in non-listed equity securities that present the Group with opportunities for return through capital gains. The Group holds a strategic, non-controlling interest of 5% in Home Entertainment Services SA. The shares are held on the balance sheet at cost.

16. Trade and other receivables

	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
<b>Due within one year:</b>				
Trade receivables	1,113	1,735	566	463
Provision for doubtful debts	(71)	(154)	(7)	-
	<u>1,042</u>	<u>1,581</u>	<u>559</u>	<u>463</u>
Amounts owed by Group undertakings	-	-	4,038	2,098
Taxes receivable	82	19	-	-
Other receivables	1,113	697	872	184
Prepayments and accrued income	1,488	779	1,281	571
	<u>3,725</u>	<u>3,076</u>	<u>6,750</u>	<u>3,316</u>

**Trade receivables**

Trade receivables held by the Group at 31 December 2007 primarily comprise amounts due from advertising sales agencies, amounts due from third parties on purchases of tangible fixed assets and amounts due from third parties for corporate subscriptions and amounts due from some residential customers in the Nordic region for rental subscriptions.

The average credit period taken on sales of goods is 30 days. The Group has fully provided for all receivables over 120 days old where specific events have led the Group to believe that recovery of those debts is at risk (for example, a business being placed into administration). Trade receivables between 30 days and 120 days are provided for based on estimated irrecoverable amounts from the sale of goods, determined by reference to past default experience and Company specific conditions.

Before accepting any new customer, the Group carries out appropriate checks to assess the potential new customer's credit quality.

**Other receivables**

Of the other receivables balance at the end of the year, £0.4 million (2006: £0.4 million) is due from dvdrentals.ie Limited, an online DVD rental company operating in the Republic of Ireland in which the Group holds a 10% equity stake. The Group purchased DVD fixed assets on behalf of screenclick.com and has the option to convert the outstanding debtor balance into a further 41% equity stake in screenclick.com. At the reporting date management had not taken up that option.

**Ageing of past due but not impaired receivables**

	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
60 – 90 days	308	94	308	58
90 – 120 days	21	336	195	121
	<u>329</u>	<u>430</u>	<u>503</u>	<u>179</u>

Notes to the financial statements for the year ended 31 December 2007

**16. Trade and other receivables (continued)**

**Movement in the provision for doubtful debts**

	<b>Group</b>	<b>Group</b>	<b>Company</b>	<b>Company</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Opening	(154)	(27)	-	-
Amounts written off as uncollectible	(9)	(127)	(7)	-
Amounts recovered during the year	92	-	-	-
<b>Closing</b>	<b>(71)</b>	<b>(154)</b>	<b>(7)</b>	<b>-</b>

In determining the recoverability of a trade receivable the Group considers any change in the credit quality of the trade receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk is limited due to the vast majority of the customer base paying for rental subscriptions one month in advance via either credit card or direct debit. Accordingly, the directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

The amounts owed by Group undertakings are unsecured, interest free and repayable on demand.

**17. Trade and other payables**

	<b>Group</b>	<b>Group</b>	<b>Company</b>	<b>Company</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Current</b>				
Trade payables	7,467	5,795	4,800	3,352
Other taxation and social security	1,340	1,004	499	313
Other payables	9	94	-	-
Accruals	1,938	2,109	1,131	1,056
Loan from a director	102	101	102	101
Deferred income	3,106	2,780	1,482	1,144
	<b>13,962</b>	<b>11,883</b>	<b>8,014</b>	<b>5,966</b>
<b>Non current</b>				
Loan from a director	<b>144</b>	<b>246</b>	<b>144</b>	<b>246</b>

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 45 days. Thereafter, interest is charged on the outstanding balances at various interest rates. The risk management policies in place ensure that all payables are paid within the credit timeframe.

Shares which have been issued to a director and remain unvested have been classified as a loan from a director.

Notes to the financial statements for the year ended 31 December 2007

18. Financial liabilities – borrowings

	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
<b>Current</b>				
Bank overdrafts	1,254	1,206	-	-
Borrowings	2,853	-	2,853	-
Obligations under finance leases	1,710	2,270	1,518	980
	<u>5,817</u>	<u>3,476</u>	<u>4,371</u>	<u>980</u>
<b>Non current</b>				
Borrowings	4,903	-	4,903	-
Obligations under finance leases				
- Between one to two years	1,032	1,886	967	1,049
- Between two to five years	1,027	448	1,028	383
	<u>6,962</u>	<u>2,334</u>	<u>6,898</u>	<u>1,432</u>

Analysis of borrowings by currency

Group

	Sterling £'000	Euros £'000	Swedish Krona £'000	Total £'000
<b>At 31 December 2007</b>				
Bank overdrafts	-	-	1,254	1,254
Borrowings	7,756	-	-	7,756
Obligations under finance leases	1,773	1,996	-	3,769
	<u>9,529</u>	<u>1,996</u>	<u>1,254</u>	<u>12,779</u>
<b>At 31 December 2006</b>				
Bank overdrafts	-	-	1,206	1,206
Borrowings	-	-	-	-
Obligations under finance leases	4,604	-	-	4,604
	<u>4,604</u>	<u>-</u>	<u>1,206</u>	<u>5,810</u>

Company

	Sterling £'000	Euros £'000	Total £'000
<b>At 31 December 2007</b>			
Bank overdrafts	-	-	-
Borrowings	7,756	-	7,756
Obligations under finance leases	1,517	1,996	3,513
	<u>9,273</u>	<u>1,996</u>	<u>11,269</u>
<b>At 31 December 2006</b>			
Bank overdrafts	-	-	-
Borrowings	-	-	-
Obligations under finance leases	2,412	-	2,412
	<u>2,412</u>	<u>-</u>	<u>2,412</u>

Notes to the financial statements for the year ended 31 December 2007

**18. Financial liabilities - borrowings (continued)**

The other principal features of the Group's borrowings are as follows

- 1 Bank overdrafts are repayable on demand. Overdrafts of £1.3 million (2006: £1.2 million) have been secured by a floating charge over the Group's Nordic subsidiaries.
- 2 The Group has one principal borrowing, a loan of £9.0 million (2006: £nil) taken out in February 2007. Repayments commenced in May 2007 and will continue until August 2010. The loan is secured by a fixed charge over the Group's DVD fixed assets not currently held under finance leases and by a floating charge over the Group's UK operations.

The weighted average interest rates paid during the year were as follows

	<b>Group</b>	<b>Group</b>	<b>Company</b>	<b>Company</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Bank overdrafts	7.6%	7.3%	-	-
Borrowings	13.8%	-	13.8%	-
Obligations under finance leases	12.9%	13.9%	12.8%	12.7%

The Group issued 7,275 (2006: 14,155) warrants to Kreos Capital II Limited in respect of borrowings incurred during the year. The fair value of the warrants was calculated as £25.25, based on the estimated market value of the shares at the date of grant. The compensation cost that has been charged against income in respect of warrants was £41,000 (2006: £45,000). This charge was included in finance costs.



Notes to the financial statements for the year ended 31 December 2007

19. Provisions

Total	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
Opening balance	1,392	-	506	-
Increases to existing provisions in the period	124	3,882	64	571
Amount credited in the period	(976)	(2,490)	(90)	(65)
Closing balance	<u>540</u>	<u>1,392</u>	<u>480</u>	<u>506</u>

Provisions have been analysed between current and non-current as follows

Current	207	1,003	147	117
Non-current	333	389	333	389
	<u>540</u>	<u>1,392</u>	<u>480</u>	<u>506</u>

(i) Property	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
Opening balance	536	-	506	-
Provided in the period	64	601	64	571
Amount utilised in the period	(120)	(65)	(90)	(65)
Closing balance	<u>480</u>	<u>536</u>	<u>480</u>	<u>506</u>

Property provisions have been analysed between current and non-current as follows

Current	147	147	147	117
Non-current	333	389	333	389
	<u>480</u>	<u>536</u>	<u>480</u>	<u>506</u>

Property provisions comprise of future rents payable on onerous leases and provisions for terminal dilapidations

(ii) Deferred tax	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
Opening balance	856	-	-	-
Provided in the period from acquisitions	60	3,281	-	-
Amount credited in the period	(856)	(2,425)	-	-
Closing balance	<u>60</u>	<u>856</u>	<u>-</u>	<u>-</u>

Deferred tax provisions have been analysed between current and non-current as follows

Current	60	856	-	-
Non-current	-	-	-	-
	<u>60</u>	<u>856</u>	<u>-</u>	<u>-</u>

**Notes to the financial statements for the year ended 31 December 2007**

**20. Called up share capital**

**Group and Company**

	<b>Number</b>	<b>£'000</b>
<b>Authorised</b>		
At 1 January 2007	6,063,860	6
Authorised during the period	-	-
<b>At 31 December 2007</b>	<b>6,063,860</b>	<b>6</b>

	<b>2007 Number</b>	<b>2006 Number</b>
Represented by		
Ordinary shares of £0 001	6,000,000	6,000,000
Redeemable ordinary shares of £0 001	46,176	46,176
Deferred shares of £0 001 each	17,684	17,684
	<b>6,063,860</b>	<b>6,063,860</b>

	<b>Number</b>	<b>£'000</b>
<b>Allotted, called up and fully paid</b>		
At 1 January 2007	3,461,745	3
Allotted during the period	91,245	1
<b>At 31 December 2007</b>	<b>3,552,990</b>	<b>4</b>

	<b>2007 Number</b>	<b>2006 Number</b>
Represented by		
Ordinary shares of £0 001	3,492,501	3,401,256
Redeemable ordinary shares of £0 001	42,805	42,805
Deferred shares of £0 001 each	17,684	17,684
	<b>3,552,990</b>	<b>3,461,745</b>

	<b>Number</b>	<b>£'000</b>
<b>Allotted during the period</b>		
Issued to employees and former employees	14,311	-
Issued to Espnt Nominees Ltd on exercise of warrants	38,013	-
Issued to European Venture Partners III Ltd	31,646	-
Issued to Kreos Capital II Ltd on exercise of warrants	7,275	-
	<b>91,245</b>	<b>1</b>

The holders of ordinary shares are entitled to one vote per share at meetings of the Company. Included within ordinary shares are 49,147 shares (2006 38,136) which have restricted voting rights. The holders of redeemable and deferred shares have no voting rights.

The Company is permitted to grant up to 279,455 ordinary shares (or options to acquire ordinary shares) to directors, employees or consultants to secure or retain their services. As at 31 December 2007 39,900 (2006 98,766) such ordinary shares remained available for issue under this permission.

The Company is permitted to issue up to 78,600 ordinary shares (or warrants to acquire ordinary shares) in connection with the raising of finance by the Group. As at 31 December 2007 32,404 (2006 78,600) ordinary shares (or warrants to acquire ordinary shares) remained available for issue under this permission.

Notes to the financial statements for the year ended 31 December 2007

21. Share based payments

**Lovefilm International Limited Company Share Option Plan**

The Company has a share option plan under which it grants options and shares to directors and employees of the Group. This plan has been approved by HM Revenue and Customs, although both approved and unapproved options have been granted under the plan. No discounted options have been granted and the usual vesting period is 4 years. If the options remain unexercised for a period after 10 years from the date of grant, the options expire. Options are forfeited if the employee leaves the Company before the options vest.

**Ex-Video Island Company Share Option Plan**

Following the acquisition of Video Island Inc. in 2006, all options under the Video Island Company share option plan were rolled over into the Lovefilm International Limited Company share option plan. The vesting period is 4 years. If the options remain unexercised for a period after 10 years from the date of grant, the options expire. Options are forfeited if the employee leaves the Company before the options vest.

**Lovefilm International Limited Company Non-Plan Options**

The Company granted options to consultants and a non-executive director during the period. Those options were granted differing vesting periods, from fully vested on grant to 4 years. If the options remain unexercised for a period after 10 years from the date of grant, the options expire. Options are forfeited if the employee leaves the Company before the options vest.

**For the year ending 31 December 2007**

Movements in ordinary share options outstanding

	Lovefilm non-plan options Number	Weighted average exercise price £	Lovefilm option plan Number	Weighted average exercise price £	Ex-Video Island option plan Number	Weighted average exercise price £
1 January 2007	-	-	181,607	£21.33	34,126	£0.81
Granted during the period	19,061	£14.78	49,735	£25.25	-	-
Exercised during the period	-	-	-	-	-	-
Forfeited during the period	-	-	(19,300)	£21.33	(10,516)	£0.81
<b>At 31 December 2007</b>	<b>19,061</b>	<b>£14.78</b>	<b>212,042</b>	<b>£22.21</b>	<b>23,610</b>	<b>£0.81</b>
Weighted average remaining contractual life	9.25 years		8.75 years		7.25 years	

No options were exercisable at the end of the period.

**For the period ending 31 December 2006**

Movements in ordinary share options outstanding

	Lovefilm option plan Number	Weighted average exercise price £	Ex-Video Island option plan Number	Weighted average exercise price £	Weighted average share price £
1 July 2005	-	-	-	-	-
Rolled over from Video Island	-	-	39,754	£0.81	-
Granted during the period	182,607	£21.33	-	-	-
Exercised during the period	-	-	(1,775)	£0.81	£21.33
Expired during the period	(1,000)	£21.33	(3,853)	£0.81	-
<b>At 31 December 2006</b>	<b>181,607</b>	<b>£21.33</b>	<b>34,126</b>	<b>£0.81</b>	<b>£21.33</b>
Weighted average remaining contractual life	9.25 years		8.25 years		

No options were exercisable at the end of the period.

Notes to the financial statements for the year ended 31 December 2007

21. Share based payments (continued)

**Fair value**

The fair value of the options is estimated at the date of grant using a Black-Scholes option-pricing model that uses assumptions noted in the table below. No performance conditions were included in the fair value calculations.

	2007	2007	2006	2006
	Lovefilm	Lovefilm	Lovefilm	Ex-Video
	Non-plan	Plan	Plan	Island Plan
Expected life of options (years)	2	2	3	3
Exercise price	£14.78	£25.25	£21.33	£0.81
Share price at grant date	£25.25	£25.25	£21.33	£21.33
Risk free rate	4.5%	4.5%	4.5%	4.5%
Expected share price volatility	47%	47%	58%	58%
Expected dividend yield	0%	0%	0%	0%
Estimate of % of options vesting	100%	34%	69%	52%
Weighted average fair value per option granted	£13.81	£6.90	£8.32	£20.64

The Company uses historical data to estimate option exercise and employee termination within the valuation model. Expected volatilities are based on implied volatilities as determined by a simple average of a sample of listed companies based in similar sectors. The risk free rates for periods within the contractual life of the option are based on the UK gilt yield curve at the time of the grant.

**Other information**

The compensation cost that has been charged against income in respect of share options and for continuing operations for the Group was £771,000 (2006: £516,000). This charge was included in administration expenses.

Notes to the financial statements for the year ended 31 December 2007

22. Shareholders' funds and statements of changes in shareholders' equity

Group	Share capital £'000	Share premium £'000	Merger reserve £'000	Other reserve £'000	Translation reserve £'000	Retained earnings £'000	Total equity £'000
<b>At 30 June 2005</b>	1	67	-	-	-	(6,695)	(6,627)
Shares issued in the period							
- AAM BVI Loan conversion	1	10,185	-	-	-	-	10,186
Acquisitions of							
- Lovefilm Sverige AB	-	5,593	-	-	-	-	5,593
- Video Island Inc	1	-	35,684	1,139	-	-	36,824
Other issues	-	60	-	-	-	-	60
Warrants issued for loans	-	-	-	105	-	-	105
Loss for the financial period	-	-	-	-	-	(11,123)	(11,123)
Share based compensation	-	-	-	-	-	516	516
Exchange adjustments	-	-	-	-	44	-	44
<b>At 31 December 2006</b>	<b>3</b>	<b>15,905</b>	<b>35,684</b>	<b>1,244</b>	<b>44</b>	<b>(17,302)</b>	<b>35,578</b>
Shares issued in the period	1	1,610	-	-	-	-	1,611
Other issues	-	102	-	-	-	-	102
Loss for the financial period	-	-	-	-	-	(8,802)	(8,802)
Share based compensation	-	-	-	-	-	771	771
Exchange adjustments	-	-	-	-	617	-	617
<b>At 31 December 2007</b>	<b>4</b>	<b>17,617</b>	<b>35,684</b>	<b>1,244</b>	<b>661</b>	<b>(25,333)</b>	<b>29,877</b>

Company	Share capital £'000	Share premium £'000	Merger reserve £'000	Other reserve £'000	Retained earnings £'000	Total equity £'000
<b>At 30 June 2005</b>	1	67	-	-	(6,695)	(6,627)
Shares issued in the period						
- AAM BVI Loan conversion	1	10,185	-	-	-	10,186
Acquisitions of						
- Lovefilm Sverige AB	-	5,593	-	-	-	5,593
- Video Island Inc	1	-	35,684	1,139	-	36,824
Other issues	-	60	-	-	-	60
Warrants issued for loans	-	-	-	105	-	105
Loss for the financial period	-	-	-	-	(5,381)	(5,381)
Share based compensation	-	-	-	179	337	516
<b>At 31 December 2006</b>	<b>3</b>	<b>15,905</b>	<b>35,684</b>	<b>1,423</b>	<b>(11,739)</b>	<b>41,276</b>
Shares issued in the period	1	1,610	-	-	-	1,611
Other issues	-	102	-	-	-	102
Loss for the financial period	-	-	-	-	(3,377)	(3,377)
Share based compensation	-	-	-	-	771	771
<b>At 31 December 2007</b>	<b>4</b>	<b>17,617</b>	<b>35,684</b>	<b>1,423</b>	<b>(14,345)</b>	<b>40,383</b>

Notes to the financial statements for the year ended 31 December 2007

**22. Shareholders' funds and statements of changes in shareholders' equity (continued)**

**Share premium account**

The share premium account is used to record amounts received in excess of the nominal value of shares on issue of new shares

**Merger reserve**

The merger reserve arose on the acquisition of Video Island Inc in 2006. This represents the excess of the fair value of the shares issued in consideration for the acquisition over their nominal value.

**Other reserve**

The other reserve has been used to record the fair value of warrants that have been issued (£982,000) and shares yet to be issued (£262,000). In the Company balance sheet a further £179,000 relates to the capital contribution arising from share based payments in the prior year.

**Translation reserve**

The translation reserve is used to record foreign exchange differences arising from the translation of the financial statements of foreign subsidiaries into sterling.

**Parent Company loss for the year**

As permitted by section 230 of the Companies Act 1985 no income statement has been presented for the Company. The loss for the Company for the year was £3,377,000 (2006: £5,381,000).

**23. Cash flow from operating activities**

Reconciliation of loss before taxation to net cash generated from operating activities

	Group 12 months 31 December 2007 £'000	Group 18 months 31 December 2006 £'000	Company 12 months 31 December 2007 £'000	Company 18 months 31 December 2006 £'000
<b>Loss before taxation</b>	<b>(9,398)</b>	<b>(13,548)</b>	<b>(3,377)</b>	<b>(5,381)</b>
<b>Adjusted for:</b>				
Depreciation of property, plant and equipment	5,561	4,348	2,837	2,261
Loss on disposal of property, plant and equipment	3,536	2,310	1,995	1,385
Amortisation and impairment of intangibles	2,957	8,765	5	496
Finance income	(186)	(109)	(61)	(39)
Finance costs	2,150	1,336	1,775	857
Share based payments	771	516	771	337
(Increase) in trade/other receivables	(251)	(1,276)	(973)	(853)
Increase in trade/other payables	1,736	2,198	1,945	4,471
Increase/(decrease) in provisions	4	536	(26)	506
<b>Net cash flow from operating activities</b>	<b>6,880</b>	<b>5,076</b>	<b>4,891</b>	<b>4,040</b>

**Notes to the financial statements for the year ended 31 December 2007**
**24. Cash and cash equivalents**

	<b>Group</b>	<b>Group</b>	<b>Company</b>	<b>Company</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Cash and cash equivalents	<b>3,060</b>	2,563	<b>1,507</b>	605
Bank overdrafts	<b>(1,254)</b>	(1,206)	-	-
	<b><u>1,806</u></b>	<b><u>1,357</u></b>	<b><u>1,507</u></b>	<b><u>605</u></b>

**25. Leasing commitments**

Future minimum lease payments under finance leases are as follows

	<b>Group</b>	<b>Group</b>	<b>Company</b>	<b>Company</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Within one year	<b>2,036</b>	2,605	<b>1,836</b>	1,184
Between two and five years	<b>2,577</b>	2,754	<b>2,495</b>	1,678
Total minimum lease payments	<b>4,613</b>	5,359	<b>4,331</b>	2,862
Less future finance charges	<b>(684)</b>	(695)	<b>(658)</b>	(390)
Deemed interest on discounting of loan	<b>(160)</b>	(60)	<b>(160)</b>	(60)
Present value of minimum lease payments	<b><u>3,769</u></b>	<b><u>4,604</u></b>	<b><u>3,513</u></b>	<b><u>2,412</u></b>

The Group has finance leases for various items of plant and equipment, fixtures and fittings

Future minimum rentals payable under non-cancellable operating leases are as follows

	<b>Group</b>	<b>Group</b>	<b>Company</b>	<b>Company</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Within one year	<b>388</b>	276	<b>388</b>	276
Between two and five years	<b>975</b>	962	<b>975</b>	962
Total minimum lease payments	<b><u>1,363</u></b>	<b><u>1,238</u></b>	<b><u>1,363</u></b>	<b><u>1,238</u></b>

Operating lease payments represent rentals payable by the Group for certain of its office and distribution properties

Notes to the financial statements for the year ended 31 December 2007

26. Financial Instruments

**Capital risk management**

The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns while maximising the return to shareholders through the optimisation of the debt and equity balance. The capital structure of the Group consists of debt, which includes the borrowings disclosed in note 18, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in notes 20 and 22.

**Gearing ratio**

The Group's Board reviews the capital structure on each occasion that additional debt or equity funding has been required. As part of this review, the Board considers the cost of capital and the risks associated with each class of capital.

The gearing ratio at the year end is as follows:

	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
Debt	(11,525)	(4,604)	(11,269)	(2,412)
Cash and cash equivalents	1,806	1,357	1,506	605
Net debt	(9,719)	(3,247)	(9,763)	(1,807)
Equity	29,877	35,578	40,383	41,276
Net debt to equity ratio	33%	9%	24%	4%

Debt is defined as long and short term borrowings, excluding overdrafts, as detailed in note 18. Equity includes all capital and reserves of the Group attributable to the equity holders of the parent.

**Externally imposed capital requirement**

The Group and the Company are not subject to externally imposed capital requirements.

**Categories of financial instruments**

	Group 2007 £'000	Group 2006 £'000	Company 2007 £'000	Company 2006 £'000
<b>Financial assets</b>				
Cash and equivalents	3,060	2,563	1,506	605
Receivables	3,725	3,076	5,994	3,316
<b>Financial liabilities</b>				
Payables	13,947	12,129	8,139	6,212
Borrowings	11,525	4,604	11,269	2,412
Bank overdrafts	1,254	1,206	-	-

**Financial risk management objectives**

Cash and debt for the Group are managed by the Company and all cash funds surplus to local working capital needs are held by the Company. New debt or equity finance is obtained based on projected cash requirements and held at group level. The group's Scandinavian and German operations hold sufficient cash balances to fund day to day working capital requirements, in the case of Scandinavia, this takes into account an overdraft facility agreed with the Group's bankers in 2006. Funds are transferred from the United Kingdom in line with short term cash forecasts.



Notes to the financial statements for the year ended 31 December 2007

26. Financial instruments (continued)

During the year the Company provided certain guarantees to subsidiaries operating in Scandinavia and Germany to maintain the financing arrangements of these subsidiaries. The fair values of these guarantees are shown below

	2007	2006
	£'000	£'000
Scandinavia	4,438	2,030
Germany	1,590	144
	<u>6,028</u>	<u>2,174</u>

Foreign currency risk management

The Group owns subsidiaries in Scandinavia and Germany whose results are translated into sterling at the year end. The Group pays interest on certain borrowings in foreign currencies, hence exposures to exchange rate fluctuations, although limited, do arise.

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Liabilities		Assets	
	2007	2006	2007	2006
	£'000	£'000	£'000	£'000
Swedish Krona	2,846	3,063	559	1,009
Norwegian Krona	268	250	321	448
Danish Krona	213	342	109	33
Euro	2,145	139	106	229

The Company pays interest on certain borrowings in foreign currencies, hence exposures to exchange rate fluctuations, although limited, do arise.

The carrying amounts of the Company's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Liabilities		Assets	
	2007	2006	2007	2006
	£'000	£'000	£'000	£'000
Euro	1,998	-	-	-

Foreign currency sensitivity analysis

The Group is mainly exposed to the Swedish Krona and the Euro.

The following table details the Group's sensitivity to a 10% increase and decrease in Sterling against the relevant foreign currencies. Ten per cent represents management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates. A positive number below indicates an increase in profit and other equity where Sterling strengthens 10% against the relevant currency.

	Swedish Krona impact		Euro impact	
	2007	2006	2007	2006
	£'000	£'000	£'000	£'000
Profit or loss	-	-	47	-
Other equity	208	187	185	(8)

Notes to the financial statements for the year ended 31 December 2007

26. Financial instruments (continued)

A negative number below indicates a decrease in profit and other equity where Sterling weakens 10% against the relevant currency

	Swedish Krona impact		Euro impact	
	2007	2006	2007	2006
	£'000	£'000	£'000	£'000
Profit or loss	-	-	(51)	-
Other equity	(229)	(205)	(204)	9

The Group's sensitivity to foreign currency has increased during the current period mainly due to the draw down on new Euro denominated borrowings during the year

The Company is exposed to the Euro and the following table details the Company's sensitivity to a 10% increase and decrease in Sterling against the Euro. A positive number below indicates an increase in profit and other equity where Sterling strengthens 10% against the relevant currency

	Euro impact	
	2007	2006
	£'000	£'000
Profit or loss	47	-
Other equity	182	-

A negative number below indicates a decrease in profit and other equity where Sterling weakens 10% against the relevant currency

	Euro impact	
	2007	2006
	£'000	£'000
Profit or loss	(51)	-
Other equity	(200)	(205)

The Company's sensitivity to foreign currency has increased during the current period mainly due to the draw down on new Euro denominated borrowings during the year

**Interest rate risk management**

The Group is exposed to interest rate risk as entities in Sweden currently have an overdraft facility on which interest is charged at a floating rate. The Company is not exposed to interest rate risk.

**Interest rate sensitivity analysis**

If interest rates had been 0.5% higher/lower and all other variables were held constant, the Group's financial performance for the year would not be materially affected. A 0.5% increase or decrease represents management's assessment of the reasonably possible change in interest rates.

**Credit risk management**

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group and the Company. The Group and the Company have adopted a policy of only dealing with creditworthy counterparties as a means of mitigating the risk of financial loss from defaults.

Trade receivables comprise amounts due from advertising sales agencies, amounts due from third parties on purchases of tangible fixed assets and amounts due from third parties for corporate subscriptions and amounts due from some residential customers in the Nordic region for rental subscriptions. Ongoing credit evaluation is performed on the financial condition of accounts receivable.

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

Notes to the financial statements for the year ended 31 December 2007

**26. Financial instruments (continued)**

**Liquidity risk management**

Ultimate responsibility for liquidity management rests with the board of directors. Management of the Group's short, medium and long term funding and liquidity management requirements are discussed at board meetings on a regular basis during the year. The Group and the Company manage liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and reviewing the maturity profiles of financial liabilities.

Full disclosures of the Group's borrowings are in note 18.

**27. Related party transactions**

Transactions between the Company and its Group undertakings represent related party transactions and have been eliminated on consolidation.

The Group conducted business with Arts Alliance Media Limited, a related party to a major shareholder. During the year the Group made purchases of goods and services from Arts Alliance Media Limited of £180,000 (2006: £309,000) and sold goods worth £4,000 (2006: £29,000) to Arts Alliance Media Limited.

The Group conducted business with dvdrentals.ie Limited in which it holds a 10% equity stake. During the year the Group sold goods worth £124,000 (2006: £235,000) to dvdrentals.ie Limited.

Transactions between the Company and its Group undertakings are disclosed below.

	31 December 2007 £'000	31 December 2006 £'000
<b>Transactions with Group undertakings</b>		
Sales of goods and services	4,118	2,734
Purchase of goods and services	-	28

Amounts owed by Group undertakings are disclosed within note 16.

**28. Events after the balance sheet date**

On 25 April 2008, the Group acquired the online DVD rental businesses of Amazon EU Sarl in the United Kingdom and Germany for a total consideration of £61 million. As part of this transaction, Amazon EU Sarl will make a cash investment and become the largest shareholder in the Group. The two companies will also enter into a multi-year marketing agreement in which Amazon EU Sarl will promote the Group's services to its United Kingdom and German customers.

This transaction will be accounted for in 2008 using the purchase method of accounting in accordance with IFRS 3 *Business Combinations*. All assets and liabilities will be recognised at their provisional fair values and the residual over the net assets acquired will be recognised as goodwill.

At the date of finalisation of this report, the necessary market valuations and other calculations had not been finalised; therefore the Group has elected not to disclose the fair value of assets acquired nor the goodwill arising on the acquisition.

**29. Ultimate controlling party**

In the opinion of the directors there is no ultimate controlling party.